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The Role of the Economist in Economic Development

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Abstract

This paper is a reconsideration of the role of the economist in economic development. This is necessary, we argue, because this role has been obscured. We provide a history of development economics to understand how we have arrived at the current situation. We then argue that the development establishment has overlooked the importance of indigenous institutions in achieving economic progress. To remedy, this we apply Mises' regression theorem to understand indigenous institutions. Included in this discussion is a framework for understanding why the current view of the economist in this area persists.

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1. Introduction

The issue of economic development has been at the center of economics from its beginnings. Adam Smith, writing in 1776, attempted to determine the factors that led to the wealth of nations. He concluded that low taxes, peace and a workable system of justice would lead to economic growth (1776, xliii). Robert Lucas, discussing the economic development of India more than two centuries later wrote: "The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think about anything else" (Lucas, 1988: 5). Clearly, economic development is still a central issue in modern economics. However, the economic development establishment has changed greatly since the time of Smith.

As the evolution of this field has taken place over time, there is one critical question that has been overlooked: where is the economist in all this? In other words, what role is the economist to play in understanding economic development? This question is rarely, if ever, considered. Is it the job of the economist to research and discuss historical successes and failures? Must he go further and make policy recommendations based on the results? If so, what does economic science offer him in terms of fulfilling his duties? Reading the mainstream literature on the topic would lead one to think that not only is the economist in a position to analyze past occurrences, but also that he has access to an economic oracle that allows him to provide invaluable insights in both predicting future development and providing advice to reach these goals.

This charge is not specifically against academic literature. A non-academic, viewing the development establishment today, would conclude that the role of the economist is one that includes attempting to understand how the economic system works

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as well as in making prescriptions that involve various interventions to guide the economy in a certain direction. This contention is evident when one looks at Joseph Stiglitz's best selling book, *Globalization and Its Discontents* (2002). Stiglitz's book is a good representation of the current trend in much of the development literature and has been popular among both academics non-academics alike. Stigltiz's book also serves to provide key insights into how those in the development establishment view the role of the economist given that the author was both chairman of the Council of Economic Advisers and chief economist at the World Bank. After discussing various economic failures in developing countries, with perhaps some sporadic success stories discussed as well, the author concludes with recommendations of how to "correct" the failures discussed in the preceding sections.[1] Stiglitz (2002) puts forth a smorgasbord of recommendations to correct the errors of past development efforts. Included in his list of recommendations are: the creation of international public institutions (222), a change in the governance and "mind set" of the WTO and IMF (224-227), acceptance of the danger of capital markets, bankruptcy reforms and standstills, less reliance on bailouts, improved banking regulations, improved risk management, improved safety nets, improved responses to crises (236-40), refining conditionality of assistance and debt forgiveness (242-3). One gets the distinct feeling that the author is claiming, "If only I had been in charge of designing interventionist policies, they would have been effective."

It is the failure to consider the role of the economist in the area of economic development that serves as the foundation of this paper. It is our contention that the true

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[1] This of course is not the case of all writings on the topic. The examples considered here are far from an exhaustive listing of the works in this area. Over the past few years alone, literally hundreds of books have been written on this topic. We merely attempt to point out a general trend in many of the works on this topic.

role of the economist in economic development has been obfuscated.[2] The science of economics has been incorrectly used as the basis of piecemeal planning as well as quantitative forecasting and prediction - areas that clearly lie outside its realm. This paper reconsiders both the field of economic development and the economist's role within that field.

We begin, in section 2, with a brief history of development economics. The purpose is to understand how we arrived at the current state of affairs. In section 3 we argue that indigenous institutions, a critical component of understanding any economic order, have been overlooked by those in the development community. We employee Mises' regression theorem to understand the nature of these institutions and why they are important in achieving successful development. Section 4 provides a reconsideration of the nature of economics and a framework for understanding why the current view of the role of the economist in development economics persists. Section 5 concludes.

2. The Rise and Failure of Development Economics: A Brief History

As mentioned above, the issue of the wealth of nations can be traced back to Smith (1776). However, it was only after World War II that economists began to pay particular attention to the needs of poor countries. Prior to World War II, the focus of economists in terms of growth theory was mainly on wealthy countries (Arndt 1997). These economists, influenced by the Great Depression in the U.S. and the industrialization of the Soviet Union through forced investment and saving, focused on a labor surplus which

[2] We are not the first to recognize this. In fact, Peter Bauer dedicated most of his career to consistently criticizing the development establishment (see Bauer 1954, 1972, 1981, 1991 and Bauer and Yamay 1957). Given the intellectual climate in the 1950s, which emphasized central planning, the development community was not accepting of Bauer's critique. The emphasis on central planning persisted through the collapse of communism. While most would now recognize that central planning cannot work, most still call for an active role for government in economic development.

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they concluded had to be absorbed. The result was what became known as the investment gap theory. According to this view, capital accumulation was critical because growth was proportional to investment. How was this gap to be filled?

