Economic Development: An Individualistic Methodology[1]

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Abstract

This paper establishes two theoretical frameworks in the study of economic development. These are constitutional analysis and interdisciplinary perspective. This study acknowledges that the economists are the ones to blame for lost of the underdevelopment in many parts of the world. These two theoretical frameworks are part of an individualistic methodology. The paper first, discusses individualism as an economic and political philosophy. Then it looks at the idea of methodology and its historical roots. Finally, it presents a brief overview of economic development theories. Then, it concludes by noting that in order to put an end to the cycle of poverty currently experienced by many developing nations, constitutional analysis and interdisciplinary perspective should be included in any analysis of economic development.

Keywords:

Individualism, Methodology, Economic Development, Constitutional Analysis, Interdisciplinary Perspective.

Introduction

The purpose of this paper is to demonstrate that the main source of frequent failures in the development efforts of countries around the world is the result of the flawed method of research used by many economists today. After John Maynard Keynes' famous quote which said that "we are all dead in the long-run," many policy analysts among economists turned

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into just concentrating on solving the short run economic issues faced by those countries which were not just experiencing poverty because of the effects of WWII but also the ones which were experiencing poverty before (Baldwin, 1954). The idea behind economic development was now a turn towards the fact that the focus of economists should be on solving the short-run problems of developing countries, and somehow the long-run would fix or adjust itself. Unfortunately, economists still view economic analysis from an ideological perspective. That is exactly why the field of economic development among economists is a combination of idealistic interpretations of philosophy, sociology, and even political science. On the other hand, there is massive specialization amongst economists in their attempts to understand economic analysis. Even though specialization could be a beneficial phenomenon, it could lead to a flawed and narrow understanding of economists' perception of human behavior. On the other hand, through the process of progress in economic development theories, there has never been any guideline or study which explicitly defines the role of the economist in this process (Boettke & Coyne, a). Economics is a science that focuses on the study of human interactions and decision-making process within certain social and political limits. Understanding this process from various perspectives is the only way to capture its dynamics (Robbins, 1984).

This paper attempts to introduce two different theoretical frameworks that could lead to a better understanding of the process of economic development and put an end to this so-called cycle of poverty experienced by many countries around the world. As Robert Lucas said when he was discussing the development situation in India: "The consequences for human welfare involved in question like these are simply staggering." (Lucas, 1988).

The current analysis among economists lacks constitutional analysis and an interdisciplinary perspective. The idea here is not for economists to consider these two frameworks separately. Rather consider them as a necessary structure for conducting any academic research program in the field of economic development. As you can see, the paper has three sections: Individualism, Methodology, and Economic Development. So in order to get to the conclusion established above, I should briefly discuss these three elements of the paper before drawing my conclusions. Hence, the paper will first look at the idea of individualism as an economic and political philosophy. Then the paper focuses on the importance of methodology and its philosophical and historical roots. After that, there will be a brief demonstration of the path that economic development theories have taken since Adam Smith. Then the paper concludes by establishing its two methodological components: constitutional analysis and interdisciplinary perspective. At the end a theoretical implications is presented.

Individualism

Individualism is an economic and political philosophy that places the individual as the main driver in economic, social, political, and cultural dynamics. Classical liberalism, libertarianism, neo-liberalism, and new-conservatism are the four distinct versions of individualism. Classical liberalism is a doctrine shaped over the years by the many thinkers who sometimes simultaneously presented their thoughts about individual rights and responsibilities. Its emphasis is on individual freedom, rule of law, private property rights, and the importance of individuals in social, economic, and political changes. Libertarianism, on the other hand, not only focuses on those important issues but is also extremely in favor of the reduction of the role of government in the economy and political system (Boaz, 1997).

Neo-liberalism is a political doctrine that emerged at the time that Margaret Thatcher (1979-90) became the prime minister of England. She with her knowledge of the discussions of such scholars like Hayek and Mises started a set of policies which influenced the political situation in England, Europe, and even the U.S. These policies included privatization and other such policies which encouraged and protected individual rights. Simultaneously, with the Presidency of Ronald Reagan (1981-1989) such similar policies came into law in the United States. However, now these policies stemmed from the works of such economists like James Buchanan rather than the European classical liberal theorists like Hayek or Mises. *Supply side economics* or *Reaganomics* are two terms that refer to those sets of policies during the Reagan era. Therefore, individualism is a philosophy which emphasizes the importance of individuals in social and political changes. Now, let us look at methodology.

