Christian Ethics, Formal Institutions, and Economic Growth

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ABSTRACT

Christians have a moral obligation to help the poor and destitute, and many Christians argue that we must exercise our moral obligation by, for example, redistributing income or by enacting price controls and minimum wages. Christians must proceed with caution when prescribing such policies: the resulting changes in incentives embodied in changed formal institutions may in fact work to the detriment of "the least of these" among us.

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I. THEORIES OF ECONOMIC GROWTH

The world has undergone a revolution of stupendous magnitude in the last two and a half centuries. Sustained growth of the variety seen in the Western world is historically unique; indeed, Solow and Temin (1978) note that the very phenomenon of economic growth is what separates the last few centuries from the rest of human history. The West's record in the last two and a half centuries is unmatched by anything produced by the great empires of history (Jones 1988 [2003], McCloskey 1995). The West has attained—and continues to attain—levels of wealth that previous generations would have found incomprehensible, and what it means to be "poor" in the modern industrialized world is very different from what it has meant to be "poor" throughout human history.

In an evaluation of the British experience during early industrialization, McCloskey (1995:242) writes that "the heart of the matter is twelve," specifically, the twelve-fold increase in British per-capita income that has happened since the beginning of industrialization. Other European countries and European offshoots have experienced similar changes. And yet these massive accumulations of wealth tend to be confined largely to Western Europe and its overseas offshoots. Why?[18]

Incidentally, the advent of the "age of economists" coincides with the advent of the radical changes in standards of living that constitute the aforementioned revolution. Adam Smith first published his *Inquiry into the Nature and Causes of the Wealth of Nations* in 1776, right as nations (actually people) were producing heretofore unprecedented economic advances that have since manifested themselves in exponential increases in per capita wealth. Most scholars date the beginning of the Industrial Revolution around this time or a few decades earlier.[19]

[18] The "Asian Tigers"—Taiwan, Hong Kong, South Korea, Singapore, and Japan—are a notable exception, though Hong Kong can still be considered, in many ways, an overseas extension of Great Britain.

[19] See Whatley (1997) for an account of the Scottish experience. He notes that the beginning of the Scottish Industrial Revolution has been "variously dated" at 1740, 1760, and 1780.

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It is notable that the early classical economists, many of them writing in precisely the countries where the most revolutionary changes were taking place, missed these changes (McCloskey, 1995). Over two centuries of inquiry has produced an unspectacular track record. Many of the theories we have devised over the years have failed to explain "the factor of twelve" (McCloskey, 1995).

Trebilcock (1982) devotes a chapter to the traditional growth theories of Rostow and Gerschenkron, and Romer (2001) discusses the theoretical underpinnings of conventional macroeconomics as well as the "new growth" economics. A distinguishing feature of these theories is that they explain growth largely in terms of macroeconomic policy prescriptions and technological factors: in short, they maintain that good macroeconomic policy and incentives for technological development will yield economic growth. While these theories provide us with a number of important insights regarding the wealth of nations, they have failed to account for economic performance—or the lack thereof—through time.

In this light, Douglass C. North has proposed—and a steadily growing body of empirical literature has confirmed—that institutions, more than any other factor, determine economic performance.[20] For most of the twentieth century, economic theory has focused on the mechanics of theoretical economic systems, and institutions were often peripheral to the analysis. The failure of more conventional models to account for economic performance through time coupled with the spectacular failure of the former Soviet Union has induced many economists to look to more non-traditional explanations of economic performance. In other words, physical capital accumulation, human capital accumulation, and technological change *as such* only account for a fraction of economic growth through time.[21] Something more elusive must be responsible for the economic growth of the last two and a half centuries. Standing on the shoulders of North, Coase, Williamson, and others, many economists have re-oriented their focus away from the material forces of production and toward the "rules of the economic game" as embodied in institutions.

The agenda of the "New Institutional Economics" (NIE) focuses explicit attention on a society's institutions, which North (2005:48) defines as a society's "formal rules, informal norms, and their enforcement characteristics." Institutions determine the structure of private property rights and, therefore, the cost of transacting. Research in the NIE examines the role of institutions and transaction costs within markets and organizations, and scholars working in the NIE have also made important contributions to our understanding of the evolution of human societies. We consider here an important element of North's 2005 study: the role of beliefs. Specifically, we consider how different interpretations of Christian doctrine lead us to different prescriptions for formal institutions. These differing formal institutions have implications for the Wealth of Nations: societies which have incentives that discourage production will tend to be poorer

[20] See North (1981, 1990, 1991, and 2005) as well as Davis and North (1971) and North and Thomas (1973).

