

HUMAN RESOURCES AND ECONOMIC GROWTH

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Keywords: human resources, economic growth, trust in early societies, moral economy

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Summary

Economic growth has been one of the strongest forces for turning human beings away from confrontations and wars among tribes and nations into cooperative groups living in peace. Social scientists identify two forces: institutions and personal development. Institutions are modes of behavior to which members of a society are motivated to conform, while personal development consists in improving the capacities of individuals. The legal system, the banking system, contracts, corporations, and international agreements are all institutions. At first, personal development comprises the knowledge that individuals obtain, first on world geography, astronomy, mathematics, shipbuilding, and accounting, and how legal systems function. Later, it includes the ability to form institutions, to manage resources, and to cooperate instead of confront. Together, institutions and personal behavior are called culture, or

sometimes social capital. “Economic growth” consists in increases in output, or gross domestic product. Economic growth plus the culture changes necessary to sustain it is called “economic development.”

1. Institutions and Trust in Early Societies

Since the earliest societies were agrarian, among the first institutions were those of land holding. Even communally-owned land, as in tribes, must be assigned to individuals, since the entire tribe cannot plow a given piece of land, reap the harvest, or eat the crop. Some persons must perform these tasks and others may not. In tribal societies, chiefs or priests decided who would be assigned what land, sometimes in consultation with the tribe. The manner of making this decision is known as the institution of land tenure. As disputes arose, so also did courts and legal mechanisms to settle them.

How are institutions formed?

Consider land tenure. Established property rights enhance the development of human resources. Land and implements become like extensions of the farmers’ hands, enabling them to gain knowledge about how to produce more than otherwise. Land tenure institutions were probably formed out of benefit-cost considerations. Buchanan, (Buchanan 1975: 25-34.) for example, theorizes that as good lands for hunting or farming became scarce, tribes would fight over it. When the cost of fighting became greater than the benefits of winning weighted by its probability, tribes would agree on a division of land, in which each would be better off than it would be by fighting. Demsetz (Demsetz 1967.) has suggested that property rights arose out of the recognition that land could produce the greatest output if placed in the undivided ownership of specific individuals, who might cultivate it undisturbed. Out of these agreements the initial institutions of land ownership, peaceful division of output, and agrarian law arose.

Trade.

Peaceful cooperation among producers requires trade. Chinese and Egyptians are known to have traded in their immediate areas in the third millennium BCE, and by the second millennium trade between East Asia and the Mediterranean has been recorded. The earliest trade was fraught with danger, for traders did not know what reception they would receive in foreign lands – whether or not they would be killed. They did not know whether their ships would be fired upon by pirates or competitor nations. Nevertheless, they somehow established relations of trust, probably because they became aware of the mutual benefits of trading. Trust led initially to barter, then to the making of contracts, and finally to the use of metal coins. Rudimentary banking was known in ancient Egypt.

2. Institutional Development

2.1 Transaction costs

Transaction costs occur when two or more producers or traders do not fully trust each other, or demand detailed verification of the truth of their positions, or when they incur

other expenses designed to satisfy each other's mistrust. Institutions reduce transaction costs. Legal and banking systems, for example, reduce them because producers, traders, and financiers use these established institutions and practices rather than having to invent them each time.

2.2 Theory of Douglass North

North (North 1990.) has pointed out a deficiency in classical economics, in that it takes institutions of information, contract, enforcement, and others for granted, when in fact they are necessary for the economic model to function efficiently. He has proposed a theory of institution formation based on path dependency, which he attributes to David (David 1975) and Arthur (Arthur 1988). Let us suppose that two societies (A and B) randomly make slightly different initial choices on how to reduce the costs of a transaction, say in law or banking. The next time a similar transaction occurs, the differences in the institutions of A and B widen slightly, and so on successively. Decades or centuries later, they may differ markedly from each other. For example, the institutions of B may handle trade, finance, contracts, and the like at greater cost than those of A, but B does not shift to those of A because the cost of shifting is greater than the cost of not shifting, however inefficient the latter may be.

2.3 Theory of John Powelson

Powelson (Powelson 1994) accepts North's explanation of institutions but adds one more wrinkle. While North argues that B does not shift to the institutions of A because of benefit-cost considerations, Powelson argues that rulers in B may have gained greater power over the economic system than those of A, and a shift would reduce their power. Since they - rather than the entire citizenry - make the decisions, they opt to remain with less efficient institutions that preserve their power.