Methodology

Economic theories are generalizations about our perception of reality. Since developing countries have various differences, no theory can fully capture the difficulties and changes in the development process. Hence, there is a need for a methodology that gives a series of standards that establish the theoretical basis of a research project. When we discuss the idea of method, it is a perception of the way logical and theoretical aspects of human brain can analyze reality in order to move in the road toward gaining wisdom. The first person throughout the history of human kind that looked at the idea of method was Socrates. Socrates developed his "Socrates Method" which focused on the idea of using the mind as the basis of gaining knowledge. He introduced his ideas against the famously known sophists at that time who believed that they could gain knowledge by making supernatural and spiritual contact with metaphysical beings. Two students from this school of thought were Plato and Aristotle. Plato in his famous book *The Republic of Plato* developed his ideal utopia. He also believed that it was the job of the intellectuals in the society to move and structure the society so that it can move towards that utopia in the end. He defined the role of a genius, a king, a leader who would lead this mission. On the other hand, there was Aristotle who believed that the universe centers and is guided by certain laws and the method should be structured around an understanding of these fix laws. This Aristotelian realism and Platonism utopianism were the central method of thinking that came out of Athens. During the middle Ages, Eastern and Islamic scholars became interested in the Greek Philosophy so the inspiration here was now to focus on Aristotle because his view of a universe centered on certain fixed laws was more compatible with the idea that a divine law guides the universe. Then there were the Scholastics who defined a new relationship between religion (specifically Christianity) and philosophy. Their arguments called for a legal-theoretical interpretation of science. The highest point in the growth of Scholastic thought was at the University of Salamanca in Spain, when St. Thomas Aquinas and his followers conducted their academic work. This new interpretation came to be known as the scholastics method.

After that came other philosophers such as René Descartes (1596-1650), Immanuel Kant (1724-1804) and John Locke (1632-1704) who used this idea of method as the basis of their analysis. For example, Descartes spoke of the mind as the basis of his analysis rather than focusing on a methodology of science that based its analysis on metaphysical and unobservable ideas. John Locke, on the other hand, spoke of the importance of property rights, education, and toleration in a modern society, which had its roots in the discussions that came out of the scholastics school. On the other hand, there were Georg Wilhelm Friedrich Hegel (1770-1831), Karl Marx (1818-1883), and Gustav Schmoller (1838-1917). These philosophers and historians also spoke of a method. However, their method emphasized a deep study of history as the basis of any analysis in the social science. This school of thought was later named the German Historical School. So philosophers such as Descartes, Kant, and Locke emphasized the Aristotle's version of the Socrates method and philosophers such as Hegel, Marx, and Schmoller emphasized the Plato's Utopianism, another interpretation of the Socrates method.

When Carl Menger wrote his *Investigations into the Method of the Social Sciences*, a new sphere of intellectual thought started which focused specifically on the idea of method. This intellectual confrontation is referred to as *Methodenstreit*. The fight was over methods that included the German Historical School and the Austrian School of Economics. The Germans were pro-science and had Hegelian roots. On the other hand, the Austrians were anti-science and had Aristotelian roots. Even though some economists and scholars such as Schumpeter later characterized this phenomenon as a waste of time, however, it was the basis of a new generation of scholarly work on both sides of the table: for both the Austrians and the Germans (Caldwell, 2003).[1] Looking at the Austrian side, the idea of method especially in the context of economic theory was

[1] Bruce Caldwell (2003) has a great discussion in chapter 3 of his book about *Methodenstreit* (also see Cubeddu 1993).

the main centerpiece of their analysis. This method as viewed by Mises is praxeology (see Mises 1949). For example, Vernon Smith who won the 2002 Noble Prize in economics "for having established laboratory experiments as a tool in empirical economic analysis, especially in the study of alternative market mechanisms",[1] distinguishes Mises' academic life by writing:

> The core of Ludwig von Mises's thought is the theory of human action, or praxeology, the general science he seeks to articulate. Within this general science is included_ embedded in it_ catallactics, or the science of exchange…This is because praxeology is neutral with regard to any value judgments concerning its data __that is, the ultimate ends chosen in human action (1999; 195).