[21] McCloskey (1995) discusses in detail the failure of conventional theories to explain "the factor of twelve."

in the long run while societies which have incentives that encourage production will tend to be richer in the long run.[22]

Religion—Christianity in particular—has received attention in recent studies of economic development; however, attempting to draw a causal link between "Christianity" writ large and economic outcomes is to paint with too broad a brush and to confound the issue.[23] The Weberian doctrine of the "protestant work ethic," for example, has been offered as a reason for economic development. There are different interpretations of Biblical ethics, and these different interpretations will yield fundamentally different formal institutions (with correspondingly different economic results). I restrict my focus to a debate within Christian sects and denominations about whether or not the state should forcibly redistribute wealth. The fundamental propositions of Christian ethics—love thy neighbor, care for the poor, et cetera—are uncontroversial. Controversy arises when we ask whether or not the state should intervene to promote certain social goals.

The next section defines precisely what we mean by "institutions" and sketches the mechanism by which institutions affect economic performance. Section III surveys some of the literature on the theory of the state, and section IV argues that "interventionist" and "libertarian" readings of Christian scripture will yield different formal institutions and assess the consequences of these institutions for economic performance. Conclusions and directions for future research are offered in section V.

II. BELIEFS, IDEOLOGIES, AND INSTITUTIONS

Institutions are "formal rules, informal norms, and their enforcement characteristics" which are the "rules of the game" and which determine the incentives to which people respond (North 2005:48). Institutions that give people an incentive to compete by production and exchange will be successful in that they will increase long-run standards of living. Institutions that provide incentives to expropriate and redistribute existing goods and resources will manifest themselves in decline and stagnation.[24] The correlation between economic freedom and development across countries has been explored recently by Adkins, Moomaw, and Savvides (2002) and Klein and Luu (2003), among others. Societies prosper when people have incentives to enrich themselves by

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[22] See Furubotn & Richter (1998), Klein (2000), and Williamson (2000) for comprehensive surveys of the New Institutional Economics. Brock (2002) evaluates the NIE from a Christian perspective. See Acemoglu, Johnson, & Robinson (2005), Acemoglu & Johnson (2005), Adkins, Moomaw, & Savvides (2002), Klein & Luu (2002), and Rodrik, Subramanian, & Trebbi (2004) for recent empirical examples. See Miller (1992) for a discussion of institutions within the firm. North and Nye (2002) argued forcefully for a reorientation of research in economic history away from conventional cliometric methods and toward the analysis of institutions. DeLong and Summers (1992:1) state that "much of the variation in productivity growth rates cannot be traced to macroeconomic policies and must be attributed to structural and external factors." Finally, see McQuade (2000:18-88) for an excellent historical survey of the literature on institutions and economic performance.

[23] Barro and McCleary (2003) evaluate the impact of religion on economic growth.

[24] See North (1981, 1990, 2005) for extended discussions of the characteristics of desirable incentives.

producing better products and lower prices. Societies stagnate when people have incentives to enrich themselves by expropriating private property. Trade creates wealth by increasing the utility of both parties to the transaction, while transfer is, at best, a redistribution of resources from one party (who is demonstrably harmed) to another (Rothbard 1956 (1997]). Further, the political process by which expropriation and redistribution occur is itself costly (North 1990, 2005).

North focuses on institutions precisely because they are the incentive structures to which people respond and because they ultimately determine whether or not an economy succeeds or fails.[25] It is these incentive structures that determine whether or not an economy will stagnate or succeed, and it is changes in these incentive structures that determine whether or not stagnation or success will persist over time. The phenomenon that Professor McCloskey called "the factor of twelve" is a direct result of changes in the constellation of institutions that allowed entrepreneurs to flourish.[26] A country's institutional constellation has its foundation in the beliefs and ideologies of the polity, and North devotes a substantial portion of his 2005 study to the matter of how beliefs and preferences shape the performance of economies through time.