Development economists at the time postulated that poor countries would be unable to save enough to grow. The gap was to be filled through foreign aid and investment from wealthy countries. This aid would, in theory, increase investment in capital in the poor countries leading to greater output and growth. Because foreign aid would flow from the governments of wealthy countries to the governments of poor countries, the state was placed at the center of all efforts at economic development. Indeed, the intellectual climate in the 1950s was grounded in the belief that state planning within both developed and developing countries was critical for economic success.[3]

The investment gap theory took firm hold in the United States. At the time, the Soviet Union was viewed as an economic power. The U.S. wanted to show that there was an alternative to growth via forced savings and investment. Under the Kennedy administration (1961-1963), foreign aid reached its historical maximum at $17.3 billion. After this peak, the U.S. slightly decreased aid under Johnson (1963-1969) with a high of $17.2 billion in 1966 and a low of $11.8 billion in 1969.[4]

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[3] On the topic of economic development, Nobel laureate Gunnar Myrdal wrote:

> The special advisers to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problem, no matter who they are…all recommend central planning as the first condition of progress (1956: 201).

Bauer, in his review of Mydral's three books on development economics wrote:

> The main instruments of development policy envisaged by the author are clear. He considers comprehensive development planning, in the sense of government determination and control of economic activity…as indispensable and presumably sufficient for that increase in output which is the essence of economic improvement for the masses (Bauer 1972: 467).

Bauer put forth a complete analysis and criticism of foreign aid as the key to economic development (1972: 95-135).

[4] Source: "How Does the Proposed Level of Foreign Economic Aid Under the Bush Budget Compare with Historical Levels? And What Would Be the Effects of Bush's New 'Millennium Challenge Account'?" By Isaac Shapiro and Nancy Birdsall, Center for Global Development. Available at http://www.cbpp.org/3-14-02foreignaid.htm#N_1_.

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Amidst the widespread acceptance of the investment gap theory, Robert Solow published his famous growth model in 1957. The underlying argument was that investment cannot sustain growth due to diminishing returns. Simply put, the incentive to invest falls as the individual invests more. For Solow, long-term growth could only be sustained with technological change, not investment. Solow's model was fiercely debated in the literature and while it had a large impact, development economists were hesitant to accept that investment wasn't the dominant cause of long-term growth.

With the advent of the computer in the 1970s, economists attempted to calculate the exact amount of foreign aid necessary to fill the investment gap. The revised standard minimum model was developed with the growth part of the model known as Harrod-Domar. The Harrod-Domar model postulated that the growth rate of GDP was proportional to last year's investment level (Easterly 2001: 35).

However, as time progressed, it was realized that investment was not the key to sustained growth. The assumptions of the models were simply unrealistic. For instance, it was assumed that aid would correlate with investment one for one. Further, it was assumed that in addition to the foreign aid, the country receiving aid would increase its level of national saving. Finally, it assumed that there is a linear relationship between investment and GDP growth. The major issue was that there was no incentive for individuals in the country receiving aid to invest it or increase their own level of savings. There were incentive issues in terms of the government as well. Most importantly, government officials, when operating under the investment gap theory, have the incentive to maintain or increase budget deficits since it widens the gap leading to more aid. Although the theory eventually fell out of favor in the academic literature, Easterly notes that it is still widely used in the many international financial institutions who make

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decisions regarding aid, investment and growth (2001: 35-37). Figure 1 highlights Zambia one of the many failures. Zambia, stemming from the mainstream view of the role of foreign aid:

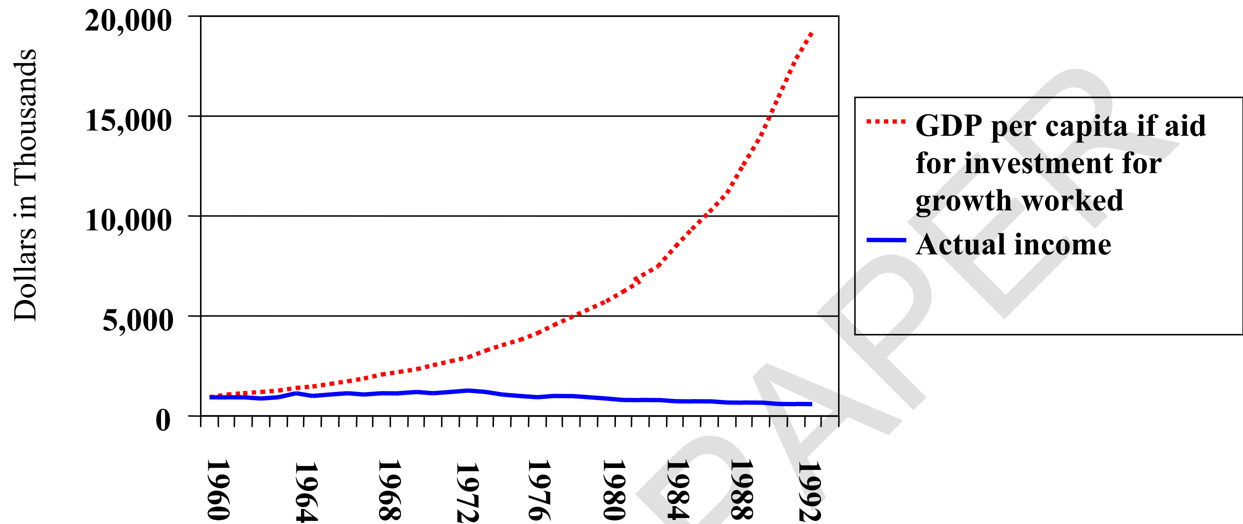

Figure 1: Foreign Aid to Zambia[5]

If the $2 billion of aid had worked as the investment gap theory predicted, Zambia would have a $20,000 per capita income as compared to the actual per capita income of $600. Further, as Easterly points out, Zambia had a high level of investment prior to receiving aid and investment moved inversely to the level of aid (2001: 42).

