

## **On the Concept of Transition**

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### Abstract

This article tries to reassess the meaning of transition. After a critical review of the traditional approach, it is argued that meaningful transition requires emphasis on the change of the institutional path-dependent process. In this light, the issue of transition may also apply to the West.

Put differently, the notion of transition is here referred to broader context than that acknowledged by the orthodox views, and now includes the dynamics of power, the attitude towards risk and uncertainty within a civilization and also ideology. It is maintained that changes depend heavily on the opportunities for rent seeking, which may be enhanced or stifled by technological progress or other exogenous events.

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# On the Concept of Transition

## 1. Introduction

The "Economics of transition" was born out of the collapse of the Communist regime in Eastern Europe. This is probably due to two reasons. First, it was not politically suitable to call East-European economies with their real name - developing or undeveloped countries. That would have been at odds with the political objectives of making the former communist countries feel treated as equals by the Western community and of preventing possible nationalistic tensions in that part of the world. Second, a new name had to be coined to justify policies that proved rather ineffective in the Third World experience, but were proposed once again - sometimes in different versions - in the East-European context. One may thus wonder whether the economics of transition makes any sense at all, or whether its usefulness may be better perceived from other perspectives.

The purpose of this paper is to suggest an answer to such questions. In particular, sections 1 and 2 review the orthodox approaches to transition, and some efforts to meet their shortcomings. Sections 3 and 4 reformulate the scope for a theory of transition to developed countries and reassess the legitimacy and rationale of governmental economic intervention in the Western World. The key element of this reappraisal is summed up in section 5, where a new concept of transition is put forward, focused on the individual, rather than on a society or a country.

### *1.1 The classical approach*

From the classical viewpoint, the issue of transition is closely connected with that of growth. In particular, the classical school emphasized the static technical features of economic systems. Trade and labour specialization, together with higher capital endowment and improved (maritime) transportation<sup>1</sup>, were rightly considered conducive to growth and higher living

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<sup>1</sup> Among other things, this latter element contributes to explain why the Western World started to grow significantly only since the second half of the XVth century, i.e. after the Portuguese introduced the Caravel, which enhanced exploration and allowed relatively safe and cheap long-distance commercial transportation. See Hugill (1993).

standards. Since the economics of technological progress played a secondary role or no role at all, it is plausible to claim that the classical school ignored two crucial elements: the possibility of changing production functions through the acquisition of knowledge, the influence of institutions on transaction costs.

As a consequence, the classical case for transition implies a strong plea in favour of free trade, limited government intervention and - especially when it comes to poor countries - foreign aid to enhance capital formation. Put differently, classical transition refers to countries that move out of mercantilist practices, as well as to those in critical need of better infrastructure (e.g., railways in the Western world during the second half of the XIXth century). From a normative perspective, the classical school therefore spells out the desirable policies to enhance growth in relatively poor countries<sup>2</sup>. Whereas from a positive standpoint, classical transition applies to a country that complies with the appropriate set of sound economic rules, but has not yet secured the full benefits they are supposed to generate. In this light, countries are simply classified as those who are on their way towards their potential consumption-possibility frontier and those who aren't. That is, as those that grow; those that do not grow because the minimum requirements for growth have not been attained<sup>3</sup>; and those that have already achieved maturity and no longer expand. In a nutshell, classical transition theory turns out to be the analysis of the minimum conditions for growth, and of how they can be obtained.

## 1.2 *The neoclassical view*

Neoclassical economics has surely led to major analytical results and has allowed scholars to study in sophisticated detail the features of the allegedly perfect machine known to some as the "Nirvana" economy. The cultural and institutional incentives that drive individual behaviour, however, have been by and large overlooked. Similarly to the classical teaching, neoclassical modeling describes a static world where exogenous transaction costs prevent it from functioning flawlessly. Time and learning play a limited role and so does institutional dynamics. As suggested

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<sup>2</sup> Whether such policies are also effective is of course another matter, still open to doubt. See for instance Rodriguez, Rodrik (1999) on the role of trade policy; and the history of aid and project development in the undeveloped world as far as the role of infrastructure is concerned.

<sup>3</sup> Until a few decades ago, these requirements were thought to be a minimum amount of income, so that at least some resources would be available for investment, including infrastructure. Clearly, the features and size of today's world capital markets makes such minimum standards virtually irrelevant.

by Hodgson (2000), it is no coincidence that neoclassical economics is cherished throughout the political spectrum.

The neoclassical perception of transition remains thus inadequate. A transition economy is still perceived as a machine that for some reasons - ignorance, market imperfections - runs below its full potential. Developed and developing economies do differ, either because the blueprints are not equally accessible, or because such blueprints are not equally easy to be put into practice, so that agents need time to adapt to the new rules of the game. There is no doubt, however, that all these rules allow the reproduction of the allegedly ideal system, and are to be introduced as quickly as possible (Winiecki, 1998).

The normative undertaking of the neoclassical economist is accordingly twofold. On the one hand, he tries to export the Nirvana blueprint to all countries that are significantly below their production possibility frontier, whatever that may mean. Growth then becomes the inescapable consequence of transition. Hence, the role of the so-called "Western expert", who is to explain and adapt a well-known prototype to an unknown but supposedly easy-to-model reality. Furthermore, he is supposed to suggest suitable aid packages in order to reduce the cost of transition and make transaction costs acceptable. Transition is the name of this experiment in social engineering.