In asking "why are some people rich while other people are poor," economists necessarily concern themselves with when, where, why, and how societies "get it wrong" by experiencing starvation and stagnation or "get it right" by experiencing sustained intensive growth (North, 2005).[27] The animating question in economic history appears to be not only "why do economies grow?" but also "what prevents economies from growing?" For example, Jones' study (1988 [2003], p. xxi)

> (i)nverts the usual question, "What brought growth into being?" Instead, it proposes that a world of acute poverty there would always have been an incentive to raise the material standard of living. There would have been a propensity among some people in any society to improve their lot. The likelihood is that when circumstances favored them, or more pertinently ceased to hold them back, their efforts would reinforce one another (doubtless unintentionally) and spill over into improving the lot of their fellows. *Growth would occur unless something was checking it* (italics mine).

Jones directly addresses a question that is a central focus of North's study: how and under what conditions do we create conditions that yield institutions conducive to intensive economic growth; conversely, how and under what conditions do we create institutions antagonistic to intensive economic growth?

The necessary conditions have yet to be identified, but we know at least some sufficient conditions for economic development: secure property rights,

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[25] See the empirical literature cited above. In particular, Rodrik, Subramanian, and Trebbi (2001) are not shy in announcing that "institutions rule," and Adkins, Moomaw, & Savvides (2002) and Klein & Luu (2002) show that economic freedom is positively associated with technical efficiency.
[26] Holcombe (1998) discusses the entrepreneurial foundations of economic growth.
[27] Jones (1988 [2003]) defines intensive growth as increases in per-capita output.

certainty, and low transaction costs.[28] We don't know how these conditions obtain. Greif (2006) argues that societies that have evolved institutions amenable to impersonal exchange—in other words, institutions amenable to market economies—tend to respond well to truly novel situations and prosper accordingly, while societies that have not evolved institutions amenable to impersonal exchange—i.e., "primitive household economies"—tend to respond poorly to truly novel situations and suffer accordingly. And impersonal exchange is one of the most important "novel situations" in economic history (North, 2005).

Curiously, thousands of years of human society show us that we tend to "get it wrong" far more often than we "get it right," to use North's terminology. The story of human history has been one of a struggle against starvation, the elements, and the uncertainties of the natural world. Our historical inability to generate sustained economic growth should give us pause, and if our interest is in generating sustained economic growth, we should share North's (2005) "direct pragmatic interest" in the structure of beliefs and in the mental models that people construct to explain the world around them.

The relationship between beliefs, institutions, and (ultimately) economic outcomes constitutes an important research frontier. People form beliefs about what is good and bad, about what is just and unjust, and, importantly, about the appropriate responses to good and bad outcomes. These may lead to the development of institutions which are in fact antithetical to development because while, on the surface, they appear to satisfy appealing normative criteria, they in fact alter incentives in such a way as to encourage people to enrich themselves through political means and thereby reduce economic growth. Religions create elaborate ethical systems. These ethical systems, in turn, contain normative prescriptions about the quality of the world and the role of the state. Interpreters of Christian scripture, doctrine, and ethics have developed extensive theories about the proper relationship between God, man, and country. These have implications for how societies will be organized and, therefore, whether people will thrive or not.[29]

III. SOCIETY AND THE STATE

George Washington once compared government to fire, arguing that it is "a useful servant" and "a fearful master." North (1977, 1981) and Barzel (2002), among others, offer positive theories of the state; in particular, North (1981:21) defines the state as "an organization with a comparative advantage in violence, extending over a geographic area whose boundaries are determined by its power to tax constituents."[30] The literature on the role of the state, the character of a just society, and the nature of a person's obligation to his fellow man is

[28] As it regards sufficient conditions for growth, Mises (1949), Rothbard (1962[2001]), and Reisman (1996) argue forcefully for the optimality of the unhampered market. O'Driscoll, Holmes, and Kirkpatrick (2001), Adkins, Moomaw, & Savvides (2002) and Klein & Luu (2002) offer empirical evidence to support this hypothesis.

[29] It is certainly possible that causality runs in the opposite direction, as ideology often influences interpretation.

[30] See Nye (1997) for a discussion of the relationship between transaction costs and coercion.

ponderous.[31] One tradition holds that justice transcends the state, that the agents of the state are bound by divine law, and that the state, if it is to exist at all, is not to play an active role in economic life beyond being "a terror…to the evil (works)."[32] In short, the first position holds that Christian social theory and libertarian philosophy are virtually identical and may be called libertarian Christianity.