A shift in the trend of economic development occurred in the 1980s and 90s. It was argued that investment in physical capital was not the only factor of production. Also important was investment in human capital. Given this, the Solow growth model was augmented to control for the education of workers. The fashionable trend in development economics became pushing an agenda of government sponsored education of citizens. Adriaan Verspoor, of the World Bank perhaps summarizes the position best: "The education and training of man – and although often neglected – of woman

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[5] Source: William Easterly, "The Five Myths of Third World Development", available at http://www.worldbank.org/research/growth/present.htm

contributes to the economic growth through its effects on productivity, earnings, job mobility, entrepreneurial skills, and technological innovation" (1990: 21).

With the human capital model gaining momentum, there was an explosion in education. The worldwide median primary school enrollment increased to 99% in 1990, up from 80% in 1960. Further, between 1960 and 1990, the median college enrollment rate of countries worldwide increased to 7.5% from 1% (Easterly 2001: 73). Despite the growth education, it is widely agreed that the correlation between growth and schooling is highly disappointing.[6] Figure 2 illustrates this disappointment – highlighting the trend of if increasing schooling but decreasing growth:

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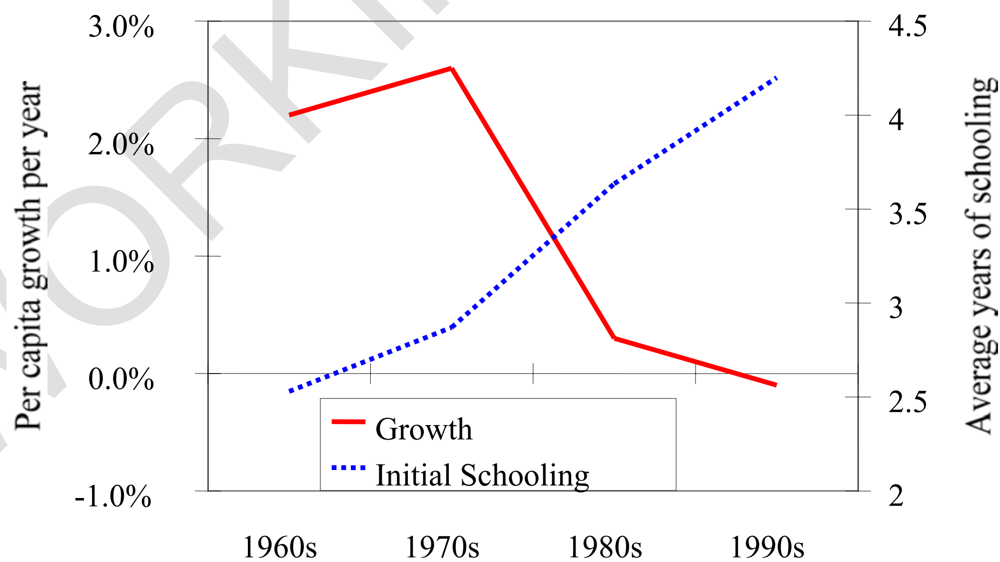

[6] Barro (1991) and Barro and Sali-i-Martin (1995) have found that growth is related to initial schooling although this is usually assumed to be temporary.

Figure 2: Average Years of Schooling & Yearly Growth[7]

Education and skills provide a benefit in an uninhibited marketplace where labor resources are free to move and interact with other laborers. If this is not the case however, the incentive to become educated remains small. Hence, no one becomes educated and the circle of poverty continues. Simply forcing education has little or no effect without the other contributing factors. Simply transferring resources to build schools and provide teachers does not lead to growth.

The emphasis on human capital and education, while failing to produce results in terms of sustained growth, has remained one of the key focuses of both development economists and international organizations involved with development. It is true that no unskilled country has become rich. But then why have education efforts largely failed? There must be something else that development economists are overlooking.

While the emphasis on human capital is still a major component of development economics, the latest trend can be simply summed up as "institutions matter." This trend is in response to the work of Nobel Laureate Douglass North who emphasized the importance of institutions and institutional change.[8] This realization however leads to the question: which institutions matter? The current trend in the literature is a focus on exogenous institutions imposed by government or some international agency.

Within this context, the focus has become finding the right institutional mix for growth. It is widely realized that the institutional mix is not the same for all countries. Economists have focused their efforts on developing complex quantitative models to assist in making specific recommendations regarding what institutions should be imposed

[7] Source: William Easterly, "The Five Myths of Third World Development", available at http://www.worldbank.org/research/growth/present.htm.

[8] See North 1994.

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on developing countries. Interestingly, one can also see that the past trends discussed above are still very present. There is still an emphasis on investment, foreign aid and education but now under the guise of "institutions."

