# Solving Social Dilemmas

## *Ethics, Politics, and Prosperity*

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## Contents

# Preface

> This exchange society and the guidance of the coordination of a far- ranging division of labor by variable market prices was made possible by the spreading of certain gradually evolved moral beliefs which, after they had spread, most men in the Western world learned to accept. These rules were inevitably learned by all the members of a population consisting chiefly of independent farmers, artisans, and merchants and their servants and apprentices who shared the daily experiences of their masters.
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> They held an ethos that esteemed the prudent man, the good husbandman and provider who looked after the future of his family and his business by building up capital, guided less by the desire to be able to consume much than by the wish to be regarded as successful by his fellows who pursued similar aims.
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> **— Hayek ([1979] 2011, pp. 164– 165)**

Hayek's explanation for the emergence of extensive networks of exchange has been accepted by a subset of economists and historians, but it is by no means the most common explanation for economic development. This may be because no scholar has taken the time to analyze the ways in which rules of conduct can directly and indirectly affect the extent of commerce. This book undertakes that task.

It is an important project for several reasons. First, it fills a lacuna in economic, political, and social theory by explaining how ethical dispositions tend to affect the scope of market activities. Second, it helps to explain the variety of "market outcomes" witnessed through time within and among societies. Market networks can be extraordinarily productive systems for satisfying material wants and generating the free time necessary to pursue other interests, but not all markets are equally productive—a variation that requires an explanation. Third, the analysis undertaken suggests that other explanations such as scientific advance, urbanization, and capital accumulation are secondary rather than primary causes of development. Fourth, a better understanding of the root causes of prosperity can improve our current policies— for example, avoiding laws and regulations that tend to undermine the ethical dispositions that have contributed to and continue to support our prosperity.

Prosperity and progress are surprisingly recent phenomena, and the continuation of our past two centuries of exceptional economic history is by no means guaranteed. If some ethical dispositions facilitate economic development, others must have long impeded it. It is not ethical behavior per se that generates economic growth, but rather a small subset of principles and rules of conduct deemed ethical that do so. To fully understand the roles that ethical dispositions play in economic development requires exploring both dispositions that support extensive trading networks, specialization, and innovation, and those that do not. It also requires explaining how such dispositions can emerge and be sustained.

This book suggests that solving critical social dilemmas is the key to prosperity, and it turns out that many of the rules that we consider ethical or moral tend to solve or ameliorate those dilemmas.

A subset of the most critical dilemmas have long been solved or ameliorated, as necessary for the emergence of attractive sustainable communities. However, overcoming the dilemmas most critical for economic growth was achieved far more recently—most likely through changes in norms that produced quite different notions of the "good life" and "good society" in the past few hundred years.

As a consequence, general prosperity emerged for the first time in human history, and commerce became more central to the lives of more people than it had been at any previous time in human history. The commercial society had emerged.

## The Commercial Society

Contemporary adult lives in much of the world are centered on the "workday" and "workweek," which are the periods in which one "hires oneself out for wages" and accepts the duties associated with such an exchange. Most food and clothing are purchased from large economic organizations, rather than homegrown, homespun, or homemade. We keep our savings at banks or at brokerage firms, rather than under the mattress or buried in the backyard. "Vacations" are special times when we can leave our jobs and focus on activities other than ones we are paid to do. When on holiday, we take our cash and credit cards to a destination of interest and rent or purchase the necessities of life— the roofs over our head, meals, transport, and perhaps a few more frills than usual. Leisure has come to mean the absence of job duties rather than a time of rest, recuperation, and reflection. Indeed, those who pursue active forms of leisure while on vacation often engage in greater physical efforts while on holiday than when at work. They may climb a mountain, take long walks through city streets, undertake a bit of remodeling, or catch up on yard work at home.

The pattern of life associated with the commercial society has greatly increased the material comfort and longevity of most persons participating in the complex networks of voluntary transactions that make up the world's great networks of exchange, production, and innovation. Those highly productive networks emerged in the past three centuries—which is a long period in terms of a human life, but a short one in human history.