The second position was popularized by the Christian socialist movement of the early twentieth century and roughly embodied in the "liberation theology" and "prosperity theology" movements, holds that the state must take an active role in promoting a just society. This position is diametrically opposed to the first position and holds that Christian social theory and socialist philosophy are virtually identical and may be called socialist Christianity.[33]

To the extent that ideology helps determine an economy's institutional framework, libertarian and socialist Christianity will necessarily generate different formal institutions.[34] Not surprisingly, a world in which socialist Christians are in a position to make policy will be characterized by redistributive intervention by the state on behalf of the poor, interference with market prices, and in extreme cases the possible abolition of private property.[35] A world in which libertarian Christians are in a position to make policy will be characterized by minimal state activity (if a state exists at all).

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[31] For recent summaries and extensions of this literature, see Schansberg (2002), Soo Meng (2002), Michel (1999), de Soto (1999), and Gorga (1999). 153(1) of the *Journal of Institutional and Theoretical Economics* contains a symposium on religion and economics. See in particular Herms (1997) and the comment by Kubon-Gilke. 5(1) of the *Journal of Markets and Morality* contains the proceedings of a conference on the social thought of Abraham Kuyper & Leo XIII. De Jasay (1998) discusses positive and normative aspects of coercive intervention. Brewster (2002) and Bastiat (1848 [1996]) offer entertaining treatments of the problems and contradictions of the state, and Bastiat (1850 [1996]) discusses the relationship between religion and governance. Frey (2001) asks whether or not we can have "government" without coercion. Van Creveld (1999) offers an historical treatment of the historical evolution of the state. Ehrenreich (2001) argues for state intervention based on Christian principles, and Hamill (2002, 2003) argues for redistributive tax reform in Alabama on the basis of Judeo-Christian ethics. See Ekelund and Hebert (1997:9-89) and Rothbard (1995) for surveys of these debates as they occurred in medieval and pre-modern circles.

[32] Romans 13:3 (KJV).

[33] The phrases "libertarian Christianity" and "socialist Christianity" are used to highlight extremes. There is a continuum of interpretations between these opposite ends. The theory that "Jesus was a socialist" can be found in the writings of Francis Bellamy and other Christian socialist theologians of the late 19th-early 20th century. Mises (1922 [2000]) devotes an entire chapter to addressing the doctrines of Christian socialism in the late 19th and early 20th centuries. A Google search for the phrase "Jesus was a socialist" offers a crude measure of the popularity, force, and persistence of the idea: a search on August 31, 2006 produced 560 hits.

[34] I acknowledge that reducing the spectrum of Christian political ideology to "libertarian" and "socialist" is an oversimplification. However, for purposes of this essay, the oversimplification does not damage the central thesis: that intervention may increase uncertainty and decrease economic growth.

[35] The utopian communal settlements that dotted the American landscape in the 19th century are good examples of the role of ideological conformity in maintaining cohesive social order. Deutsch (1944) writes about ideological conformity and social cohesion in the medieval world, and both Warner (1993) and Maurer (1925) discuss the role of religion in the development of the US, and Durey (1992) offers an historical discussion of "utopian socialist" tracts. Block (1999) critiques Bethell's (1998) comments from the perspective of libertarian legal theory.

Many religious scholars and progressive commentators focus their attention not on activities that enlarge the pie, but on activities that change the way the pie is cut, with relatively little attention paid to how pie-cutting activities will alter pie-producing incentives.[36] The *imprimatur* of ideological and spiritual leaders may facilitate and encourage wasteful rent-seeking in stable societies. As Mancur Olson (1982, 1983) notes, incentives to establish rent-seeking special interest groups—who often stand to gain substantially from changes in incentives—will likely slow economic growth. It is worth quoting Olson (1983:918) at length here:

> …no society will achieve that comprehensive organization of all common interest groups that would make it possible for the leaders of all groups to baragin with one another until an efficient, core allocation of resources for the society is obtained. As time goes on in stable societies, however, more of those groups that have the potential to organize will have enjoyed the favorable circumstances and good leadership needed to get organized. Since organizations that succeed in obtaining the selective incentives needed to survive rarely disband or collapse, stable societies (which do not destroy organizations through violence or repression) will accumulate more organization for lobbying and cartelization as time goes on.