In another instance, Murray Rothbard who was probably the best student of Mises, in an article named *Praxeology: the Methodology of Austrian Economics* writes:

> Praxeology is the distinctive methodology of Austrian school… While the praxeological method is, to say the least, out of fashion in contemporary economics as well as in social sciences generally and in the philosophy of science it was the basic method of the earlier Austrian school and also of a considerable segment of the older classical school… Praxeology rests on the fundamental axiom that individual human beings act, that is, on the primordial fact that individuals engage in conscious actions toward chosen goals (1997; 58-9).

Hence, the European and for that matter the world intellectual movement has always centered on the idea of method and or the fight over methods. Therefore, any significant and influential progress in science is a result of a deep consciousness or understanding of a method of science.

A Brief Overview of Economic Development Theories

The story of economic development starts with Adam Smith. Smith wished to find the determinants of development that created wealth. At the same time that he presented his criticism against mercantilism and

[1] For more information about the specifics of the Noble Prize visit http://nobelprize.org/economics/laureates/2002/

developed his theory of the indivisible hand, he concluded that an open economy, fewer regulations (especially fewer taxes), and more political stability were the fundamental factors that led a nation to experience sustained and systematic process of wealth creation (1776, 2003).[1] For example, he argues that low taxes, a reasonable judicial system, and open market are the basic conditions for economic prosperity:

> Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice: all the rest being brought about by the natural course of things. All governments which thwart this natural course, which force things into another channel or which endeavor to arrest this progress of society at a particular point, are unnatural, and to support themselves are obliged to be oppressive and tyrannical (Smith; 1776).

The theory of comparative advantage was first developed in 1817 by David Ricardo as one of the most important models in international economics theory. Others later considered this theory such as John Stuart Mill (1806-1873), Bertil Ohlin (1979-1899), Robert Torrens (1864-1780), and even Paul Samuelson (1915-). Then Schumpeter came with his brilliant book in 1911 that dealt exclusively with the idea of economic development. In that book, he focused his analysis on the idea of entrepreneurship as the most important element of economic development analysis. Even though Schumpeter never considered himself a part of the Austrian School of Economics, his academic works have a distinct Austrian flavor. Many prominent Austrian School economists, namely Friedrich von Wieser and Eugen von Bohm-Bawerk whose ideas went back to the famous Methodenstreit debate that took place against the German Historical School (Vaughn, 1994), trained Schumpeter. However, the modern story of economic development started when economists realized that most of the people in the world were not living in modern capitalistic societies. [1] Hence, a new body of economic thinking was

[1] It is important to note that even before the war, there were few economists who focused on the idea of economic development of "underdeveloped nations." For example, Colin Clark wrote a study in 1939, *Conditions of Economic Progress* that showed that most countries around the world were not experiencing constant and stable economic growth (see Schumpeter 1985).

devoted to the idea of finding new ways of solving these development problems and creating the environment for economic growth and stability for many of these nations. The first attempts of economists focused on European nations who were coming out of WWII, which started with the Marshal Plan and led to the creation of multination organizations such as the United Nations, IMF, and the World Bank.

The intellectual movement during the 1950s and 60s based its theoretical framework on the idea that the government should play a central role in the process of economic planning. The earlier development theorists who seriously started the intellectual movement to establish economic development as a research field in economics were Simon Kuznets and Arthur Lewis. Simon Kuznet theorized the idea that many underdeveloped nations in Europe, Asia, Africa, and Latin America at that time had different characteristics compared to Western European and other industrialized nations (Kuznets, 1973). The ideas of these two economists shaped the foundation for second generation of theorists that mostly focused on the issues of economic development as a "stage process". This was most revealing from some of the works conducted by Walt Rostow. As Adelman and Morris argue, both the modern pioneers of development economics and the new-classical theorists stress the important of "growth process" as the central theme of their analysis. This process refers to the constant reallocation of economic resources (factors of production), from less to more productive areas of the economy.