### *1.3 Summing up on the orthodox economics of development and transition*

What has been argued in the previous paragraphs suggests that according to the orthodox view the difference between development and transition economics is a matter of human capital and - in earlier times - infrastructure. Developing countries are those where both these variables are poor, while the problem with transition countries is the past system of centralized planning, which prevented the economy from benefiting from consumer sovereignty and specialization.

In both cases foreign aid is believed to play a crucial role. In developing economies it is supposed to encourage education and speed up investment until a critical threshold is secured, beyond which growth and development become self-sustained. In transition countries foreign aid is to soften the adjustment-cost problems that the institutional shocks generate. In addition, it makes a free-market economy acceptable either to the rent-seeking minorities who regarded themselves as better off under during the Communist regime, or to those workers who perceive the short-run costs of transition, but do not care very much for its long-run benefits.

From a practical viewpoint, the failures of mainstream development and transition economics are apparent. They are due to their disregard vis-à-vis the institutional framework and

the variables that interact with both formal and informal rules and organizations. Transition paths based on exogenous-growth hypotheses were indeed justified from a static viewpoint, for the greater the distance from the ideal blueprint, the greater the opportunities for catching up. The empirical evidence in this direction has however been disappointing, to say the least. Attempts to go back to classical economics and stress the role and the dynamics of factor endowments (be it fixed capital or human capital) did provide answers to some of the neoclassical riddles. But their overall predictive power remained modest<sup>4</sup>.

## 2. Can we escape bad economics?

Disillusion with the mainstream approach to growth has encouraged analyses from different angles. Two lines of thought have proved to be particularly popular. One has emphasized the interaction among political players. Another one has taken into consideration income distribution.

### 2.1 *On the political-economy approach*

The aim of political-economy analysis is to explain the manifest contradiction between the availability of allegedly desirable welfare-enhancing prescriptions on the one hand, and the systematic reluctance - by policymakers and public opinion alike - to follow the supposedly optimal blueprint.

By drawing heavily on public-choice theory, it is argued that the introduction of standard neoclassical blueprints into a previously distorted situation may run against more or less powerful pressure groups. Policymakers are surely vulnerable to particular interests. Hence, although all politicians tend to accept neoclassical prescriptions in theory (for it would be hard to object to a Nirvana state), in fact they tend to ignore the so-called public interest and engage into ongoing negotiation with the various coalitions, so as to preserve their rents and power.

The public-choice addition deserves credit, for it surely fills the gap between positive and normative orthodox theory by showing why good theories are not necessarily put into practice by rational and omniscient policymakers. Nevertheless, the fundamental weaknesses of the orthodox vision persist. Since no theory is put forward as regards the development of social and institutional variables, the enriched mechanics offered by the political-economy approach assumes that the rules

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<sup>4</sup> See Olson (1996) for a critique of the recent endogenous-growth literature; and Arrow (1962) for a synthesis of the orthodox view, which includes both classical and neoclassical elements.

of the game are constant and that they can hardly be changed by the agents. This is of course a heroic assumption, as a consequence of which it becomes impossible to clarify the origin of the differences in the rent-seeking, law-making game across the world.

In addition, the dynamics of transaction costs are indeed mentioned, in order to explain the birth of and the interaction among interest groups. But the essence of growth as a competitive process among different institutional solutions aiming at reducing transaction costs and disequilibria is systematically disregarded<sup>5</sup>.

## 2.2 *On capitalism with a human face*

A second line of thought suggests that successful growth recipes can be accepted - and thus meet success - only if distributive issues are taken into account adequately. And if higher income levels correspond to higher living standards, to be measured according to more or less sophisticated indicators (such as education, life-expectations and exploitation of child labour).

Yet, social-justice criteria are not likely to produce noteworthy results, unless one provides a satisfactory definition of social justice itself, and is ready to accept the concept of "society" as being distinct from a system of interacting individuals. Unfortunately, the advocates of social justice fail on both accounts. Their (declining) fortune seems to profit more from their implicit promises of redistribution, which justifies social engineering and satisfies envy; rather than from their proven ability to foster economic progress overall and/or individual advancement.

As a matter of fact, growth with a human face has been another experiment in free-market constructivism, whereby expert and scholars have tried to solve the public-choice problem (interest-groups resistance), preserve the bureaucracies, and overcome the market failures generated by a static free-market theory. In short, growth and development have been transformed into an instrument functional to vaguely defined social-justice policies.

## 2.3 *Preliminary conclusions*

As mentioned earlier on, by identifying economic progress with the application of a known blueprint, mainstream economics has missed the essence of transition and growth. Instead, these phenomena consist of the development of new blueprints, which in turn depend on the existing stock of knowledge and combine the stock of knowledge with the rules of the game and with the individual proclivity to take advantage of the existing opportunities (North, 2000; Colombatto,

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<sup>5</sup> See on this Alchian (1950) and North (1994).

