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The Applied Theory of the Bourgeois Era: A Price-Theoretic Perspective*

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Abstract

What can we learn about applied price theory from the Bourgeois Era? In this paper, we contend there are three important lessons that can be extracted from McCloskey's work on the Great Enrichment. First, transaction costs are not constraints, but objects of choice. Second, property rights are not merely a "bundle of sticks," in that private property rights make exchange *possible*, but a culture of liberal ideas makes exchange *viable*. Third, ideas conducive to liberalism give rise to generalized increasing returns to the *scope*, rather than scale, of market exchange, which generated the Great Enrichment.

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Introduction

It is a great pleasure for us to be honoring Deirdre McCloskey, whose work on the Bourgeois Era[1] has been critical in developing and disseminating an account of humanomics that is not only rooted in the Chicago price theory going back to Frank Knight, and of which she herself is a crucial figure (see McCloskey 1985), but has also advanced our understanding of the nature and causes of the Great Enrichment. To understand what McCloskey means by "humanomics," it is helpful to first contrast it with what it is *not.* An illustration of the antithesis to humanomics can be found in a well-known paper on economic development, written by another economist identified with the Chicago School, namely Robert Lucas. As he writes,

> I prefer to use the term "theory" in a very narrow sense, to refer to an explicit dynamic system, something that can be put on a computer and *run.* This is what I mean by the "mechanics" of economic development – the construction of a mechanical, artificial world, populated by the interacting robots that economics typically studies, that is capable of exhibiting behavior the gross features of which resemble those of the actual world (Lucas 1988, 5, emphasis in original).

The individual who populates this anti-humanomics approach to explaining economic development is none other than what McCloskey refers to as "Max U," the atomistic maximizer of a well-defined utility function who optimizes under given constraints. We have drawn attention to Lucas's account of the mechanics of economic development as a foil not only to shed light on a proper understanding of price theory, but also how such a proper understanding serves as an analytic anchor from which to ground our analysis on the conditions that gave rise to the Great Enrichment. In doing so, we wish to motivate our contribution with the following question: what are the *price-theoretic* lessons that can be drawn from the Bourgeois Era?

Our use of the term "price-theoretic" is meant to distinguish McCloskey's humanistic account of economic theory from a "choice-theoretic" approach that is characteristic not only of Samuelsonian economics, but also an approach that had been propagated by Robert Lucas and other economists of the post-WWII Chicago School, such as George Stigler and Gary Becker (see Buchanan [2010] 2020). A choice theoretic approach to economic theory is one that collapses the optimizing activity of a rational agent onto the conditions of general competitive equilibrium. Such a conflation implies a direct link between the rational agent and equilibrium outcomes, one in which the intentions of individual "choice" are inferred from the constraints that approximate an equilibrium outcome, similar to fitting pieces into a jigsaw puzzle (see

[1] The term "The Bourgeois Era" corresponds to McCloskey's *The Bourgeois Virtues: Ethics for an Age of Commerce* (2006), *Bourgeois Dignity: Why Economics Can't Explain the Modern World* (2010), and *Bourgeois Equality: How Ideas, Not Capital or Institutions, Enriched the World* (2016). Like McCloskey (2016, p. xi), we will use this term in reference to the entire trilogy.

Klein 2010). Institutions and prices serve as the constraints to which individuals passively respond, rather than as variables of human choice.

However, a price-theoretic approach to economic theory is one in which there is an indirect link between the rational agent and the tendency towards equilibrium. That is, not only institutions and prices emerge from exchange between individuals engaging in open-ended choice under a world of uncertainty, and once emerged, become guides for future action. More importantly for McCloskey, it is also from such social interaction that the ideas and rhetoric granting dignity to commerce emerged, enriching the world as we know it. As Knight makes this point: "The essence of association is communication. There can be no question that we build up our knowledge of an external world through the interchange of experience with our fellow beings" (1925, 397–398).[2] It is in this vein that we regard McCloskey as representative of the grand tradition of Chicago price theory, as understood by Frank Knight, Jacob Viner, and Henry Simons, but her application of this approach to her understanding of the Great Enrichment places her more closely within a neglected branch of Chicago price theory (see Boettke and Candela 2014; 2017b; 2020a,b; 2021), advanced by Armen Alchian, James Buchanan, and Ronald Coase in the post-WWII era.