However, they all lack a concrete and solid research methodology. An even if there were success stories among economic development theorists, they were mostly amongst economists (such Amartya Sen and Douglass North) who specialized in a specific field of economic theory and then started theorizing in economic development. For example, Douglass North who won the Noble Prize in economics in 1993 "for having renewed research in economic history by applying economic theory and quantitative methods in order to explain economic and institutional change," stresses the importance of institutions in the process of economic development theories.[1]

[1] For more information, see the press release of the 1993 Noble Prize in economics. This document is available at http://nobelprize.org/economics/laureates/1993/press.html.

Constitutional Analysis

As many economists argue, the problem in many parts of the developing world is a lack of uncertainty about well-defined institutions (North 2005; Stiglitz 2002). These institutions include property rights, tax regulations, investment incentives, and more importantly the judicial and political structure of the society. The most important institution, which incorporates all of these sets of laws, is the constitution of a country. Hence, a deep and concise analysis of the ways in which a constitution of a nation comes into being, is probably the most important aspect of the process of economic development. Unfortunately, there are no such deep and systematic studies of a developing nation's economy from the constitutional perspective.

A constitution defines the roles of all other institutions. It sets the guidelines for the roles that the government should play in the economy, political system, and in the process of "cultural creation". At the same, it defines the role of the private sector and the individuals in the society and the rights that they can enjoy as citizens. Some economists argue that even the idea of entrepreneurship is an institutional phenomenon. Boettke and Coyne, for example, argue that in order for the process of development to take place, the institutions which encourage entrepreneurial ability, should be present. So even entrepreneurship is not the cause of economic development, but rather it is the result of well-defined institutions which encourage entrepreneurial behavior in the society (Boettke & Coyne, b).[1] The idea that clearly defined institutions are an important step towards a systematic development process is not new (e.g. Douglass North, James Buchanan, John Commons, and Gordon Tullock).[2]

When there is any talk of constitutional analysis in economics, the name of James Buchanan comes to mind. James Buchanan received the 1986 Alfred Nobel Memorial Prize in Economic Sciences for his "development of the contractual and constitutional basis for the theory of

[1] Of course, it should be noted that when discuss the idea of entrepreneurial ability we don't mean arbitrage, but rather a certain set of decisions under certain constraints which lead to an efficient production of goods and services.

[2] For more information about the importance of institutional in economics, (see Buchanan & Tullock 1962; Commons 1931; North 2005).

economic and political decision-making" (Ostrom, 1987). The central theme of Buchanan's intellectual career is his focus on framing his analysis on the constitutional level. This is most evident in his famous book *The Calculus of Consent* that he coauthored with Gordon Tullock. This book established the theoretical foundation for transforming economic thinking into the constitutional analysis. Buchanan uses an "individualistic" methodology to look at "collective choice" entities such as the government (Buchanan & Tullock, 1962). This individualistic methodology formed the basis for the public choice theory. Public choice theory is a discipline within economics which takes the principles that economists use to understand and analyze individuals as they interact in the marketplace and applies it to the decision making process of group of individuals.[2] This branch of economics found its home in the Center for Study of Public Choice at George Mason University, which was founded by James Buchanan (Boettke, 1998; Ostrom, 1987). Since, a constitution defines such myriad of institutions, its study requires an interdisciplinary understanding of social theories. Therefore, the constitutional analysis and the interdisciplinary perspective are two intertwined frameworks of understanding economic development. Now, let us look at the interdisciplinary perspective.