2001). In this light, transition can still be defined as the change in the rules of the game. Such a change, however, is not necessarily aimed at starting some kind of a mechanical catch-up process; but rather at reducing transaction costs and provide better opportunities to meet individual objectives. This has important consequences, since it implies that the issue of transition may clearly apply to the so-called developed world as well, Western Europe in particular.

The persistence of missed opportunities in large areas of the West for over the last two centuries (Maddison, 1995) calls for a deeper investigation on the role of institutions, and on the driving forces that have been affecting the evolution of the rules of the game in Western societies. The approach proposed in these pages is fairly close to that suggested by institutional economists. One substantial difference is to be stressed, though. The institutional school investigates institutional development and economic growth as path-dependent processes. These may be influenced by other variables, but are more or less always set into motion by exogenous shocks. Contrary to that, it is here believed that the effects of historical accidents depend heavily on the cultural features of the societies they fall upon. Put differently, the following pages argue that the slow evolution of the patterns of individual behavior - perhaps more aptly defined by Hayek (1952) as the "sensory order" - leads to the dynamics of civilizations. This may promote the advancement of the stock of knowledge, as institutional scholars sometimes define it. But may also promote rent-seeking games, as the public-choice school maintains<sup>6</sup>. In turn, the state of civilization explains the need for transition, as well as the chances for transition to take place.

Of course, this does not rule out the possibility of analyzing the evolution of civilizations as self-contained stories that start from historical accidents, develop, flourish and decline according to a set pattern (Quigley, 1961). For although unquestionably deterministic and rather mechanical, these patterns usually rest on a dynamic theory of development, which may differ among the various authors, but nevertheless does not suffer from the neoclassical flaws discussed in the sections above. The crucial difference between the view proposed here and the self-contained visions suggested in the literature stems from the ambition to use indeed the institutional insights, but also emphasize the role of the stock of knowledge, of coalition interplay, and combine vaguely-defined exogenous shocks with cultural change.

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<sup>6</sup> This is also the essence of the (old) view of institutional economics, as held by Veblen and Common - see Hodgson (2000, p.326).

### 3. On the origins of Western behaviour

The essential economic-policy question in today's Western Europe can be formulated in two steps, related to each other. First, although public opinion is not particularly unhappy with living standards, there exists a prevailing feeling of dissatisfaction. It is believed that Western Europe is producing well below potential output and that many resources are not allocated efficiently, including the labour force, of course.

Second, there is widespread agreement about what should be done in order to attain better results - i.e. improve the institutional framework<sup>7</sup>. Nevertheless, the demand for better rules of the game has been developing rather slowly. It has gone from a situation when disappointing performance was attributed to lack of government intervention, along Keynesian guidelines; to one where government intervention needed to be improved and made more efficient, following technocratic rule; to one where efforts were required in order to reduce the size of the government machine altogether. Still, the role of government has remained by and large intact<sup>8</sup> and the political space for truly free-market parties rather modest.

#### 3.1 *A standard interpretation*

The general framework summarized above is usually explained in public-choice terms, whereby policymakers are subject to pressure from rent-seeking interest groups. When these are effective enough, they secure rents from politicians, even when such rents negatively affect overall welfare and growth. Those who suffer from such rent-seeking activities are too weak to resist pressure or to respond<sup>9</sup>.

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<sup>7</sup> It is worth emphasizing that overall agreement has also been reached as for what should be done in detail. This regards the need for a drastic reduction in the role of the state, better protection of property rights and of contractual, voluntary agreements. These are indeed the core features of a capitalist system.

<sup>8</sup> Some window dressing has taken place, however. For instance, direct state management has been replaced by regulation, centers of powers have moved away from national capitals to a federal center, privatization policies have been carried through, although driven by urgent needs for cash, rather than by solid free-market beliefs.

<sup>9</sup> As is known, a reaction vis-à-vis rent seeking groups is made more difficult by the rules of the political game, whereby issues are seldom discussed and voted upon by the population one at a time. Instead, they are generally bundled together in rather vague terms or programs once every four or five years. The electorate hardly knows what the vote is about and the policymakers succeed in hiding behind fairly high information costs and thus low accountability. It is not surprising that the emotional impact of a charismatic leader may become far more important than its political record as

Its dynamic version, whereby the amount of rent-seeking is a function of income, surely enhances explanatory power over time and provides a useful theory - say - to understand the expansion of the welfare state in the second half of the XXth century. The possibility that rent-seeking groups affect the institutional environment is not ruled out, either. However, although they do explain how today's illiberal democracies work<sup>10</sup>, these theories do not even attempt to ask why and how illiberal democracies became so successful. As a consequence, they shed no light on their future developments.

Current explanations also find it increasingly hard to explain how some categories of coalitions form their objectives, for interest-group members often times deviate from their expected, utility-maximizing behaviour. That is clearly the case when consumers express themselves in favour of protectionism, even when the industries to be protected are not those where consumers work. Large numbers of youth (including among the unemployed) do advocate pervasive state legislation and rigid labour markets, even when they do not have access to significant unemployment benefits. Similarly, politicians find it extremely hard to resist pressure from relatively small interest groups (such as farmers), whose requests for subsidies are commonly perceived as harmful to social welfare.