Commerce itself is not new. A small subset of humanity has traded and consumed products from all over the world for several thousand years. Goods from ancient China are found, for example, in the tombs of Egyptian kings. Trading families and centers of trade have existed even longer than international trade, but relatively few people outside capital cities and seaports devoted much of their lives to producing goods for sale. Markets existed, but for the most part, they were elite phenomena in which only a relatively small number of urban artisans and shippers participated. The vast majority of persons during human history were hunter-gatherers, farmers, or farmworkers. Their cycle of life was tied to the seasons rather than to a workweek determined by commercial organizations. Farmworkers and servants were paid mostly in kind with "room and board" rather than money. And most farm communities were largely self- sufficient, producing most of the necessities of life for their owners, employees, and renters.

Subsistence farmers and their associated communities were not truly parts of a commercial society, even in cases in which they sold a bit of their produce and occasionally purchased spices from the Far East, olive oil from Italy, or a few pieces of hardware or jewelry from urban artisans. Most of the goods traded were produced by nearby small family enterprises: village potters, spinners, millers, carpenters, smiths, and farmers. Village tradesmen were often participants in local commercial societies, in that they used their barter and money receipts to acquire most of their necessities of life, rather than producing them themselves; but village networks of exchange tended to be local for the most part, rather than regional, national, or global. And relatively few people were primarily engaged in such activities. Indeed, rather than trust to market networks, the largest farms often included such artisans among their employees.

Even in relatively commerce- oriented regions of the world, most people lived in the countryside, and most of their "productive hours" were devoted to agriculture and household production, rather than market-oriented activities undertaken at the behest of large commercial organizations.

### The Recentness of Progress

That ancient seasonal agricultural-based pattern of life largely disappeared in the West during the past two centuries, as urbanization increased and as farming became more market oriented. Rather than the long-standing 90:10 (or more) ratio of farmers to persons employed by commercial enterprises, the new division of labor generated a ratio of 10:90 (or less) during the twentieth century, with fewer and fewer farmers. The vast supermajority of persons began "hiring themselves out for wages" to both large and small organizations devoted to producing things and services with the aim of selling them to others at a profit, rather than consuming them.

By historical standards, this was a relatively swift and radical change, far faster than the emergence of agricultural communities 8,000 to 12,000 years ago, or regional governance and writing, which took place over many centuries in the period after agriculture emerged. In just a few centuries, extended markets and specialization replaced self-reliance at the level of farms and farm villages as the main source of food, clothing, and shelter— first in what came to be known as "the West," and then in much of the rest of the world.

That great extension of trading networks and specialization was generated by a series of increases in the net benefits that could be realized from market activities. Many of these were associated with technological innovations such as improvements in agriculture and shipping. Others were, arguably, generated by changes in organizational and institutional innovations. A third causal element involved changes in culture— in particular, changes in the ethos of persons living in the communities where commercial societies emerged.

The ethical explanation for the rise of commerce is the main focus of this book. The first two parts of the book demonstrate how internalized rules of conduct can increase the efficiency of market networks both directly through effects on the behavior of market participants and indirectly through effects on the rate of innovation and the nature of government policies. Social dilemmas are commonplace, and without solutions to them, progress is blocked—or at least greatly slowed down—and it turns out that changes in internalized rules of conduct are the most likely explanation for such solutions. Part III of the book provides evidence that changes in internalized norms did in fact provide greater support for trade and production in the period leading up to the great acceleration of commercialization in the nineteenth century. Other shifts in norms helped induce public policies that encouraged or at least did not greatly impede the process of commercialization. And it turns out that much of the observed change in norms occurred at the point in history just before the acceleration of economic development occurred.

Normative dispositions were not the only factor that induced shifts from agrarian lives to commerce-based ones, but they were arguably the most important factor. Indeed, they were often prerequisites for the others. Subtle changes in ideas about character, life, and society played central roles in all the processes through which commercial societies emerged. Solutions to social dilemmas reduced what economists refer to as transactions costs, increased rates of capital accumulation and innovation, and induced changes in public policies that had long impeded economic development.