Given the failure of past attempts to impose institutions, why should we assume that current recommendations to do more of the same will lead to better results? The failure that seems to go unnoticed by the authors is not that the right institutional mix has yet to be found, but rather that *both* indigenous and exogenous institutions matter. While focusing on exogenously imposed institutions, the discipline of economics has invested few resources in understanding indigenous institutions. Much of this results from confusion over the role of the economist and the demands of the state on economists which we will discuss later in Section 4. In Section 3, we focus on why indigenous institutions are important and provide a framework for understanding them.

3. What is Missing? Understanding the Role of Indigenous Institutions

What exactly is our goal when undertaking issues of economic development? Presumably, it is to understand why certain economies progress while others are stagnant or regress. As discussed above, it is widely agreed that the institutional framework of any economy will influence its progress or lack thereof.[9] Although there is not complete agreement on exactly what institutional mix is necessary for progress, most agree that the capitalist institutions of private property, rule of law and some degree of stability are necessary for progress to occur.[10]

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[9] See for example, Kasper and Streit (1994), North (1994), Platteau (2000) and Scully (1992) among others.
[10] This is certainly not an exhaustive list of the institutions necessary for economic growth. It is simply meant to highlight that there is some agreement on the underlying institutions that are necessary for economic progress to occur. For example, we now have significant empirical evidence that the socialist model of planned industrialization doesn't hold the answer to economic development (see Boettke, 1990, 1993, 1994a, 1994b, 1994c). We do know that market economies grounded within the context of a rule of

This of course leads to a critical question. Given that we know what it takes for economic development, are these institutions transportable? Can institutions that are successful in one country be exported and imposed in other countries in the hopes that the results will be the same?[11] This is the question that underlies the entire endeavor of economic development. Economic theory provides the means to analyze the consequences of differing rule regimes. But what can it offer in terms of helping the economist to understand why some rules stick while others fail to do so?

As discussed above in Section 2, the current emphasis in the development community is on exogenous institutions while indigenous institutions are overlooked. Achieving an understanding of indigenous institutions not only requires a comprehension of institutional change but also a theory of why there is acceptance or rejection of certain institutions. The anthropologist James Scott (1998: 6-7) has revived the Greek word *mētis* which will serve as the foundation for our understanding of indigenous institutions.

Mētis includes skills, culture, norms and conventions that are shaped by the experiences of the individual. This concept applies to both interactions between people (i.e., interpreting the gestures and actions of others) and the physical environment (i.e., learning to ride a bike). The notion of *mētis* is not one that can be written down neatly as a systematic set of instructions, but rather is gained only through experience and practice.[12]

In terms of a concrete example, think of *mētis* as the set of informal practices and expectations that allow ethnic groups to construct successful trade networks. For

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law which protects private property and freedom of contract demonstrate robust progress (see for example, Berger, 1986; Boettke 1996; Gwartney et al 1996, 1998, 1999; Scully, 1992).

[11] When using the term "institutions," we follow the New Intuitionalist literature as meaning both formal and informal rules which serve to govern human behavior.

[12] One can see a connection between *mētis* and the work of Hayek, especially the role of prices in economizing on tacit knowledge of time and place, see Hayek (1948).

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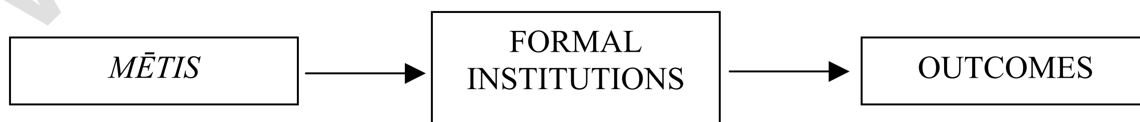
instance, orthodox Jews dominate the diamond trade in New York City (and many other locales), using a complex set of signals, cues, and bonding mechanisms to lower the cost of trading (Bernstein 1992). The trade would not function nearly as well if we simply dropped random traders into the same setting; that difference can be ascribed to *mētis*. The informal institutions of the current traders allow potential situations of conflict to be transformed to situations of coordination, where an overwhelming majority of traders are better off by sticking to the established rules.

Mētis is not static in nature. Obtaining and acting on knowledge should be viewed as a changing process over time. As knowledge travels between groups and international borders, new *mētis* is created and old *mētis* fades away and loses relevance. Therefore, a key problem in economic development is whether *mētis* has adapted to the new and changing circumstances. As we will see, if the stock of *mētis* does not align with reforms and formal institutions, these institutions will fail to be effective even if they are growth-inducing institutions. It should also be noted that the existence of *mētis* does not guarantee successful economic development. If the stock of *mētis* aligns with institutions that are growth retarding, economic development will not be achieved.

The solution often offered by development economists is that we must impose the correct incentive structure in order for institutions to be accepted.[13] However, the realization of the role of *mētis* illustrates why this reasoning is wrong. Consider the causal connection between *mētis*, institutions and outcomes as depicted in Figure 3.