### 3.2 *On the role of the State*

It is plausible to claim that individuals generally accept or indeed advocate government intervention for three reasons. They might believe that government action can at least partially compensate market failures. In this case the state is then required to play an active role as a producer. In addition, the state is often asked to intervene and take decisions instead of individuals, even when there is no *a priori* reason to believe that such decisions are preferable to those taken by individuals themselves. In this particular situation, the state relieves the individual from the strains and challenges involved in the decision-making process. Finally, the state may be required to perform a redistribution policy, according to some kind of allegedly agreed-upon social-justice criterion.

### 3.3 *Rule of Law*

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a reformer or as a promoter of rule-of-law and efficiency.

<sup>10</sup> See Zakaria (1997), who uses the term "illiberal" to denote the violations of individual liberties that normally take place in today's modern democracies.

The first set of cases regards the provision of rule-of-law, i.e. the quasi-monopoly of violence as a way to guarantee and defend individual liberties, against external aggression and domestic turmoil<sup>11</sup>. By and large, this role is accepted as a general principle. But frequent deviations tend to be tolerated whenever rule-of-law obstructs democratically-approved redistributive or collective-welfare goals<sup>12</sup>. As a consequence, today's Western societies are not run according to rule-of-law principles, but rather following some kind of discretionary legislation, which of course leads to - and sustains - the quest for discretionary power.

### 3.4 *Personal responsibilities*

Relief from personal responsibilities - the second source of legitimacy for state action - is not only important per se, but also because it allows to understand when redistribution and/or collective-welfare policies are more important than rule-of-law. This amounts to saying that the overall attitude of individuals towards state intervention depends crucially on their willingness to take personal responsibilities in the decision-making process. Of course, in most cases this attitude turns out to affect the degree of government intervention, rather than being a clear-cut, yes-or-no decision. This is perhaps apparent today, when the role of the state beyond law-and-order, personal freedom and sometimes even Constitutional guarantees is taken for granted<sup>13</sup>. It is worth reminding, however, that for most of our (Western) history the crucial decision was not about the optimal amount of state intervention, but whether the state was to intervene at all beyond rule-of-law. By and large in Western civilization the answer was clearly negative until the end of the Eighteenth

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<sup>11</sup> The argument whereby government intervention is supposed to secure competitive conditions is a much more recent phenomenon, which derives from the neoclassic idea of static competition and the need for welfare-optimizing microeconomic policies. These issues will however be neglected. Although the role of the state as a neutral welfare maximizer still dominates the political debate, there is now widespread agreement on the flaws of the Marshallian idea of competition as opposed to its dynamic (Austrian) version.

<sup>12</sup> Redistribution and collective welfare differ in one important respect. Redistribution aims at transferring purchasing power from one set of individuals to others. While collective-welfare action plans to provide public financing and sometimes public production of selected services, e.g. education, health, social security. Such plans may imply income transfers to the poor, but not necessarily. Indeed, in many cases the rich benefits from these programs to a larger extent than the poor does.

<sup>13</sup> "If the personal freedoms guaranteed by the Constitution inhibit the government's ability to govern the people, we should look to limit those guarantees" (President Bill Clinton, August 12, 1993).

Century. Until then, the boundary could be and was indeed encroached upon. However, until some two centuries ago the incumbent ruler knew that whenever this happened, his legitimacy would be weakened and his power jeopardized. In this light, the crucial question is now to realize the mechanisms that led vast layers of the population decided no longer to be responsible for broad areas of the decision-making process and to delegate the state instead.

### 3.5 *Redistribution*

The transfer of personal responsibilities is closely associated with the issue of redistribution. This becomes apparent if one observes that redistribution is seldom justified by referring to the principle of transferring income, but rather to the need to finance government intervention according to equity grounds. In other words, fairness is not usually justified by the need to define *ex ante* the desirable net income (or purchasing power) of the each individual, but rather by the need to finance government activity according to each individual's capacity to contribute (i.e. tolerance *vis-à-vis* tax pressure). This leads to the concept whereby the idea of social justice is not deemed to be acceptable *per se*, but only as a guideline for expenditure financing. And sheds light on the fact that although direct taxation is clearly progressive, in fact the net result of government action is much closer to neutrality than public opinion is induced to believe<sup>14</sup>.

As is known from the public-choice and institutional literature, redistribution also plays two additional roles. It is the instrument through which the social tensions are allegedly softened and through which politicians strive to obtain power. To these aspects are now devoted the remaining part of this article.

## 4. A conjecture on the evolution of Western behaviour

What are today defined as "Western societies" are the result of Judeo-Christian ethos, as it developed throughout the past twenty centuries, possibly more. Christian behavioural patterns are far from uniform, though. For Judeo-Christian path-dependent processes were affected by various kinds of shocks in different geographical areas, i.e. in different environments. In other words, and in

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<sup>14</sup> This has another important implication, for it explains why redistributive policies are limited to the national boundaries of the state. Indeed, if Western societies really shared an ideal of social justice - whatever that may mean - there would no doubt about the most deserving beneficiaries of the transfers, i.e. the populations of the low-income countries, where even modest amounts of money make the difference between life and death. Yet, these kinds of transfers are only a very minor part of the state budget.

accordance with the institutional literature, each of these major shocks gave way to new path-dependent processes, which do shared similar (Judeo-Christian) rules of the game, but did not necessarily lead to converging results. The following paragraphs try to clarify some basic patterns in this evolution, and draw some conclusions attaining to today's world.