Interdisciplinary Perspective

As I mentioned earlier in my discussion, in the eyes of many economists, economic development has turned to an ideologically motivated doctrine of economics. Unfortunately, this perception led many economists to search for ways to look at economics from an objective perspective. Their search led them to the development of econometrics. However, in the process, they not only found the solution to the problem of methodology in economics, but ignored it all together. In general, in order to understand empirical studies, we need to ask such questions: What is empirical analysis? Is it just interpretations of observations that we make with our five senses? Alternatively, is it our perception of those observations? The answers to such questions will result into a meaningful definition of the idea of empirical analysis. However, even many economists who mostly use this as the basis of their academic work fail to present a concise definition of it. This ambiguity has led to "cookbook" scientific research in economics that has distorted the trust of economists and other social theorists about the use of on econometrics and mathematical economics in economic research (Samimi, 2003). In order to use econometrics and mathematical analysis in conducting research, economists should understand and fully define the boundaries of such an analysis, so they can effectively use it in their research. However, this paper argues that economists should not stop just at that. A successful research program is one that incorporates various ways of understanding the decision-making process of individuals in the society. This includes sociology, historical analysis of theories, philosophy, and law.

Conclusion

In this paper, two new theoretical frameworks for the study and understanding of the process of economic development were presented. These two frameworks include constitutional analysis and interdisciplinary perspective. In the process of establishing these frameworks, I first discussed the idea of individualism as an economic philosophy. Secondly, the paper explained the idea of methodology and its importance in science especially economics. Then, a brief overview of economic development theories was presented. Hence, constitutional analysis and interdisciplinary perspective as two new theoretical fronts that could strengthen the analysis of economists were presented. The idea here is that a constitution is a doctrine which defines all aspects (whether political, social, economic, or cultural) of a society. A constitutional analysis of the development process of countries around the world, hence, requires an interdisciplinary understanding of social and political theories. Even though, the interdisciplinary and constitutional studies are two separate issues, they are both a necessary element of any successful study of economic development.

A Theoretical Implication

Now that this paper established the new economic development methodology which is based on the philosophy of individualism, lets look at an important and common economic theory; simply the concept of entrepreneurship. [1] Many economists especially the ones who work in economic development speak of the idea of entrepreneurship and its role in economic development. However, only three individuals, Israel Kirzner (1930-), Joseph Schumpeter (1883-1950), and Ludwig von Mises (1881-1973), come to mind who considered this concept from a deep perspective. Even though they were all very articulate in terms of expressing their view of this concept, their notions and specific attributes that they associated with this concept varied considerably. This section of the paper distinguishes these three definitions of entrepreneurship and the role that they play in economic development. Then it concludes by saying that the definition of Mises is the most plausible one when viewed from this individualistic methodology established in this paper.

Schumpeter was one of the most influential economic theorists who established the idea of entrepreneurship based on his Austrian[3] roots. Kirzner for example in his famous book *Competition and Entrepreneurship* writes that "…for Schumpeter the essence of entrepreneurship is the ability to break away from routine, to destroy existing structures, to move the system away from the even, circular flow of equilibrium" (1973; 127). Therefore, Schumpeter defines the entrepreneur as a dynamic agent in the economy. At the same time, Schumpeter defines entrepreneurship as an *innovator.*

Israel Kirzner on the other hand has a different view. For example, in the same book, he says:

> The pure entrepreneur…proceeds by his alertness to discover and exploit situations in which he is able to sell for high prices that which he can buy for low prices…It is not yielded by exchanging something the entrepreneur values less for something he values more highly. It comes from discovering sellers and buyers of something for which the latter will pay more than the former demand. The discovery of a profit opportunity means the discovery of something obtainable for nothing at all (1973; 48).

[1] In the paper presented in the conference, the role that property rights play in economic development was one of the main implications of this methodology of economic development. That section was eliminated in the final draft.

So again, Kirzner defines the entrepreneur as a dynamic agent in the economy. However, he characterizes the entrepreneur as an *arbitrager*. As he writes in another part of his book:

> In economic development, too, the entrepreneur is to be seen as responding to opportunities rather then creating them; as capturing profit opportunities rather then generating them…Without entrepreneurship, without alertness to the new possibility, the long-term benefits may remain untapped (1973; 74).