Olson continues in his next paragraph:

> Most organizations for lobbying or cartelization have no incentive to strive to make the society in which they exist more efficient or prosperous; the members of the organization will normally get only a minute fraction of the society's gains from greater efficiency, but will bear the whole cost of any effort to increase social efficiency. Normally these organizations can best serve their memberships by seeking a larger share of the social output for their members by distributional struggle—*they will be coalitions concerned about distribution rather than production* (italics mine).

In other words, rent-seeking coalitions will develop and persist in stable societies, and the actions of entrenched interests will then slow economic growth. Direct rent-seeking can be enabled by ideology: Caplan (2007) argues out that democracies choose inefficient polities not necessarily because of rent-seeking *as such*, but because of voters' "systematically biased beliefs" about economic issues. These "rationally irrational" beliefs by otherwise disinterested members of the polity imply that democratic institutions may not effectively check on rent-seeking special interests, though this is open to further testing.[37]

Religious institutions are an important source of ideological influence on economic policy. DiIulio (2004) summarizes and emphasizes what *The Catechism of the Catholic Church* calls "*preferential love*" for the poor and our

[36] I am grateful to Zagros Madjd-Sadjadi for this insight and characterization.

[37] Lindert (2004a, 2004b) argues that the relative efficiency of democratic governance induces high-transfer welfare states to adopt tax policies that are less distortionary than those in low-transfer countries.

obligation to remedy "*sinful inequalities*," noting that the *Catechism* also teaches that "(t)he decisive point of the social question is that goods created by God for everyone should in fact reach everyone in accordance with justice and with the help of charity."[38] Of course, "goods created by God" are not simply rained down like manna from Heaven. They require human intermediation, and before we ask about "the decisive point of the social question" regarding distribution, we must first solve the problem of how these goods and services are to be produced. DiIulio (2004:669) again quotes the *Catechism*: "The equal dignity of human persons requires the effort to reduce excessive social and economic inequalities. It gives urgency to the elimination of sinful inequalities" (Konstant 1994:472). Leaving aside such questions as "how much inequality is 'excessive,'" we are forced to struggle with whether intervention to remedy this inequality will be effective or necessary.[39]

Arbogast (2005) and Keckeissen (2005) argue that a misunderstanding of economic principles has been a key feature of recent Catholic social teachings. Arbogast, an energy company executive and practicing Catholic, draws our attention to US Catholic Bishops' 1986 "Pastoral Letter on Catholic Social Teaching and the U.S. Economy" entitled *Economic Justice for All*. The letter was motivated by the fact that "(e)conomic decisions have human consequences and moral content," and the Bishops who wrote the Letter are careful to point out that they "speak as moral teachers, not economic technicians" who are moved by their observation of "too much hunger and injustice, too much suffering and despair, both in our country and around the world" (US Catholic Bishops, 1986). It promoted a view of markets that Arbogast "found unnerving, even surreal;" in his words, the letter revealed "serious conceptual gaps in economics" within the body of teachings comprising Catholic Social Doctrine (Arbogast, 2005:41,42).[40]

Arbogast offers to Catholic leaders a recommendation reminiscent of James Buchanan's charge to economists.[41] Where Buchanan advised economists to consider "exchange" rather than "optimization" as the subject of their inquiries, Rather than attempt to redistribute income or interfere with market prices, Arbogast suggests that Catholic leaders focus their attention on promoting institutions and "rules of the game" that reward entrepreneurship and allow firms and individuals to fully participate in the market. Keckeissen (2005:161) concurs, pointing out that the "zero-sum" view of economic activity implicit in recent teachings—along with the view that poverty in poor countries is caused by prosperity in rich countries and the obligation to redistribute wealth—are likely to be growth-reducing.

[38] DiIulio (2004:667-668), quoting pp. 470, 587, 588, and 590 of Konstant (1994). Emphasis is original to the *Catechism*.
[39] On whether conventional measures of inequality are appropriate or not, see Nye (2002a, 2002b).
[40] Discussion of *Economic Justice for All* relies on Arbogast (2005), who offers a full discussion and critique of the Letter. I summarize here some of his main criticisms.
[41] For statement and discussion of Buchanan's recommendations, see McQuade (2000), Heyne (2000), and Block et al. (2006).