#### *4.1 The West until the XIIIth century*

For the purpose of the present analysis, the key fracture of the paleo-Christian ethos with the pagan world is twofold: its vision of risk and its concept of individualism. Risk in the classical world meant discovering the unknown and challenging - sometimes even trying to influence - Destiny. Contrary to what seems obvious today, in the pre-Christian period the acquisition of knowledge was understood to be the moral duty of the individual, in order to prove his superior nature as a human being and his right to citizenship, i.e. to his becoming a member of the community. Defying the Gods would expose people to wrath and punishment. But it was not regarded as socially or morally disgraceful; at most just foolish. For the individual was perceived as the lowest layer of a continuum of more or less powerful divinities, from Zeus down to semi-Gods such as Hercules or supermen like Achilles. Religion, as understood in the Christian era, was out of question.

Surely, the acquisition of civic dignity concerned a relatively small number of people, i.e. those for whom making ends meet was not the foremost daily problem. Importantly enough, however, those who could care about the acquisition of knowledge were not particularly interested in enhancing their own material welfare. The elites were already enjoying substantial rents, their time horizon was relatively limited, transaction costs in general were too high to justify "research and development", rights on intellectual property were hard to enforce. If anything, scarcity could be overcome by robbing or enslaving the neighbors, rather than by working harder or finding new ways of production. It is no accident that warriors came after "philosophers" in the social scale, but well ahead of workers. Finally, there was of course limited interest in enhancing the collective well-being of society as a whole, both because of relatively modest concerns for the poor and - more important - because the existing distribution of political power and of economic rents could have easily been perturbed by a different distribution of wealth. The bottom line was that the dynamics of institutions tended to be much more responsive to the need of politics than of economic betterment<sup>15</sup>.

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<sup>15</sup> See on this Kaufer (1996), who also points out that private initiative was however held in

Within this framework, as from the IVth century the Christian message had an immense impact and drastically changed the rules of the game<sup>16</sup>. In the classical world - which in this context started to decline already before the Jugurthine wars - social status was the reward of a painstaking process of individual discovery, whereby risk and uncertainty were not eliminated, but acted as the instrument through which a man would acquire maturity and become a full member of the community. Being able to challenge uncertainty was more relevant than being able to reduce it.

On the contrary, in the Christian world dignity was a built-in feature of the human being, lost with the Original Sin, but partially regained through Baptism. The institutional consequences of this vision can hardly be overestimated, for the Christian concept of individual dignity succeeded where the Roman Empire had failed. On the one hand, by guaranteeing equal rights to all Christians<sup>17</sup>, it enabled the Western world of the time to absorb the *Völkerwanderung* and successfully resist Islamic invasion. Second, Christendom provided social cohesion and a fundamental path-dependence rule, by giving the Church the power to guarantee legitimacy to rulers, ruling elites, feudal institutions<sup>18</sup>. Social cohesion came from the strikingly strong bond

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some esteem in the classic world, for slaves could acquire freedom through their labour and efforts. As thinkers as wide-apart as Sieyès and Rousseau recognized centuries later, however, slavery and - more generally - a class society with different political rights, was an indispensable element to explain the concept of freedom in the classical world.

<sup>16</sup> The emphasis on the IVth century is important, for in that period Christendom acquired political prerogatives and ceased to be just a Middle-eastern sect stemming out of the Jewish tradition. The doctrinal aspects evolved accordingly. See for instance the brutal solution to the Pelagian dispute (early Vth century) or the new significance attributed to Baptism. Contrary to its paleo-Christian meaning, whereby Baptism signified the sacrifice and resurrection of Christ, as from the IVth century this Sacrament identified freedom from the original sin.

Of course this comment calls for another important question. One may indeed wonder why the turn in the secular significance of Christendom did take place in the IVth century, and not at a different moment in history. Although this would lead us well beyond the scope of these pages, the approach suggested in this article would suggest that the answer lies with the *Völkerwanderung* itself, which put pressure on the military structure of the Western Empire, disrupted its organization, led to increase taxation and stronger local rent-seeking positions, ultimately delegitimized imperial authority.

<sup>17</sup> Of course, that does not mean that all were treated as equals. But it does mean that people could not be legitimately be discriminated against because of their inferior personal dignity. Put differently, individual dignity was something, which could be lost, mainly by means of sin.

<sup>18</sup> This is something that the Roman Emperors perceived relatively soon, led them to encourage the diffusion Christendom, and eventually to adopt it as State religion. Barbarian rulers followed quickly. Clovis, for instance, was christened as early as 493 AD, less than twenty years

between religious norms, Church authority and secular power. Path dependence and predictability were generated by the increasingly high costs of staying out of such a social system, i.e. of being non-Christian. Incumbent rulers would have had weak legitimacy, and be more exposed to domestic uprisings or to foreign aggression legitimized on religious grounds. Economic agents would have also been damaged by not accepting the rules of the game enforced by the Church, since lack of religious sanctions would have led to even less enforceable contracts. Indeed it is no accident that for a long period in Western European history financial transactions could take place only because of religious guarantees.