Mises provides the best definition compared to the other two above. The Schumpeterian innovator and the Kirznerian arbitrager have two characteristics. First, they both believe that the entrepreneurs are a specific class of people in the society who have certain levels of skills, education, capital, etc… However, Mises believes that all of the individuals in the society are an entrepreneur. This definition is much more characteristic of individualism. On the other hand, Kirzner and Schumpeter rarely consider method as the bases of their analysis. However, all of the ideas presented by Mises gather around his major thesis: the praxeological method in economic science or praxeology, which he developed in his famous book *Human Action.* For example, Mises writes:

> In any real and living economy, *every actor is always an entrepreneur* and speculator… Economics, in speaking of entrepreneurs, has in view not men, but a definite function. This function is not the particular feature of a particular social group or class of men; it is inherent in every action and burdens every actor. The term *entrepreneur as used in catallactic theory [or praxeology] means*: acting man exclusively seen from the aspect of the uncertainty inherent in every action (1949; 252-3).

So as argued above, based on the individualist methodology established above, the definition presented by Mises about entrepreneurship and the role that it plays in the economy is the ideal definition.

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Notes

[1] Adam Smith established the idea of free trade as a reaction to mercantilism. Adam Smith argued that the problem with mercantilism was its focus on government regulation as the central point in expanding economic growth and welfare of countries around the world. Instead, Smith argues for an open market. He with is his simple examples (such as the pin factory) presents the idea that the larger the market, the more specialization. Specialization means higher productivity. Higher productivity in the end will result into more production of goods and services. Hence, open markets lead to more wealth. With these simple theoretical arguments, Smith is one of the best classical liberal theorists who started the movement of economic science.

[2] Public choice theory derived its analysis from its opposition to the idea held by Keynesian and Socialist (communist\Marxists) economists that governments area the only agents in the economy which can correct market failures. Although there are some exceptions (e.g. Mancur Olson), because of this skeptical view among many public choice theorists about the role that the government should play in the economy, public choice economists are mostly considered to be either conservative, new-conservative, and or libertarian. Public choice theory is at George Mason University, but other schools such as Washington University St. Louise, University of Michigan, and University of Rochester are also involved in this research program. Public choice theory clearly argues that governments can fail. Therefore, governments are not composed of individuals that suddenly become the servants of the people after they enter into public office. Rather, they are self-interested agents that through the whole period of government service follow their own desires. Public choice theorists do not believe that their job is to make politicians servants of the people. They rather acknowledge that self-interest is a rational and moral incentive for government service. James Buchanan argues that in looking at theorizing government activity based on the foundations of economic analysis, requires an "individualist methodology" and a "realistic perspective." Therefore, Buchanan believes that government is as an institution composed of millions of choices made everyday. Therefore, a government is a "collective choice entity." At the same time, Buchanan stresses the importance of realistic method rather than an idealistic method in the analysis of government activity. He merits Knut Wicksell, Frank Knight, and the Italian Public Finance tradition for their development of his so-called realistic way of looking at politics. *The Calculus of* Consent, as Peter Boettke argues, was a productive collaboration between Buchanan's philosophical perspective and Tullock's economic perspective. To find more information about public choice theory and the role of James Buchanan (see Boettke 1998; Atkinson, 1987; Romer 1988; Mueller 1989; Buchanan&Tullock 1962).

[3] The term “Austrian” refers to the school in economic theory named Austrian economics. This school started when Carl Menger (1840-1921) wrote his famous book Grundsätze der Volkswirtschaftslehre in 1871. However, its roots go back to Aristotle who was at that time introduced into Vienna by Franz Brentano (1838-1917) and the Scholastics school. Of course, later with the rise of such figures as Mises, it gained some new-Kantian roots. After Carl Menger, came Eugen von Böhm-Bawerk (1851-1914) and Friedrich von Wieser (1851-1926) who theorized the concepts of Austrian school as methodological individualism and stressed the importance of the subjective nature of economic value. They also entered the Austrian perspective into the mainstream economic theory at that time. Then came such figures as Friedrich von Hayek (1889-1992), Mises, etc… who emphasized the school’s ideas even further. However, it was exactly during this time in the early 20th century that the school found its new home in America. Karen Vaughn (1994) has done a masterpiece on this whole transformation and its outcome for the future of the school. Today the Austrian school is gaining more strength day by day and such economists like Karen Vaughn, Peter Boettke, and Israel Kirzner are leading this school in its attempt to introduce the philosophy of Austrian economics which is mainly based on methodology, individualism, and the subjective nature of economic value into economic theory (see Vaughn 1994; see Cubeddu 1993).