IV. CHRISTIAN ETHICS AND INTERVENTION[42]

The Common Faith of Christianity includes a common ethical core: in addition to "One Lord, one faith, one baptism, One God and Father of all, who is above all, and through all, and in you all,"[43] Christians share a body of common ethical propositions that govern human behavior and are embodied in the Ten Commandments, the Beatitudes, and the Golden Rule.[44] It is uncontroversial to assert that we are to help those who cannot help themselves, that we are to love our neighbors as ourselves, and that we are to refrain from theft, murder, adultery, covetousness, and false witness.

The bone of contention appears not when we ask whether or not we are to love our neighbor as ourselves or whether or not we are to care for the poor, but when we ask how these virtues are to be manifested in the social environment and political arena. First, the capitalist revolution that gave rise to the Christian socialist movement of the late 19th and early twentieth century in fact worked a great benefit to the poor; however, many popular caricatures of this period suggest that it was characterized by rapacious greed and oppression, which necessitated state intervention. Second, well-intentioned formal institutions designed to redistribute wealth or control prices may in fact work to the detriment of the poor.

We know that formal rules have a pronounced impact on economic performance. They consist of the set of "thou shalts" and "thou shalt nots" decreed by the state, and different interpretations of scripture will yield different assessments of what the content of these rules should be. In the libertarian ideal, a state would be an organization that merely protects property rights in exchange for revenue—akin to the insurance company proposed by Hoppe (2001) and enforcing the commandments that "thou shalt not steal" and "thou shalt not kill." In the socialist ideal, a state acts to ensure that everyone has adequate material provision.

Christian socialists' aversion to capitalism stemmed from what they observed in the industrial economies of the United States and Western Europe. The Christian socialists of the late 19th and 20th century felt that the unequal distribution of wealth between the workers of the world and capitalist plutocrats was unacceptable. The plight of the poor cried out for social intervention.

While money incomes were certainly unequal, it does not follow from this fact that the unfettered market wrought unambiguous social injustice. Lindert (1995) and Lindert and Williamson (1983) show that the industrialization of Great Britain resulted in net welfare increases for workers, including women and children. In a collection of lectures delivered at the University of Buenos Aires in 1959 and published posthumously in 1979, Ludwig von Mises noted that the rise of

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[42] A version of this section appeared in an earlier article and is used here by permission of M.M. Scrivener Press.

[43] Ephesians 4:4-6 (KJV).

[44] I stress that this common ethical core represent, as Paul mentioned in his epistle to the churches in Galatia, effects of faith rather than causes of faith.

capitalism in the 19th century provided greater opportunities for everyone. As Mises puts it,

> The famous old story, repeated hundreds of times, that the factories employed women and children and that these women and children, before they were working in the factories, had lived under satisfactory conditions, is one of the greatest falsehoods of history. The mothers who worked in the factories had nothing to cook with; they did not leave their homes and their kitchens to go into the factories, they went into factories because they had no kitchens, and if they had a kitchen they had no food to cook in those kitchens.[45]

He notes that the situation for the children was equally grim:

> (T)he children did not come from comfortable nurseries. They were starving and dying.[46]

Harold B. Jones (2005:168) describes the capitalist revolution this way:

> The poverty and economic stagnation of pre-industrial society gave way to rapid progress, child labor began to disappear long before there were any laws against it, and the common man came to enjoy a standard of living unknown even to kings a few centuries before.

The capitalist revolution of the 19th century was a great boon to the daily life of the common worker, with some of the strongest evidence coming in the form of revealed preference. As Mises notes, the move from farm to factory was voluntary. While conditions in the factory may have been repulsive by modern standards and while the choice to work in the factory may have been a Hobson's choice for many, it represented the best alternative in the eyes of the workers. Even if this boon is insufficient by some ethical criteria, it does not follow that state intervention will succeed in improving the well-being of the less fortunate.

Intervention and redistribution may be intuitively appealing: what better way to help the poor or advance equality than to take from those who have and give to those who have not? Why wouldn't Christians who believe that we should love our neighbor and care for the poor support these policies? After all, the capitalists of the 19th century and the "robber barons" of the early 20th century certainly possessed the means to provide for those less fortunate.[47]

The fundamental lesson of economics is that people respond to incentives, and a change in formal institutions (such as redistributive intervention or price control) necessarily changes the structure of incentives in the long run and may, in fact, work to frustrate the entrepreneurial mechanisms that produced

[45] Mises (1979 [2002]), p. 7
[46] ibid.
[47] I ignore for now the obvious ethical difficulties associated with coercion. For a full discussion, see Rothbard (1982).

phenomena like “the factor of twelve.” One effect of redistributive coercion may be to increase uncertainty about the structure of property rights. This will decrease the present value of potential investments and, at the margin, lead to lower levels of investment and capital accumulation. Lower investment entails a reduction in economic growth and a potential reduction in future consumption possibilities for everyone.