In other words, starting from the IVth century the Western world evolved according to a path-dependent process rooted in the Christian concept of the individual. This led to the birth of two powerful interest groups. One was the Church itself, which acted to enforce the established notion of the individual, worthy of human dignity only as long as he belonged to a recognized social group, did not strive for social mobility and gave up his will and power to acquire knowledge through a speculative process, or wealth through entrepreneurial activities. Clearly, efforts to acquire new knowledge and entrepreneurship would have been a realistic threat to the Christian notion of a tolerant and subdued individual, and thus to the existing social order.

#### 4.2 *Individualism between the XIIth and the XVIIIth centuries*

The pre-Christian concept had survived in some parts of Europe, especially those at the margin of the *Völkerwanderung*, where the influence of the Church was substantially weaker (Gurevich, 1995). Nevertheless, until early 1200 AD there was no doubt that the theology of the Original Sin had cancelled all ambitions to conceive the individual as an agent willing to improve his status and experiment new venues. The *ubi sunt* teachings reinforced the widespread persuasion whereby the soul had been contaminated by the Original Sin and encapsulated into dirty material spoils. The only way to acquire human dignity again was through repentance and humiliation of the soul and of the flesh. From a social viewpoint, the search for a group to belong to was far more important than the search for the individual.

This view started to be questioned at the beginning of the XIIth century and eventually led to the birth of the present subjectivistic concept of the individual. The coming to maturity of hereditary Feudalism - a system initiated by the military requirements of the time<sup>19</sup> - was probably

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after the Fall of the Western Roman Empire.

<sup>19</sup> As is known, Feudalism originated at the end of the IXth century, as a response to the

one of key events that explain a crucial change in attitude. Feudalism gave rise to a new decentralized political structure and the king was by and large transformed into little more than the president of a loose federation of local lords. This expanded dramatically the need for trained scholars and intellectuals, hired by feudal lords and by kings alike in order to enhance and legitimize their patrons' position against rival secular power, but also to counteract unwarranted encroachment by the Church. Universities were thus created. Scholars were indeed almost invariably educated by religious faculty, but they often found a career in the secular world, where a new elite of entrepreneurs was being borne out of the city economy: the merchants. Intellectually trained (and loyal) people started to become a political resource for the rulers. Put differently, a new elite based on personal qualities started to come to the surface. Education and intellectual abilities became an asset and a reason for pride, rather than a sinful activity and a source of heresy.

There is no doubt that at the beginning, the change affected the elites only. The vast majority of the population had other, vitally more important things to attend to than individualism. However, in the following three centuries the world changed radically. Religious terror intensified individual tensions and anxiety. But obsession with sin and the virtual certainty of Hell (Delumeau, 1983) encouraged people to pay more attention to the joys of life. The introduction of Purgatory and Confession forced individuals to look at sin as a private responsibility, rather than as an objective burden<sup>20</sup>. Black Death made labour scarce, and stimulated people to perceive their worth as human capital. The expansion of the geographical horizons of the time created new opportunities for trade and - more important - made it possible for the new entrepreneurial class to emerge<sup>21</sup>. Sin was no longer the central element regulating individual behaviour, social relations, political structures. Instead, Humanism accompanied and in some cases even replaced the ethics of fear and submission.

New economic opportunities and a growing perception of the human being as an individual

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military facing the Empire from the South (Islam), from the North (Normans) and from the East (Magyars). As recalled by Kaufer (1996), another decisive element was the introduction of the heavy plough, which led to the village economy (and later to the cities).

<sup>20</sup> Abelard had come close to heresy for having said something similar at the beginning of the XIIth century.

<sup>21</sup> Of course, the incentives for a better enforcement of property rights strengthened. Success in this direction led to new entrepreneurship. See also Jones (1999) for an attempt to quantify parts of this mechanism.

led to a new ethics, which was often against Catholic principles, but found a (slightly) more favorable religious environment in the Reformation<sup>22</sup>. In short, Humanism was a method to appraise and evaluate the real world. Although addressed to the educated elites only, in fact it trickled down to almost all layers of the population and became the *Weltanschauung* that allowed the Western World to start its growth process, as we know it today. It justified and encouraged scientific research, originality, free trade and the establishment of rule-of-law even *vis-à-vis* non-Christians<sup>23</sup>.

#### 4.3 *Individualism after the French Revolution*

Surely, the Humanist method and vision that shaped Western Civilization as from the XVIth century was not consistently accepted. Its logical policy implications were often overlooked. Free trade was not always the rule; tolerance was far from widespread and nationalism gradually came to the surface. Science was also regarded with suspicion, in many reformed countries as well. Rent seeking increased as the cost of coercion fell, and non-encompassing interest groups became more pervasive and powerful. That also included the bureaucracy and the ability of governments to tax and thus increase - among other things - warfare. Growth prospects were obviously harmed.