In the sections that follow, we contend there are three important lessons that can be extracted from McCloskey's work explaining the Great Enrichment. In Section 1, we illustrate that transaction costs are not constraints, but objects of human choice. In Section 2, we explain why, according to McCloskey, property rights are not merely a "bundle of sticks," in that private property rights make productive specialization and exchange *possible*, but a culture of liberal ideas is required to make productive specialization and exchange *viable.* Thus, the rhetorical shift that resulted in the Great Enrichment manifested itself as a reduction in the cost of exchanging property rights. Lastly, in Section 3, we argue that ideas conducive to liberalism give rise to generalized increasing returns to the *scope*, rather than scale, of market exchange, which generated the Great Enrichment. Section 4 concludes.

[2] Given that we are comparing McCloskey and Knight, the latter of whom invokes the role of increasing knowledge to explain economic growth (see also Boettke and Candela 2021), one may ask how McCloskey's argument relates to that of Joel Mokyr (2002), who focuses on the accumulation of "useful knowledge" as the fundamental basis for modern economic growth. One way to interpret the distinction between Mokyr and McCloskey is that, according to McCloskey, what is identified as "useful knowledge" in the first place is context-specific. That is, what an entrepreneur will be incentivized to identify as "useful" will depend on whether cultural rhetoric lends dignity to the discovery of such knowledge in the first place.

1. Transaction Costs Are Not Constraints, but Objects of Choice

"The Great Enrichment of the past two centuries," according to McCloskey, "has dwarfed any of the previous and temporary enrichments. Explaining it is the central scientific task of economics and economic history, and it matters for any other sort of social science or recent history" (2016, xiv). What enabled the Great Enrichment was a change in the "rhetoric of trade and production and betterment – that is, the talk about earning a living among influential people" (*ibid.*, 501). Grounding McCloskey's explanation in price theory, this explanation can be restated in the following way: "What changed was the ease of making the deals…What changed were 'transaction costs.'" (McCloskey 2010, 254). We reframe her analysis in these terms not only to establish a proper understanding of transaction costs consistent with her analysis, but also to give scope to the role of entrepreneurship in changing the discourse of commerce in a dignifying way.

In the broadest sense, transaction costs refer to the cost of exchanging property rights over goods and services. However, such a broad definition requires further explanation and unpacking. To better understand transaction costs, its relationship to entrepreneurship, and changes in cultural rhetoric, it is important to distinguish between transformation costs and transaction costs. Transformation costs refer to the cost of production, or the cost of transforming inputs, such as land, labor, and capital, into consumable outputs. Therefore, whereas transformation costs refer to the cost of production itself, transaction costs refer to the cost of *organizing* production, namely the resources expended to coordinate, monitor, and conclude the production process. Thus, transaction costs consist "of obtaining the information necessary to enter into and complete bargaining negotiations" (Kirzner 1973, 227). If the information required to organize production could be directly and perfectly priced into the inputs going into the production process, there would be no distinction between transformation costs and transaction costs (see Dahlman 1979, 145). It is precisely because transactions costs represent imperfections in the information required to conclude a transaction that extra-commercial discourse not embodied in the price mechanism is important. This includes the role of culture and rhetoric in framing discussions of commerce, particularly whether exchange is interpreted in a dignified manner as a positive-sum game or derided as a zero-sum game.

According to Don Lavoie, "culture is to be understood broadly as the complex of meanings that allows us to comprehend human action: it is the background context that renders purposeful action intelligible. Culture is the language in which past events are interpreted, future circumstances are anticipated, and plans of action are formulated" (1991, 34). This definition of culture parallels McCloskey's discussion of the role of language, which she refers to as a "scheme of thought, backed by social approval and conversational implicatures" (2010, 302). How does this relate to role to transaction costs, changes in rhetoric, and the Great Enrichment?

To understand this relationship, we must first realize that virtually all cooperative activity in the marketplace involves what Armen Alchian and Harold Demsetz refer to as "team production." For any productive process, there are positive transaction costs in separating, identifying, and valuing the marginal product of various individuals working together to produce a particular good or service, particularly because total value of output is simply not the summation of each factor's marginal contribution to such output (Alchian and Demsetz 1972, 779). Since it is costly to meter and monitor the economic performance of individuals, it may be in the joint interest of laborers to join a firm to organize production, whereby the workers "hire" someone to monitor their behavior and to punish anyone who does not perform as agreed. By doing so, the workers acting in concert can produce more jointly than they could ever do apart from each other. In order to incentivize monitoring, an entrepreneur who owns a firm is granted property rights over the leftover output, known as the "residual," in the form of either profits or losses, after all factors of production have been paid their marginal contribution.