Second, higher tax rates may reduce economic growth. High marginal tax rates on labor will reduce one’s incentive to supply labor services. This may be particularly damaging if we are taxing high-wage occupations, which tend to be occupations in which people are either augmenting a country’s technological foundations (research and development, for example) or making entrepreneurial and managerial decisions regarding the investment and allocation of factors of production (executives). Reducing the return to this kind of labor may reduce productivity and efficiency.

High taxes on capital will produce similar effects. Changing the prospective return to capital will affect investment decisions. Lower investment entails a smaller capital stock, which in turn entails lower future output and growth. The effect may manifest itself largely in the form of lower wages: economic theory teaches us that in a sufficiently competitive market workers are paid their marginal value product, and their marginal value product will be an increasing function of available capital. Less capital implies a lower marginal value product, which in turn results in lower wages. We can increase current consumption in the short run, but at the expense of higher future consumption over the long run.[48]

What of the incentives for the recipients of state *largesse*? While welfare reforms of the last decade have attempted to address this issue, transfer payments reduce one’s incentive to produce by diminishing his/her wage at the margin, particularly if benefits are strictly means-tested.[49] To illustrate, consider a highly simplified in which someone wakes up on Monday morning and considers whether or not to work for the week. He can earn $240 by working a 40-hour week at a fast-food job, or he can earn $250 on welfare. If he decides to work, the opportunity cost of a week of labor is $250 in welfare payments, $10 more than what he would earn by working. Even if he can earn $280 by working (and enjoy a positive marginal income of $30), the incentive to join the labor force is drastically reduced by the possibility of welfare payments.[50]

These simple models of redistribution carry an important caveat in that they assume that all else remains equal. If one considers two otherwise-identical

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[48] Lindert (2004a, 2004b) notes that taxation of capital is one area in which low-social transfer countries like the United States perform poorly relative to higher-social transfer countries.

[49] Lindert (2004a, 2004b) again takes the low-social transfer countries to task, for providing weak work incentives among the poor through strict means testing.

[50] The obvious objection to this example concerns the supposed existence of involuntary unemployment. Mises (1949) and Rothbard (1962 [2001]) question the validity of this objection and note that, in the absence of state intervention restricting employment, all unemployment must necessarily be voluntary. Hutt (1954 [1995]) discusses the importance of price flexibility. The government’s role in providing public goods has not been addressed here; on this, the reader is referred to Hoppe (1989a, 1999) and the essays in Cowen (1988).

economies, a country that taxes production to subsidize consumption will grow more slowly. In a bracing empirical reassessment of the relationship between social spending and economic development, Lindert (2004a, 2004b) points out that these "blackboard models" of government social spending have never appeared in the real world. *Ceteris* is rarely *paribus*, especially in a "second best" world, and Lindert uncovers an intriguing relationship between high social spending and a relatively efficient (distortion-minimizing) fiscal infrastructure. As Lindert (2006a) notes in his exchange with one of his critics, social transfers may be the least distortionary way in which governments intervene in markets.[51]

Lindert points out that the "free lunch" properties of the welfare state stem from the manner in which it is financed and administered. In contrasting the low-transfer US with high-transfer Europe, Lindert points out that American public finance is relatively clumsy in that it introduces more distortions than do European tax systems. In Lindert's (2004a:31) words:

> The European high-budget countries do not have higher average rates of taxation on capital income. They have been cautious about the double taxation of dividends. Rather, they rely more heavily on labor income taxes and on flat consumption (or value added) taxes. They also tax addiction goods (e.g., alcohol and tobacco) more heavily, thus taxing complements to health-compromising leisure. Granted, the rates of overall taxation are still higher in the high-budget countries, yet their attention to the side-effects on economic growth seems to have led them to choose types of taxes that minimize or eliminate any damage to growth, relative to the types of taxes levied in the lower-spending countries.