### Problems with Other Explanations

There are, of course, other possible explanations, but this book suggests that the other contributing factors were themselves consequences of changes in norms, rather than root causes of economic development.

Advances in agriculture and mechanical, metallurgical, chemical, electrical, and aeronautical engineering all had obvious and tangible effects on possible modes of production, transportation, and lifestyles, which increased specialization and allowed many new products to be brought profitably to market. The steam engine, electricity, telephone, automobile, airplane, radio, computer, and Internet all had significant effects on the productivity of resources that could be focused on innovation, production, and exchange. However, it is clear that commerce did not expand solely because of technological advances. Technology is, in principle, completely portable and can be applied anywhere in the world, but it was not widely used to extend commerce outside the West when it first emerged. Most of the world failed to take advantage of developments in engineering and large- scale organization during the nineteenth century, and so failed to commercialize during the nineteenth and early twentieth centuries. This was true of even relatively advanced and sophisticated societies such as Turkey and China. The mere invention of a "better mouse trap" was not sufficient to induce the world to beat a path to the Western door.

Nor is the cultural explanation for economic development intended to deny the importance of urbanization. Great cities are all at least partly dependent on food imports for their existence because urban residents lack sufficient space to grow enough food to sustain themselves. Trade, however, is not the only method for bringing food to towns and cities. The political elites of ancient towns and cities often controlled the surrounding lands and those farming them, and simply took what they needed as rents, payments for protection, or tax collection. It was only when food and other necessities were *purchased* from farmers in surrounding territories and from farmers in distant trading posts that significant trading networks emerged. And this change from extractive sources of wealth to more productive ones required norms, customs, and laws that supported voluntary exchange.

The relative importance of extraction versus exchange as a source of prosperity for the most famous capital cities can be assessed by comparing the size and wealth of those cities with nearby port cities. Such secondary, but still relatively prosperous places were normally far smaller and far less lavishly decorated with monumental buildings and palaces than capital cities. This observation implies that trade, per se, was less important than taxation and other methods of expropriation as an explanation for the prosperity of major cities that emerged around the home bases of regional, national, and imperial governments.

Urbanization is nonetheless an important event in the history of commerce. Many persons in cities were full-time participants in commerce, even in capital cities that were largely supported by tax revenues, tribute, and slavery. Thus, many of the norms, organizational patterns, technologies, and laws that support commerce emerged first in urban areas. Several ancient capital cities have survived and remain significant commercial centers today— Athens, Baghdad, Beijing, Byzantium, Cairo, Kyoto, Madurai, Multan, and Rome are examples. However, none of these ancient cities played a central role in the great expansion and acceleration of commerce that occurred during the nineteenth century. Urbanization alone was not sufficient to generate the prosperity associated with truly commercial societies.[1]

## Overview

This book provides a behavioral explanation for the rise of commercial societies. All communities confront an endless series of social, economic, and political dilemmas that have to be solved or ameliorated for social and economic progress to be sustained. Solutions require systematic changes in behavior. Without such changes, problematic equilibria continue, and progress is impeded and thus is far slower than possible. Hobbes ([1651] 2009) and

[1] The association between governance, religion, and market cities suggests that tax and religious revenues provided the demand that supported relatively large cities, in effect subsidizing urbanization. These "capital" cities were larger than their commerce alone would have supported. Their exports (sales to others outside the cities) were smaller than their imports (purchases from surrounding farms and businesses). The other non-m arket revenues paid for the rest.

Ostrom (1990) suggest that formal and informal rule- bound organizations (institutions) often emerge to address social dilemmas. This book is similar in spirit to those classic books, but focuses on a solution that is arguably prior to formal institutions, namely the internalization of principles and rules of conduct that directly affect individual behavior and thereby group outcomes.