Alchian and Demsetz use this the notion of team production to explain the existence of firms, but it also provides an economic basis for the understanding why culture and ideology is important, specifically because it reduces the transactions costs of framing and interpreting "fairness" in the distribution of income. As the limits of the market extend, so do the gains from trade. However, the expansion of the limits of the market also implies greater exchange under anonymity. Therefore, with an ever-growing division of labor via impersonal exchange, the link between one's contribution to output and their payment for such output becomes more indirect. Thus, the inability to directly trace the payments received to factors of production from the deliberate actions of capital owners, laborers, and entrepreneurs presents transaction costs in interpreting whether or not entrepreneurs earned their income fairly, and that other factors of production were paid their "fair share." Therefore, cultural discourse that dignifies commerce and frames exchange in a positive-sum manner is a non-price form of communication that emerges to reduce the transaction costs of exchange.

The fact that cultural discourse emerges in a world of positive transaction costs not only implies that transaction costs are a variable of choice, rather than a constraint, but also explains why ideological entrepreneurship plays such an important role in shifting conversations about commerce in a dignifying manner. If transaction costs were constraints, not only would ideas be irrelevant. We also would not be able to explain the Great Enrichment. Transaction costs understood as a constraint implies no scope for entrepreneurship in expanding the *scope* of productive specialization and exchange. In such a situation, all the gains from trade are pre-defined within such constraints, thus precluding the possibility of the Great Enrichment. But if the Great Enrichment is explained by an extension in the scope of market exchange, this extension was characterized by harnessing the creative powers of individuals whose ability to exchange had been hampered, or worse, precluded due to their legal status, race, creed, gender, or moral indignation of their craft. The inclusive nature of this extension, however, took a change in cultural discourse about the rhetoric of commerce, one that reduced the transaction costs of exchange.

2. Property Rights are Not Merely a "Bundle of Sticks"

"Every ordered community," McCloskey states, "since Moses or Solon or Sargon the Great or the First Emperor of China has enforced property rights" (2010, 316). Though indeed the definition and enforcement of property rights do matter for structuring human interaction in a peaceful and productive manner, the timing of Western Europe's economic take-off does not correspond with greater security and enforcement of property rights. Given their universality across time and place, appealing to property rights, according to McCloskey, cannot explain the Great Enrichment.

The concept of private property is one of the most important, yet most misunderstood in economic analysis, particularly as it pertains to its implications for economic development. A metaphor often used to characterize property rights amongst political economists is that that they confer "a bundle of sticks" (Boudreaux and Aligica 2007; Schmidtz 1994) or "a bundle of expectations" (Boudreaux and Meiners 2019). Indeed, this is an appropriate metaphor if we understand that property rights refer to a set of social relationships that provide expectations about one's ability to exercise choices over goods and services (Furubotn and Pejovich 1972). The constituent "sticks" in the bundle refer to particular attributes that structure human interaction by providing individuals three mechanisms of social coordination and conflict resolution: (1) the ability to exclude; (2) the ability to use; and (3) the ability to exchange. When an individual is excluded from both public *and* private predation, this implies the individual in possession of a good or service *also* bears the cost and benefits of their choice over how to use such a good. When excludability is defined, individuals are assigned residual claimancy in their ability to use resources either for present consumption or for deferred consumption (i.e. savings and investment). Moreover, residual claimancy implies a distinct ability to use a good or service, namely to exchange, or transfer title, on mutually agreeable terms. It is the ability to exchange that is the distinguishing characteristic of *private* property from other forms of property (Alchian 1965) which defines a market economy, since it is from exchange that money prices and profit and loss signals emerge to allocate resources to their most valued consumer uses (Mises [1920] 1935). Property rights, therefore, confer a right to an *action*, rather than a right to an object per se. Our ability to exercise choices over a good or service is not inherent to the physical attributes of the good itself, but how our relations with others are understood with respect to what actions are sanctioned over a good or service.

Property rights, therefore, are an important tool for positive analysis, but they are a normatively-laden concept. Property rights, according to McCloskey, cannot explain the Great Enrichment because they not only confer rights to action, but *frame propriety in action.* That is, property rights taken in isolation of the cultural context within which such property rights are embedded cannot explain the Great Enrichment. As she reinforces this point,

> repeatedly it has been observed that when property comes to matter – that is, when the beaver or the acre of land or the right to take water from the Colorado River becomes valuable enough that its misallocation would cause substantial social loss – even a communalist or tyrannical government will often start enforcing its privateness. *It does so unless, indeed, it is under the influence of some antibourgeois rhetoric* (McCloskey 2010, 333, emphasis added).