This does not necessarily mean that we can always redistribute our cake and eat it, too, particularly if we extrapolate into a broader international context, but it is a compelling finding that cries out for further investigation.[52] Redistribution appears to be a "free lunch" for the rich democratic countries of the OECD, but the failure of attempts to improve the lot of the world's poor by redistributing resources from rich countries to poor countries is indeed conspicuous, as William Easterly has pointed out in numerous places. If anything, the global benevolence efforts of International Financial Institutions have not only been not only inadequate. They have been counterproductive.[53]

Another form of intervention often supported on ethical grounds is price regulation, particularly maximum prices set for rental housing or goods for which demand might increase radically after a natural disaster, as well as minimum prices for labor in the form of higher minimum wages. Again, economic theory and evidence suggest that these interventions may not produce the effects

[51] See Bergh (2006a, 2006b) and Lindert (2006a, 2006b) for a debate about Lindert's findings with respect to Sweden. Margo (2004a, 2004b) discusses Bergh (2006c) argues that trade openness and greater economic freedom have financed the welfare state in recent years.

[52] Lindert (2004a, 2004b) discusses the implications of his findings for Asian countries and Latin America.

[53] See on this Easterly (2002, 2003, 2005a, 2005b). Easterly (2006) argues that there is evidence of a causal relationship between economic freedom and economic growth. For an alternative perspective, see Sachs (2005).

desired by their advocates; in the case of maximum prices, these distort the information-transmitting function of prices and lead to shortages. Minimum wages also distort the transmission of information, and evidence suggests that minimum wages actually reduce employment.[54] Well-intentioned interventions again here harm precisely the people they are intended to help.

V. CONCLUSIONS

The relationship between beliefs, institutions, and economic growth constitutes fertile ground for future research. To the extent that ideologies and beliefs influence the structure of formal institutions, interventions espoused by some Christians may run counter to our moral obligation to the poor. Taxes on production—particularly taxes on capital—and subsidies to consumption may reduce prosperity. Moreover, interference with prices and with market adjustments, presumably in the name of justice, can lead to further distortions.

This analysis has been mute on the institutional and structural differences between the Abrahamic faiths, but comparative institutional analyses of benevolent institutions public and private in the Muslim world and the OECD would shed light on the limits of intervention. Kuran (1996, 2003) argues that the ethical and charitable requirements in Islamic law bind potentially productive resources into unproductive social-service organizations, and while Lindert (2004) argues that religion helps explain social transfers, it remains to be seen how benevolent institutions affect growth in the Muslim world. Moreover, continued Muslim immigration into Europe will likely change social and institutional dynamics; it will be interesting to see how these changes affect European social infrastructure.[55]

In summary, social reformers must look carefully at the unintended consequences of well-intentioned interventions.[56] Phenomena like "the factor of twelve" are anything but automatic; the phenomenal growth that characterizes the experience of the modern world was the result of a constellation of specific institutional factors, and ill-advised interventions are likely to harm "the least of these"[57] in the long run. Moreover, the widespread incidence of starvation and stagnation over the history of human civilization—including the 2000 years of the

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[54] See Neumark (2006) and Neumark and Wascher (2007) for comprehensive summaries of the research on the empirical effects of the minimum wage. Aaronson and French (2007) find that increases in the minimum wage lead to disemployment. In a policy study prepared for Missouri's Show-Me Institute, Neumark (2006:1) summarizes empirical evidence on the impact of minimum wages:

> The evidence from a large body of existing research suggests that minimum wage increases do more harm than good. Minimum wages reduce employment of young and less-skilled workers. Minimum wages deliver no net benefits to poor or low-income families, and if anything make them worse off, increasing poverty. Finally, there is some evidence that minimum wages have longer-run adverse effects, lowering the acquisition of skills and therefore lowering wages and earnings even beyond the age when individuals are most directly affected by a higher minimum.

[55] See Ahmad (2005) for a discussion of globalization and Islamic receptiveness to market institutions.
[56] This paragraph is adapted from an earlier essay and is used by permission of M.M. Scrivener Press.
[57] Matthew 25:40 (KJV)

Christian era—certainly suggests that we tend to "get it wrong" far more often than we "get it right," to use North's (2005) terminology. "Getting it right" in terms of establishing economic institutions conducive to economic development requires more than good intentions. It requires that we understand the downstream consequences of policy choices.

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