[13] Stiglitz realizes that part of the problem with the current globalization is that it "undermines traditional values" (2002: 247). Unfortunately, he fails to make the connection that acceptance of institutional change requires a shift in these underlying values. Instead, he calls for the gradual implementation of reforms so that the populace can adjust slowly.

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Figure 3: The relationship between mētis*, institutions and outcomes*

This relationship can only move from left to right – formal institutions must be based on the *mētis* of the people acting within them. If the stock of *mētis* fails to align with the formal institutions, then they will fail to stick and be effective. For example, if the populace fails to have any notion of property rights, simply imposing this system will ultimately fail as individuals will not respect or utilize the system as it was intended. This serves to explain why institutions that are effective in one context cannot simply be transported and imposed in other contexts. There is no guarantee that the transported institutions will yield the desired result because the underlying stock of *mētis* differs across societies.

Mētis provides the knowledge necessary for individuals to coordinate around mutually beneficial ends. If the stock of *mētis* aligns with the institutional structure, individuals will coordinate around the institutions and they will stick with little to no external involvement. If however, the stock of *mētis* fails to align with the institutions, they will fail to stick.

It s critical to remember that *mētis* is not static. We are not proposing that social change can never take place. Our contention is that if the underlying stock of *mētis* fails to align with institutional changes, they will fail to be effective. As such, one must either introduce institutional changes which align with the underlying stock of *mētis* or the stock of *mētis* must change such that the desired institutional changes can be effectively made.[14] If at some point in time, the stock of *mētis* fails to align with growth-enhancing

[14] As Bauer and Yamay write, "…it is clear that economic progress requires and causes significant changes in social institutions and in the people who are served by them" (1957: 68-9).

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institutions, it does not mean that the society is doomed. It does mean, however, that a shift in *mētis* is necessary before the growth-enhancing institutions can become fully effective.

This contention is supported by the work of Boettke and Leeson (2003) who describe the repeated failures of attempted market reforms in Russia as a result of planning and imposition instead of the recognition of the social processes necessary for the acceptance of such institutions. The failure of attempts at imposing institutions is not limited to market reforms. Other examples include forestry and agriculture, urban planning and language (Scott 1998). How then are we to understand and analyze this connection between *mētis*, institutions and outcomes in the context of economic theory?

One potential solution is the application of the regression theorem, as originally rendered by Mises, to indigenous institutions (Boettke 1996: 254-258). Mises originally set forth the regression theorem in order to provide a solution to the circularity problem associated with the value of money. The value of money today is determined by the purchasing power of money yesterday, but yesterday's value is determined by the value of money. As Rothbard summarizes the problem: "…how, then, can value scales and utilities be used to explain the formation of money prices, when these value scales and utilities themselves depend upon the existence of money prices?" (1962: 231). To remedy this problem, Mises introduced the time element into his analysis of money which then allowed him to regress backward the value of money. Like all other goods, the use and demand for money is reliant on it having pre-existing purchasing power. Having incorporated the time element into the analysis, we can then push the regression

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backward until the point where the underlying commodity must have had previous non-monetary use, in the world of barter.[15]

What insight does the regression theorem offer in our quest for understanding the acceptance or rejection of institutions? *Mētis* emerges through time and serves to coordinate individuals in their daily activities. Like money, certain institutions cannot be planned by some central organization and imposed upon the populace.[16] Applying this realization to institutional change, Boettke writes:

> It is not due to an intellectual argument against 'Western imperialism' that we must recognize that development is not an issue of simply either writing down the constitutional rules of a Western-style democracy or copying the economic institutions of capitalism, but rather an *epistemological argument* about rules…Economics may establish the properties of alternative rules, but culture and the imprint of history determine which rules can stick in certain environments. The problem is not one of private property and freedom of contract generating perverse consequences, but the fact that some social conventions and customary practices simply do not legitimate these institutions (1996: 257-8, italics original).

This has broad and significant implications for developmental economics as it is widely accepted today. One cannot step out of the historical context of a country and design and impose the "appropriate" institutional structure in the hopes that it will be accepted. Despite the fact that we know, as discussed previously, what institutions are necessary for growth (i.e., capitalist institutions), we are still unable to impose them due to the fact that they may not be supported by the underlying *mētis* enabling the widespread acceptance of institutions.[17]

A connection exists between our framework and the work of Mises on the issue of postwar reconstruction. Mises, writing on the reconstruction of Europe, argues: "This

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[15] Mises introduced and developed this critical theory in his *Theory of Money and Credit*, (1934: 97-123). He also discusses and defends the theory against criticism in *Human Action* (1949).
[16] Admittedly the regression theorem does not fit perfectly when applied to institutional analysis. Mises was able to trace money back until it was used as a commodity in barter exchange. Of course, institutions cannot be traced back to the point when they were used in a situation of barter. They can be traced back to when individuals first started using them in their interactions with others. The key connection is that, like money, government is unable to create certain institutions.
[17] As North writes: "The perceptions of the actors play a…central role in institutional…change because ideological beliefs influence the subjective construction of the models that determine choices" (1994: 103).

reconstruction cannot be undertaken from without, it must come from within. It is not simply a matter of economic technique, still less of engineering; it is a matter of social morale and of social ideologies" (2000: 29).