Parts I and II demonstrate that a subset of such internalized rules— rules that are largely regarded to be ethical or moral rules— can directly and indirectly solve or ameliorate social, economic, and political dilemmas. They do so by altering the manner in which alternatives are evaluated. Ethical dispositions, for example, can ameliorate the critical problem of excessive conflict noted by Hobbes ([1651] 2009) and the communal resource management problem noted by Ostrom (1990) and Diamond (2005). They can also solve or ameliorate most of the other economic and political dilemmas analyzed by economists and public choice scholars.

The central claim of the book is not that commercial networks result from ethical as opposed to unethical behavior, but that some ethical systems include rules that broadly support the development of extended market networks, specialization, and innovation. Others provide weaker support, solve a smaller subset of critical problems, or oppose economic development. Moreover, many norms have consequences that are context specific, and thus conditional in subtle ways. For example, a work ethic may facilitate productive activity in markets or support diligent efforts by government officials to expropriate all the social surplus generated. To be productive, a work ethic requires choice settings in which productive lives tend to be more rewarding than extractive ones.

This approach suggests that the extent and efficiency of commercial networks are not simply consequences of the considerations focused on in economic textbooks: production technology and tastes for goods and services— holding all other factors constant. Rather, it is largely the result of the factors being “held constant” for the purposes of simplifying the analysis undertaken in such textbooks. A good deal of statistical and historical evidence suggests that social and political support for or opposition to commerce has had major direct and indirect effects on the course and rate of economic development.

Although the scope of the book is ambitious, the analysis is undertaken with the simplest mathematical tools that are sufficient to demonstrate the logic of the argument. Parts I and II of this book use elementary game theory to demonstrate how ethical dispositions overcome social dilemmas associated with life in communities, with economic dilemmas associated with voluntary exchange, team production, and innovation, and dilemmas that tend to make governments extractive rather than productive. An implication of Part I is that the ethical dispositions that ameliorate social dilemmas at least partially determine every community’s customary law— the rules that all “good” people in a community follow. Part II demonstrates that ethical dispositions also largely determine how such laws are enforced and the manner in which new laws are adopted. Honest, conscientious law enforcement can “top up” existing norms and thereby reinforce informal solutions to social dilemmas. New laws can also speed up the process of social evolution by addressing social dilemmas that remain unaddressed by a community’s ethos.

However, governments are not “naturally” productive in either sense. In the absence of internalized norms and institutional arrangements that induce officials to advance the shared interests of citizens, the temptations to adopt extractive policies are too great. As a consequence, historically, most governments have been extractive enterprises. Such governments impede rather than facilitate economic development.

Part III provides evidence that ethical dispositions in the West became more supportive of markets and economic development in the period leading up to the great acceleration of commerce in the

West. It does so using intellectual history—a history that, perhaps surprisingly, is partly empirical in nature, although this is neglected by most intellectual historians. Most ethical theories in that period were grounded in a scholar's assessment of what the persons around them regarded to be ethical. And to persuade others that a new explanation or principle can account for ethical rules and sentiments required illustrations that readers would have found convincing. Thus, all but the most abstruse contributions to ethical theory during the period of interest are partly exercises in what would later be called social science. This empirical grounding of widely read philosophical work allows it to be used as a source of evidence about the mainstream ideas of a "good" life and "good" society in a scholar's time and place.

The authors who are reviewed were all widely read during their times (and thus taken seriously by their contemporaries). Most are still read today. Their conclusions and illustrating examples provide evidence that ethical support for lives devoted to commerce, material comforts, representative forms of government, and the rule of law generally increased in the period before the great acceleration in commerce of the nineteenth and early twentieth centuries. The stigma associated with careers in markets declined. And gainful employment, material comforts, and innovation gradually became indicators of the quality of one's life and character, rather than evidence of weakness, decadence, or other failings. The analysis of Part III parallels that developed by McCloskey (2006), although it uses philosophical, political, and economic texts as windows into cultural developments, rather than popular literature.

Among the many philosophical developments associated with commercialization, perhaps the most remarkable is that during the twentieth century, the extent of a society's commercialization (its gross national product or gross national product per capita) became the most widely used measure of the quality of life across continents, nation- states, regions, cities, and individuals. Prosperity had become not only part of a good life and good society, but their primary measure.