McCloskey's doubt as to whether private property rights can fundamentally explain the Great Enrichment should not be understood as a wholesale rejection of the importance that property rights play in economic development. However, her analysis does reveal an important lesson that the "bundle of sticks" metaphor, though useful, may be incomplete for two reasons. First, viewing private property as a bundle of sticks may suggest that each "stick" is a discrete, separable attribute, such that removing or distorting one attribute will not affect the other "sticks" in the bundle (see Anderson and Libecap 2014, 17). Though indeed each attribute is distinct, they are not mutually exclusive of each other. The ability to use a good, for example, implies a particular ability to exclude non-users, namely to use resources to define and enforce one's property rights in such a way that an individual excluding others becomes the focal point of decision-making. They are using the good in such a way that ties consequences to their actions. Moreover, the ability to exchange implies a particular ability to use a good or service, not only that parties to an exchange find such an exchange mutually beneficial, but also that other individuals do not find such an activity morally reprehensible. Thus, even if the ability to use, exclude, and exchange resources are enforced and made commercially *possible* by a governing authority, it is a culture of liberal ideas that make productive specialization and exchange socially *viable.* "Nothing happens voluntarily in an economy, or a society," McCloskey states, "unless someone changes her mind" (2016, 490). The presence of an antibourgeois rhetoric and an anti-commercial culture will not only raise the transaction costs of exchange among private parties, but, in turn, it will also raise the transaction costs of enforcing exchanges by a governing authority, thus stifling the conditions for the Great Enrichment.

If the absence of a culture of liberty and bourgeois ideas can be reframed in terms of prohibitively high transaction costs and transaction costs are a variable of choice, not a constraint (as we discussed in Section 2), then consistent with McCloskey's analysis, the Great Enrichment is explained by ideological entrepreneurship (see Storr 2008–2009), namely through "discovery, and a creativity supported by novel words" (McCloskey 2010, 381). The presence of an anti-commercial culture and anti-Bourgeois rhetoric, reframed in terms of high transaction costs, represent an entrepreneurial opportunity for their erosion, not through changing the existing bundles of property rights, but through changing the rhetoric and conversation within which exchange is embedded. Thus, for McCloskey, private property rights are a consequence, rather than the cause, of liberal ideas that frame *propriety of action*, which in turn gave rise to the generalized increasing returns to productive specialization and exchange that we discuss in the next section.

3. Ideas Give Rise to Generalized Increasing Returns

If it was ideas, rather than institutions, that fundamentally changed, first in Western Europe in the late 18th century, what was the interaction between institutions, ideas, and commercial practices? Throughout her trilogy, McCloskey gives praise to the work of Israel Kirzner, whose account of the entrepreneurial market process rests in the background of her analysis as it pertains to the Great Enrichment. Developing Kirzner's account more explicitly will render the interaction between ideas, institutions, and commercial practices in a more systematic manner, one that gives primacy to the role that ideas play in the Great Enrichment.

According to Kirzner, the entrepreneurial market process is comprised of two distinct groups of variables. The first group of variables are characterized by *exogenous changes*, which include changes in preferences, population, resource availabilities, and technical possibilities. Kirzner refers to these as *underlying variables* (UVs). The second group of variables, which Kirzner refers to as *induced variables* (IVs), are characterized by *endogenous changes*, which are systematically induced by entrepreneurs who drive the equilibrating tendency in the market process at any given moment. Induced variables consist of the prices, methods of production, and quantities and qualities of outputs, which the market at any given time generates, given the underlying variables (Kirzner 1992, 38–43). Under conditions of equilibrium, the values of the UVs predetermine the values of IVs, squeezing out economic profits and obviating the role of the entrepreneur. Under such conditions, the price of inputs and the methods of production reflect not only the full cost of production, but also reflect that the least-cost technological possibility has been exploited, given the preferences of individuals. Disequilibrium is characterized by discrepancy in the market values of the IVs and UVs, reflecting that from the array of the available resources and technological possibilities available, there remain a subset of *economically feasible possibilities* that are *unperceived and not yet embraced* by the entrepreneur.