Along similar lines, Mises focuses on public opinion and ideology as the foundation of social change in *Human Action*, where he writes[18]:

> What determines the course of a nation's economic policies is always the economic ideas held by public opinion. No government, whether democratic or dictatorial, can free itself from the sway of the generally accepted ideology (1949: 850).

And later,

> The supremacy of public opinion determines not only the singular role that economics occupies in the complex of thought and knowledge. It determines the whole process of human history (1949: 863).

The notion of *mētis* is broader than the notion of public opinion. Nonetheless, public opinion and ideology can be seen as one critical element of *mētis*. Indeed, as we will discuss below, changes in public opinion, and hence *mētis*, are critical to social change.

This framework is also consistent with the work of Hernando de Soto (1989, 2000). The motivation that underlies *The Other Path* (1989) is de Soto's desire to understand the plight of Peru. In his study of the country, he found a flourishing informal economy that was operating outside the formal political, legal and economic system. The cost of engaging in the formal system had become so high that economic actors had set up an informal institutional setting in which to undertake their activities.

De Soto followed this initial analysis with *The Mystery of Capital* (2000), in which he sought to understand why the West was rich relative to the rest of the

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[18] For Mises' complete treatment of this topic, see *Human Action*, 1949: 177-191; 886-888. For more on Mises' view of society, see Salerno 1990, especially pages 31-36, which discuss Mises' treatment of the evolution of social institutions.

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world. It is not enough for the informal sector to be successful, de Soto argues, but it must be codified or recognized as formal in order for the full potential of capital to be unlocked. In other words, the stock of *mētis* did not align with the formal institutions in Peru and therefore the formal institutions failed to be effective. Instead, the stock of *mētis* aligned with the informal institutions that emerged and, as de Soto pointed out, the informal network flourished. De Soto argues that, in order for growth to be achieved the stock of *mētis* underlying the informal institutions must be recognized in the formal institutions.

The above realizations significantly limit the procedures followed by the World Bank, IMF and World Trade Organization among others. Currently, these organizations require "conditionality" which involves forcing countries to commit to imposing certain institutions in order to secure and maintain funding. These institutions are imposed without any shift, let alone consideration, of the underlying *mētis*, and as such tend to fail in achieving the desired the ends.

As our application of the regression theorem demonstrates, indigenous institutions are the product of social processes. In order for indigenous institutional change to take place, a change in the stock of *mētis* must precede it. Institutional imposition from above cannot work. Under such circumstances, whether the imposed institutions are growth-inducing or not, they will fail to be effective. Institutional effectiveness is a function of having been the result of endogenous social processes.

Why have developmental economists overlooked this dichotomy of formal and informal institutions and chosen to focus on the former while discarding the latter? An answer can be found when we consider the role of the economist. It is our contention that

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the true role of the economist in economic development has been obfuscated. We provide a framework for understanding the persistence of this confusion below.

4. The Nature and Use of Economics: Why Does the Conventional Role Persist?

The science of economics provides us with true laws of the world. The role of the economic theorist is: (1) to identify and elaborate on these laws and (2) to use them to explain complex economic facts. When attempting to predict future events, the economist is no longer a theorist or historian but rather assumes the role of forecaster. This forecasting can take two forms - qualitative or quantitative. A qualitative forecast relies on economic laws to explain a causal relationship while a quantitative forecast places a numerical value on some future occurrence. It is often forgotten that economic laws, by their very nature, are qualitative rather then quantitative. When the forecaster engages in quantitative predictions, he has gone beyond the knowledge that the science of economics is able to provide. To illustrate, the laws provided by the science of economics tell us that *ceteris paribus* when price increases, quantity demanded decreases (a qualitative forecast). It fails to tell us that a $X increase in price leads to a Y% decrease in demand (a quantitative forecast). This is a critical realization because all of the development organizations – the World Bank, IMF, WTO, etc. – rely heavily on quantitative forecasts for their various programs as well as their analysis of economic development in general.[19] In short, the economist's comparative advantage is not in

[19] As Rothbard writes:

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forecasting but in understanding economic laws and the specific situations where they are applicable.

What then does this mean for the economist, specifically in the realm of economic development? The following dichotomy serves to explain the role of the economist. In the first instance, when analyzing the pure market in which the government plays a passive role, the economist is left only to understand and explain the workings of the economy. In other words, the economist is a "Student" of the economy. The economist is able to explain the consequential chain for some occurrence – if X occurs, then Y, then Z, etc. In the context of development economics, the economist as a "Student" is primarily concerned with understanding how the indigenous institutions of a particular country evolved to meet certain social needs and how they function within the unique cultural context of the country in question to coordinate economic activity.

However, the role of the economist changes drastically when we introduce agencies (the World Bank, IMF and WTO) whose goal is to influence the operation of the market. Given that their aim is to actively intervene in the economy, the consequences of these acts are far more widespread and intricate as compared to a simple causal connection (if X, then Y, etc.). Given the longer chains of reasoning needed to determine the impacts of various policies, the economist becomes even more important to the decision makers who take on an active role in intervening in the economic order.

