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PHILOSOPHY, HISTORY, AND METHODOLOGY OF ECONOMICS

Law, Informal Rules and Economic Performance: The Case for Common Law
Svetozar Pejovich
Cheltenham, United Kingdom: Edward Elgar, 2008 (178 pages)

Just when events seem to outpace understanding, along comes an explanatory work drawing on history; empiricism; economics; scholarship; and, ultimately, faith.

How timely is this book? Svetozar Pejovich must have written *Law, Informal Rules and Economic Performance* just before the economic crisis and U.S. presidential election of 2008. The book was certainly published before credit-market gridlock, financial-sector and manufacturer bailouts, and the near-nationalization of corporate giants, all of which some (very unlike Pejovich) attribute to a failure of capitalism. Right now is not the 1980s triumph of capitalism, nor is it the 1990s worldwide economic rise. Rather, it is an extraordinarily turbulent economic time and thus one in which to understand better the strengths, weaknesses, and operation of economic systems, as well as the costs and advantages of their change.

That issue—the economic performance of capitalism across countries and time—is precisely what Pejovich's book addresses. The book examines why capitalism has consistently done so well in promoting productive economic rules within very different societies, cultures, political conditions, and technologies.

Capitalism has done so, Pejovich argues throughout his book, because of its productive effects on and responses to formal and informal institutions undergoing change. Formal institutions, such as laws, regulations, and court decisions and informal institutions, such as tradition, customs, and family structure, obviously differ widely from one country to another. Formal and informal institutions have incentive effects on the behavior of individuals, meaning that incentive effects should also differ widely from country to country. Pejovich points to a growing body of empirical literature showing that the introduction and spread of capitalism has had positive incentive effects across time and across that wide range of countries including Hong Kong, Singapore, Central and Eastern European states, and the former Soviet republics. Capitalism has passed the economic-efficiency test of time, quite clearly unlike the failed command economies of communism and socialism. Economically free countries enjoy greater material prosperity, and, moreover, the gap between the prosperous and nonprosperous shrinks wherever capitalism develops.

On that basis, Pejovich argues that researchers and policymakers should focus on a theory of efficiency-friendly institutional change. Neoclassical economics embraces a maximization paradigm that assumes that a rational actor makes free choices in a stable system, but economies are not stable and do not operate under stable institutions. Economies must constantly adapt and change as the formal and informal institutions within which they operate change. Pejovich would have us study the selection process for and costs of institutional change, in order to ensure that change is efficiency friendly.

For example, free and efficient exchanges within orderly markets do not arise on their own as an economic panacea. Capitalism depends on the rule of law, which depends on individuals' being judged equally before rational laws under government that periodically replaces the ruling powers through an orderly democratic process. The rule of law's clear, credible, and stable processes for change foster conditions within which individuals can own property, contract for its exchange, resort to an independent judiciary to enforce those rights, and trust in a constitution to preserve a sufficiently broad arena of economic and civil rights. The economy-spurring innovations of pathfinder entrepreneurs depend on property, contract, judiciary, and constitution.

The formal institutions of law and the informal institutions of tradition, custom, and family either promote or discourage these incentive effects and, along with them, economic efficiency. For example, common-law systems, Pejovich argues, are more efficient than civil-law systems because of the capacity of judicial decisions to preserve useful rules while selectively adapting them on a case-by-case basis to new exigencies. The common law is a rich economic stock, stable enough to preserve incentive effects but constantly renewing, because it enables individuals to discretely and freely choose the direction of institutional change. By contrast, civil law invites top-down, blunt, and inefficient legislative experimentation. There are differing transaction costs and effects to top-down versus bottom-up change. As institutions change, we should study, discern, and promote positive incentive effects; those who reduce the transaction costs of exchange encourage risk acceptance, internalize long-term consequences, and enhance adaptive behavior.

As he clearly recognizes, Pejovich's argument bridges from economics to government to morality. The private property for which Pejovich advocates is, he suggests, rightly regarded as private and sacred, beginning in God-given natural resources transformed into useful goods through the sanctioned labors of man, which are in turn promoted by exclusive and transferable ownership. Indeed, for the biblically literate, Pejovich's economic themes represent well-known principles. His argument that scarcity is an inalterable condition sounds much like the poor will always be with us. His urging applied economic research and analysis to improve material conditions perhaps means that we should show the poor due concern. His advocacy that incentive effects should be maximized might be taken to mean that we should not muzzle the ox treading out the grain. His support for private-property rights sounds much like Nehemiah's lament that we are powerless when others own our fields and vineyards.

Underlying faith may be the greatest value of Pejovich's capitalism-versus-socialism dialectic. As he describes these grand organic movements groping toward improved society, Pejovich gives witness to ontology, teleology, and eschatology that is fundamentally moral. While the faithless conjecture about post-peopled worlds, Pejovich's concern is the striving of people who are originated, designed, and carried along toward an end we are compelled to discern as the movements of God.

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The Living Wage: Lessons from the History of Economic Thought

Donald R. Stabile

Northampton, Massachusetts: Edward Elgar, 2008 (163 pages)

"Economists care more about markets than they do about the poor." So say many critics who believe that economists long ago abandoned humane values in favor of the invisible hand. They should be encouraged to read this book. Stabile traces the history of a *living wage* from Adam Smith to the current debate about whether employers, workers, or the government should pay for health care. After all, healthy workers presumably are more productive. Readers of this book will discover how much importance economists have always attached to poverty. They will also better understand the practical, political, economic, and moral dilemmas that must be addressed before the living-wage movement can gain widespread support.

This book is a careful exercise in clarifying the issues surrounding the question of whether communities (and whole societies) are morally responsible for ensuring that wage rates exceed a certain norm. The debate about a *living wage* is an extension of the age-old search for a *just wage*. Both are closely related to the matter of a legal *minimum wage*.

Stabile organizes his discussion of economic reasoning about a living wage along three dimensions: sustainability, capability, and externality. This is very helpful because it allows for a comprehensive treatment of the key reasons why economists have been concerned about low-wage rates from Adam Smith to the present. Throughout, Stabile compares the assumptions and thinking of *moral* economists with those of *market* economists.