Philip II of Spain (ruled 1556-98) is an example. By the time of his rule, the institutions of land tenure, finance, and commerce in England and the Netherlands were far more efficient than those of Spain. Through his marriage of convenience with Queen Mary of England and his nominal rule of the Netherlands, he must have understood those institutions. He had sufficient power in Spain, and later in Portugal, so that he could have shifted both countries to those institutions at little financial cost. Producers, merchants, and farmers would hardly have objected, because the shift would have given them greater power. Philip did not make the move, however, presumably because his own power would have been reduced. He might not have been able to tax the producers what he believed was necessary to carry on his wars in the Netherlands and with the Ottoman Empire. He enjoyed his power so much that he would not voluntarily relinquish it. As a result, economic growth and human development were retarded in Spain, possibly until the twentieth century.

Powelson argues that the most efficient institutions will be selected in societies where rulers do not have the power to preserve inefficient ones. This happened in Japan and northwestern Europe over centuries from the Middle Ages until the present. Why Japan and northwestern Europe? Because from about the twelfth century on, in these two areas uniquely, lower-class and upper-class people (socially and economically) depended on

each other for survival in ways their counterparts in the rest of the world did not. Upper-class people would be kings, emperors, nobility, high clerics, and shoguns. Lower-class people would be peasants, producers, merchants, and low clerics.

According to Powelson's theory, upper-class people would have quarrels with each other, often violent, which one side could win only with the help of lower-class people, who won some consideration in exchange. Usually the consideration constituted an enhancement of the power of lower-class people vis-a-vis the upper. Only after hundreds or thousands of such happenings - Powelson gives historical examples of many - did power become so diffuse in northwestern Europe and Japan that democracy became a possibility. Calling this the *power-diffusion process*, Powelson searched for similar occurrences in eastern and southern Europe, Asia (except Japan), Africa, and the Middle East. He found only a small number, not significant enough to trigger the power-diffusion process. Only after that process has run for centuries does democracy become possible.

3. Democracy and Human Development

Only with democracy and the growth of civil society has human development been enhanced to the point of a literary citizenry, with scholars, scientists, engineers, and others of the same level of accomplishment. Earlier societies have possessed these individuals in small numbers, for example historians such as Herodotus and Ibn Battutah, or Chinese scholars who could assemble their libraries because of movable type (during the Northern Sung dynasty, 960-1127). But democracy opens the doors for masses of individuals of different backgrounds to participate in scholarship and in higher-level decision-making, as in government and executive positions in business. Only with democracy do the rights of women and minorities become recognized, educational institutions become first class, business schools formed, and so on.

3.1. Education

The purpose of education has long been to preserve and re-create a social system, generation after generation. In ancient Mesopotamia and Egypt education was confined to priests; in Confucian China it taught moral sensitivity and duty to family and state; among the Maya and Aztecs it trained for the priesthood and nobility, who were charged with understanding the calendar and religion. In ancient India Brahmins were the men of learning. In a religion-based society, education is reserved for clerics, or if not, at least it will bring up the citizenry in the accepted religion.

In the early Chou period in China (1121-721 BCE), when social classes were rigidly separate, schools for the nobility were found in the national capital and capital cities of feudal estates. Elementary schools, including separate ones for girls, taught common laborers their duties. In early Europe education was private, usually by social class, and dependent on the type of society. In a chivalrous society - as in the twelfth century - education was confined to the upper classes; it included knightly fighting and falconry. In a society dominated by an ideology, such as communism, education is ideological and controlled by the rulers. A society where women are repressed teaches them only household chores and child care.

3.2 The Enlightenment in China

Only when a society become open to seeking knowledge without prejudice about its origin or type does liberal education with unbiased research become possible. As the feudal order disintegrated in the later Chou period (721-221 BCE) in China, cities arose and commerce increased, and along with them came social philosophers. Some authors have called this period the most creative in Chinese history, in which Taoism, Confucianism, Moism, and Legalism all had their own private schools, competing for favor among the princes and dukes who took to supporting scholars as a matter of prestige.

After a brief setback during the Ch'in dynasty (221-206 BCE), in which rulers demanded their own prescribed uniformity in education, schools became more open during the Han dynasty (206 BCE-229CE), encouraging philosophers, historians, artists, and poets. During the T'ang dynasty (618-906 CE), in which Buddhist scholarship was greatly respected, public schools expanded. After a period of chaos (906-960), the Sung dynasty (960-1279) also saw the expansion of education. It is no coincidence that these were all periods of greatness for China, with the expansion of commerce, invention, and new varieties of crops. Although trade, education, and philosophy all advanced during the succeeding dynasties (Yüan, Ming, and Ch'ing), restrictions placed upon Chinese merchants and explorers enabled foreigners to dominate trade with China. Though scholarship continued to blossom during the early Ming and early Ch'ing dynasties, China had lost its chance to become a leading power in science, philosophy, industry, and trade. As economic growth slackened, so also did the intellectual and scholarly level of human beings. Human development and economic growth were correlated positively as they increased and as they declined.

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