> The pretensions of econometricians and other 'model-builders' that they can precisely forecast the economy will always flounder on the simple but devastating query: 'If you can forecast so well, why are you not doing so on the stock market, where accurate forecasting reaps such rich rewards?' It is beside the point to dismiss such a query…by calling it 'antiintellectual'; for this is precisely the acid test of the would-be economic oracle (1970: 257).

This is not to discount the role of model building and econometrics as an economic tool for use in analyzing historical events. It is only to highlight the point that using such tools to forecast future occurrences is outside the realm of the science of economics.

For an example of the IMF's use of forecasts and projections, see the "World Economic Outlook, September 2002 -- Statistical Appendix" available at: http://www.imf.org/external/pubs/ft/weo/2002/02/pdf/appendix.pdf

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In this context, the economist becomes a "Savior". As a "Savior," the economist is guided more by his, and his employer's, desire to affect successful change than his ability to actually do so. The economist as "Savior" is overly ambitious regarding the effectiveness of his policy recommendations. These recommendations are not only limited to how government may be able to better enforce existing rules, but also are primarily concerned with what new institutional arrangements should be imposed to replace "inefficient" indigenous ones.

The following matrix (Figure 4) serves to illustrate the interaction between the various roles of the government and the economist.

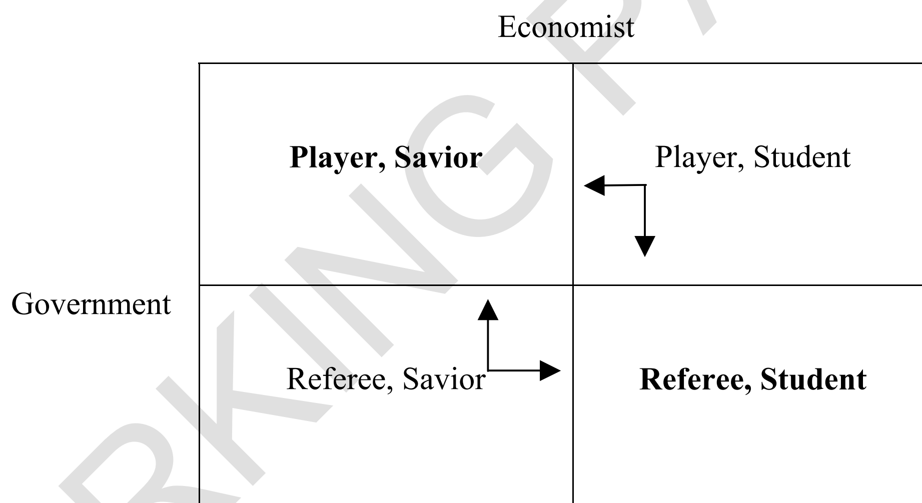

Figure 4: The Development Dilemma

The government can act either as a "*Referee*" or a "*Player*". As "Referee," the state is limited to enforcing indigenously emergent institutional rules. Its capacity as "institutional builder" is restricted to the mechanisms of enforcement and its presence in the social order is passive. As a "Player," the state not only enforces endogenously emergent rules of the game, but also actively creates these rules and the institutional

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composition of society itself. In this capacity, government exogenously imposes institutional order from above instead of merely recognizing and providing a network of enforcement for indigenous institutional arrangements that evolve spontaneously from below. As discussed above, the economist can either take on the role of a "Student" or of a "Savior."

When presented in this fashion, it is obvious that some of the pairs form a stable equilibrium while others do not. When government assumes the role of a "Player" and the economist as "Student," or when government acts as "Referee" and the economist as "Savior," the situation is unstable. Without active policy recommendations from savior-minded economists, the government cannot effectively act as "Player." Similarly, if government is restricted to the passive role of "Referee," simply enforcing indigenous rules, the economist's overly ambitious policy recommendations concerning how to create institutional order anew in his role as "Savior" have no impact. In the event of either of these disequilibria pairings the system tends to move to one or the other of the equilibrium pairings (in bold) indicated by the arrows in Figure 4.

In the equilibrium depicted in the upper left box of the matrix, government is a "Player" and the economist is a "Savior." This equilibrium represents the current situation in development economics as well as reform attempts by the development community over the past half a century. Here, the economist designs a new institutional order ignorant of existing indigenous, endogenously emerged arrangements and the government imposes this order. Section 2 provided an overview of the failure of this approach, which emphasizes only the "right" exogenous institutional mix to be imposed on underdeveloped economies.

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The other equilibrium is depicted in the lower right box of the matrix – government as "Referee" and the economist as "Student." Here the economist primarily seeks to understand indigenous institutional history and function and the state's activity is limited to refining the means by which indigenous institutional arrangements are enforced. This approach takes full account of *mētis* and its connection to the effectiveness of indigenous institutions.

Clearly, a misunderstanding of the nature of the discipline of economics is part of the reason that the role of the economist has become distorted in the context of economic development. This matrix presented above adds to this by illustrating why the conventional view of the role of economist in economic development persists. As long as the state is a "Player" in the economic game, savior-oriented economists will be required. The state requires savior-oriented economists to formulate its various interventions and to provide credibility for these interventions to the populace. Moreover, this sheds light on why endogenous institutions have been largely neglected by economists and policymakers.