Humanist principles began to decline in continental Europe following the French Revolution (they eventually collapsed with World War I). On the one hand, at the end of the XVIIIth century the ability of the French administration to tax allowed a very much weakened King to raise an army of close to one million soldiers<sup>24</sup>, which in a few weeks defeated the three major military powers of the time combined. This undoubtedly contributed to create a view of power that was no longer perceived as the outcome of divine will, but rather as the result of the people's unity and might, of the national resolve. That is, the notion of a collective will was about to replace

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<sup>22</sup> The Weberian view of the causality link between Reformation and economic progress is now widely rejected. In fact previous reform movements failed because they came too early and did not find fertile enough ground in the ethics of the individual of the time. That is, pre-Lutheran movements were not satisfying the demand for a new version of Christendom.

There is however no doubt that substantial support also came from the exceedingly high taxation by the Church, which reached unprecedented peaks in the early XVIth century and led to widespread resentment across all layers of the German population.

<sup>23</sup> See Krug (1999) for the example provided by the rise of the Dutch as from the early XVIIth century.

<sup>24</sup> Before the French Revolution a very large European army numbered about 100,000 soldiers.

humanist subjectivism.

On the other hand, by achieving absolute monarchy and absorbing Enlightenment - itself an offspring of Humanism - the Western World found itself in a vacuum. For the legitimate claim of the monarchy to command a huge amount of power was no longer acknowledged. The fight for power could have begun any moment. In fact, it started where absolutism was greater and the monarch weaker. As argued in de Jouvenel (1945), the Revolution did not destroy power. It simply transferred it, from a weak monarch to a new class of ruthless rulers, sometimes the leaders of democratically elected assemblies, sometimes just the (totalitarian) self-appointed leaders of the nation.

The aftermath of the French Revolution has been well explained - among others - by de Jouvenel (1945) and de Jasay (1985). The democratic legitimacy changed the political rules of the game, and the new rules gradually affected individual behaviour and attitudes. The notions of "common will" and of "common welfare" acquired a clearer and clearer meaning in continental Europe. The degree to which the common will could encroach on the individual became a matter of degree, surely not of principle. As Benjamin Constant was quick to realize, the crucial novelty that became manifest during the French Revolution was nothing else other than the struggle for the power secured by the late XVIIIth century state.

Since then, it has absorbed increasing amounts of energies and resources. At the same time and because of it, the gradual rise in the ability to exercise discretionary power by means of (illiberal) democratic rules has raised the desire for security, rather than for individual freedom. For obvious reasons, this phenomenon became even more acute after World War I and the crisis in the 1930s.

## **5. Towards a new approach to transition**

Consistent with the institutional tenet, the previous section suggests that Western Europe experienced four major path-dependent processes in the Christian era. One refers to the period during which institutions were driven by the political need for expansion and conquest, in order to protect borders, secure more slaves and agricultural resources, appease domestic interest groups. When that process broke down, a new one became manifest in the Early Middle Ages, and was characterized by the dynamics of Church power. A third one came to the surface when the Humanist entrepreneur prevailed and gave origin to Renaissance. The final stage came out in the

aftermath of the French Revolution, when entrepreneurship, rule-of-law and individualism had to come to terms with rapidly expanding democratic systems.

There is no doubt that the description of the path-dependent processes which have characterized the Western World surely deserve much closer investigation and detailed study, from institutional, religious, political standpoints. Nevertheless, the distinctive features, although liable to further testing, are clear enough. On the contrary, it is not at all clear whether change from one path-dependent process to the other is entirely accidental - as the institutional school maintains - or not.

### *5.1 From one process to the other*

Borrowing in part from Quigley (1961), it is here claimed that path-dependent processes give rise to public-choice mechanisms that involve political as well as economic pressure groups. In turn, the relative weight of the economic and political variables depend on the rules of the path-dependent game and on the transaction costs that characterize both sets of activities. The role of exogenous factors cannot be excluded. Contrary to the institutional view, however, it is here argued that such shocks do affect the timing and sometimes also the features of the institutional breaks; but not their necessity, i.e. the fact that sooner or later a given path-dependent process breaks down.

This can be observed during the first period considered above. As the Roman Empire expanded geographically and more resources were needed to support its administrative and military structure, rent seeking became increasingly appealing and the burden on the population less tolerable. Loyalty to the Emperor was no longer justified by the half-sacred notion of Roman citizenship, or by the allegedly semi-divine nature of the Emperor. The incumbent political structure had to find new ways to enhance its legitimacy. Christendom and the Church were the answer. Put differently, Christendom was not a shock. Rather, it turned out to be the result of an institutional selection process among the various religious options available at the time. As we know, in the end this choice was not enough to save the (Western) Empire, but it did start the new path-dependent process.

The crossing from the early Middle Ages to the Humanist process presented similar features. The rules of the game dictated by Church power, and in particular the amount of taxation required to sustain it, turned out to be unsuitable to a new emerging class of (entrepreneurial) individuals. A new ethics and new religious beliefs took over, a new behavioural process was set into motion, within Catholic milieus, too. The Church survived of course, and continued to play an important role. In Nietzsche's words, the Church was actually saved by Luther. Richelieu and

Mazarin would have been unthinkable without the Counter-Reformation. But as from the middle XVIth century the role of the Church in the leading areas of Western Europe changed significantly with respect to previous times.