Though Kirzner's own rendition of entrepreneurship does not map directly into an account of social or ideological change, his dichotomization of the forces that drive the market process can be applied to the McCloskey's account of the Great Enrichment.[3] Taking the existing pattern of resource ownership, or property rights, as analogous to a UV, and changes in rhetoric as a change in an IV, the Great Enrichment can be explained by a realization of a discrepancy between what had been technically feasible,

[3] See Storr, Haeffele, and Grube (2015) for an application of Kirzner to explain social entrepreneurship in non-profit contexts.

in terms of existing property rights arrangements, and what could be economically possible, in terms of commercial practices. The catalyst between underlying institutions and commercial practices were the discovery of ideas that legitimated commerce, producing a "combustible combination" (Boettke and Candela 2016; 2017a) that resulted in generalized increasing returns to productive specialization and exchange. Thus, the "spark" that ignited this combustible combination was the realization of private property in *use*, rather than simply having existed in form, institutionalized by a reduction in the cost of exchanging private property rights.

"Modern economic growth," however, "gives the scope to do much more, whether or not the opportunity has been fully seized by everybody" (McCloskey 2010, 65). A culture of liberty does not fuel generalized increasing returns by guaranteeing that entrepreneurial profit opportunities will be seized. If such were the case, this would be neither entrepreneurial nor a profit opportunity. However, the role of culture, "conceived of as 'a pattern of meanings' that conditions the desirability of particular ends and perceptions of the appropriateness of particular means to the satisfaction of those ends" (Storr 2013, 20), is not to provide a point of orientation towards profit opportunities, as institutions do. Rather, culture provides a backdrop through which profit opportunities are interpreted by entrepreneurs. "What makes entrepreneurs successful," according to Lavoie, "is their ability to join conversational processes and nudge them in new directions" (1991, 50), which is the role that entrepreneurial discovery played in the Great Enrichment. If the market is a forum for communication, then entrepreneurs are the catalyst that redirect the conversations that individuals have, whether such communication takes the form or prices or ideas. Kirznerian entrepreneurship is necessary to discover gains from trade by redirecting the conversation in markets via price arbitrage. In McCloskey's narrative, however, this is not possible without entrepreneurship first unleashing generalized increasing returns, or giving scope to productive specialization and exchange, by redirecting the conversation about commerce via ideological arbitrage.

4. Conclusion

"The history of the attempt to define culture and found a science of culture by discovering laws of its development and change," according to Frank Knight, "is one of the most fascinating of all subjects of inquiry" ([1935] 1997, 119). McCloskey's Bourgeois Era is fundamentally a story about the beginning of a particular conversation, one that reframed our understanding of the meaning of commerce. McCloskey's account of the Great Enrichment is not just an account based on how the creative powers of individuals were harnessed through increasing the scope of productive specialization and exchange. It is an account that also provides an increasing scope to an understanding of price theory, one that not only incorporates the roles of culture, ideas, and ideological entrepreneurship, each of which are applied in understanding the fundamental question of political economy: how did humanity escape abject poverty?

Rooted in the great tradition of Chicago price theory going back to Frank Knight, we have argued that McCloskey's great contribution to understanding the nature and causes of the wealth of nations can be grounded in terms of its price-theoretic lessons, providing a richer account of economic analysis. As is the case in the market for goods and services, the purpose of specialization in the social sciences is then to exchange ideas *across* the social sciences. If price theory is to serve as a tool for social understanding and making sense of the real world, its purpose cannot be to explain a particular model of the world. We have highlighted, as McCloskey has, that the economic, social, and ideological transition from poverty to wealth could not be explained in terms of optimization with constraints, but in terms of choice and exchange *over* constraints, facilitated by changes in cultural rhetoric. If the heart of economics is captured by the study of human behavior within constraints, its soul is to illustrate the conversations that individuals have to facilitate endogenous changes to such constraints. This proceeds not only through communication via the price mechanism, but also extra-commercial communication via persuasion which brought forth changes in "habits of the lip, what people thought and said about each other" (McCloskey 2010, 403). Without reframing the conversation regarding commerce in an approbative manner, an increasing scope for productive specialization and exchange, essential for modern economic growth, could never have been realized. Such realization, in price-theoretic terms, came in the form of ideological entrepreneurship, which eroded the transaction costs associated with anti-Bourgeois rhetoric, including the pre-modern political hierarchy that reinforced such rhetoric. The deluge of economic growth that flowed from eroding barriers to entry, both formal and informal, resulted from the inclusive nature of commerce and its harnessing of the creative powers of a free people, regardless of their race, creed, gender, class, or social status.

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