Given our framework for understanding indigenous institutions and our reconsideration of the nature of economics, what does this mean for the role of the economist in economic development? Given the nature of the science of economics, there is clearly a role for the economist both in situations where he must explain the casual chain – the pure market – and where he is called upon to analyze actions that influence market activity – the results of policy. The economist is first and foremost a student of the economic order. He does not only need to understand economic theory, but must also study both formal *and* informal institutions to understand their economic

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implications. Part of the study of the economic order involves understanding the stock of *mētis* that enable individual economic agents to coordinate their activities.

A full understanding of *mētis* involves moving beyond the standard methods of looking at aggregate data and instead engaging in on-the-ground fieldwork to construct an analytical narrative. This fieldwork entails detailed case studies and ethnographic data intertwined in a narrative to understand the everyday life of those in developing and transition countries. Through the use of surveys, directed interviews and participant observer behavior, one can offer key insights into how individuals within a specific setting "get things done."[20] Given that policies and exogenous institutions that fail to align with the underlying stock of *mētis* will fail to be effective, this type of research is critical.[21]

In addition to being a student, the economist can also engage in the role of educator in which he explains the workings of the market to both the general public as well as those involved in policy. In this role, the economist plays a critical role in shaping public opinion and ideology which, as indicated by Mises, are critical for social change to take place.

In the context of public policy, there have been various views on the role of the economist. In 1953, Milton Friedman stated the following:

> The role of the economist in discussions of public policy seems to me to be to prescribe what should be done in the light of what can be done, politics aside, and not to predict what is 'politically feasible' and then recommend it (264).

[20] This is in line with P.T. Bauer who called for interdisciplinary cooperation especially between anthropologists, economists and historians in understanding the plight of underdeveloped countries and, more specifically, to understand "…the extremely important and interesting range of issues in the transmission of knowledge, skills, attitudes and inducements between countries and groups…" (1972: 304). Among the benefits of this interdisciplinary approach, "It may help to convey the value of direct observation and of unprocessed material, and conversely, the pitfalls of reliance on second-hand and third-hand material, including reliance on statistics without examination of their sources and background" (1972: 305).

[21] For readily apparent examples of this type of fieldwork, see de Soto (1989, 2000) and Chamlee-Wright (1997).

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In other words, Friedman suggests that the economist should focus on the ideal rather than the politically expedient course of action. In contrast, W.H. Hutt (1971) described a dual role for the economist. In addition to suggesting the ideal, Hutt contended that the economist should suggest the politically expedient course of action as well. In other words, Hutt argued that the economist's policy advice should be along the following lines:

> In our judgment, the best you will be able to get away with is programme A along the following lines; but if you could find a convincing way of really explaining the issue to the electorate, our advice would have to be quite different. We should have to recommend programme B, along the following lines (1971: 23).

Hutt's dual role for the economist seems to be plausible. In the absence of political constraints it would be feasible for the economist to prescribe the ideal. However, if the economist knows that there are certain political constraints on what can and cannot be achieved, his advice may change to achieve the desired ends given those constraints.

The critical point that must be emphasized is that the discipline of economics limits utopias. It informs individuals as to what they cannot achieve (for example a post-scarcity world). The economist can engage in a study of the economic system as well as the indigenous and formal institutions which influence economic activity. He is also able to communicate economic laws and the various means toward desired ends to government officials. The most important realization is that the economist is not a savior. He cannot recommend a formula that can be simply imposed via government intervention that guarantees economic growth.

5. Conclusion

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We have provided a reconsideration of the role of the economist in economic development. In doing so, we first traced the evolution of development economics to understand how the role of the economist has become what it is today. We argued that economists and policy makers alike overlook the role that indigenous institutions play in economic development. To remedy this, we applied Mises' regression theorem to indigenous institutions. We concluded that the informal institutions, which underlie formal institutions, cannot be imposed from above but must develop from the ground up. Imposing formal institutions which do not align with the underlying stock of *mētis* will not be effective. We also provided a framework for understanding why the conventional view of the economist in economic development persists.

Our reconsideration of the role of the economist in economic development concluded that there is a significant role for the economist to play in this area. The discipline of economics provides the economist with the tools to be a student of the economic system. In this capacity, he is suited to understand the interplay of both formal and informal institutions and their impact on economic activity. In addition to his role as a student, the economist can serve a critical function as an educator and adviser to both the general public and policy makers. In this capacity, the economist plays an important role in shaping public opinion and ideology which is critical in achieving long-lasting institutional and social change.

The framework developed here has widespread applications for understanding underdeveloped countries or countries currently in the process of transition. It can be applied to cases of both success and failure to aid in understanding the current institutions of these countries. Often, studies of these countries focus on the speed of reform and policy changes. The debate on "shock therapy" versus "gradualism" is one clear example

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of this. The analysis presented here sheds new light on these studies because it highlights that it is not simply the speed that matters, but whether changes in the formal institutions are aligned with the underlying *mētis*.

Truly understanding the plight of underdeveloped nations requires a complete comprehension of both formal *and* informal institutions. Grasping what economists can do to remedy the situation of these underdeveloped nations requires a complete understanding of the role of the economist and what the discipline of economics enables him to achieve. This paper has provided key insights into achieving success in both of these areas.

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