As time went by the new entrepreneurial class learnt about the benefits of rent seeking. Protectionism gradually crept in. Mercantilist attitudes in the name of the monarch or of the Guild became more and more frequent, and of course contributed to enhancing the power of the central government and weaken resistance to its action. Colbert was surely no exception in XVIIth century Europe. Pohl (1999) quite aptly remind us that mercantilism did not always mean the same thing everywhere, and did not always lead to the same type of clashes. Nevertheless, where and when the amount of centralized power became large enough, and the Church weak enough, the race for power in the name of the people began. New rules of the game were thus established or imposed. Restoration did not turn the clock back. It just made clear that power was contestable and incumbent rulers hesitant to cultivate the notion of the collective will and attend to it could be overthrown by new leaders.

## 5.2 *On transition once more*

In the light of the preceding discussion transition might now seem to be little more than an empty term. On the one hand, it is hard to maintain that there exists a period of time during which the old path-dependent process is finished, but the new one has not yet started. The fact that we are not able to see what the new process consists of does not mean that the new process is absent. In fact, it may happen that the new rules go together with old rules. And that different layers of the populations move at different speeds, according to the different rules.

Put differently, the key argument here is that societies seldom change their path-dependence process overnight. When this is the case, civil war and bloodshed are the outcome, especially when minorities try to eliminate majorities.

On the other hand, transition might be used to describe and analyze what happens to an economy (or a more or less defined social structure) when the interplay of rent-seeking coalitions ends up by generating a path-dependent process, eventually leading or contributing to its downfall<sup>25</sup>. In this light, transition would become some kind of a dynamic, public-choice

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<sup>25</sup> This pattern was already proposed in Quigley (1961), who analyzed at great length the rise and fall of a number of civilizations. These pages suggest that the same paradigm could be used to analyze path-dependent processes within the Western civilization over the last 2000 years.

investigation. Though acceptable, however, this notion of transition would not probably be of great use, either. After all, the terms of the rent-seeking game change continuously whenever coalitions are allowed to interact. In other words, all countries are almost always in transition, unless a totalitarian regime stops rival pressure groups from coming to the surface<sup>26</sup>.

In short, looking for new or emerging models of economic activity may be an interesting speculative exercise, but unlikely to be of great use unless one understands how those models are going to be incorporated in actual economic activity and give birth to new assignments of property rights. For example, it is widely thought that today's Western economies are following a free-market pattern, and that East-European countries have accepted such model in order to shape their own economic institutions. Yet a quick look at the data on the size of the government sector, of taxation, of regulation, or at the respect for rule-of-law should make it clear to anybody that the Western World today is no way near the free-market paradigm and that Eastern European leaders do not actually pursue free-market models. Indeed, in both cases the political elites would easily lose consensus if they acted otherwise.

### 5.3 *The role of the individual*

The analysis presented in the previous pages suggests a perhaps more promising avenue to evaluate the nature and the stage of current path-dependent processes. Since societies are shaped or at least influenced by groups of individuals, it seems reasonable to pay special attention to the way individual preferences evolve. In this respect, de Jouvenel (1945, chapter 18) already pointed out that in the modern world freedom is a secondary need. Security comes first.

That is a crucial statement, with two very important consequences. First, rent-seeking activities are to be expected whenever there is a possibility of extracting rents or of engaging in law-making negotiations; even if rents are to be paid for and the net gain turns out to be close to zero, or even negative. In fact, the purpose of rent seeking is not just to appropriate rents (which have to be bought, anyway), but rather to acquire stability and thus reduce competitive pressures.

Second, one who promises stability, even without significant redistribution, will always defeat a leader who promises freedom. This does not necessarily mean that freedom is irrelevant. But it does imply that freedom becomes a relevant issue only when stability is guaranteed. In a stable society, freedom may be more important than additional stability, but becomes a questionable

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<sup>26</sup> This is actually what happened under the Soviet regime in Eastern Europe and still occurs today in many undeveloped countries.

target if accompanied by less security. This concept can also be rather easily extended to the role of ideology. For a socializing ideology can be highly effective in creating political support, since it promises security within a large social group (Miller, 1998). Whereas an ideology enhancing individual freedom and protection against social infringements is more likely to meet failure. By delegitimizing the notion of society or coalitions as politically entities prevailing on personal interests, individuals feel more vulnerable. In this light, freedom or personal economic interest in the neoclassical sense become very marginal issues.

Therefore, it seems that the change in the rules of the game in today's allegedly free-market societies is to be considered a cultural issue, rather than a mere technical one. If so, transition should then be concerned with the change in individual perceptions, preferences and attitudes, both in Western economies and in the East-European areas. In other parts of the world - say formerly Soviet Central Asian countries - change in individual attitudes may even regard other moral values and systems. In these situations the assignment and enforcement of property-rights according to an ideal free-market model may not only be less than acceptable, but just inconceivable.

Hence, the chances of experiencing transition in the Western world are at least as relevant as those typical for East-European countries, where the new moral codes can be appreciated and perhaps understood not before a new generation, possibly two, have gone by. If anything, the analysis of the Western case may be closer to our possibilities. What makes it interesting from a subjectivistic viewpoint is that security is by and large taken for granted, while faith in the virtues of social engineering, which is to a large extent supported the myth of the collective will, is vanishing. Whether we are on the point of a humanist comeback, however, remains an open question.

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