Human Capital, Wealth and the State: Reflections on Gary Becker
When Popper Met Friedman
The Redefinition of Economics

“one of the major benefits that I personally derived from the first meeting of the Mont Pelerin Society in 1947 was meeting Karl Popper and having an opportunity for some long discussions with him, not on economic policy at all, but on methodology in the social sciences and in the physical sciences. That conversation played a not negligible role in a later essay of mine, "The Methodology of Positive Economics," … It just shows how nature and science works in wondrous ways.

Milton Friedman interviewed by David Levy 1992
Friedman and Becker

• “Progress in positive economics will require not only the testing and elaboration of existing hypotheses but also the construction of new hypotheses. ...The construction of hypotheses is a creative act of inspiration, intuition, invention; its essence is the vision of something new in familiar material. “
  
  M. Friedman “The Methodology of Positive Economics”

• “what most distinguishes economics from other disciplines in the social sciences is not its subject matter but its approach... maximizing behavior, market equilibrium, and stable preferences, used relentlessly and unflinchingly, form the heart of the economic approach.”
  
  G. Becker “Introduction to the Economics of Human Behavior.
The Beckerian Combination

• The Human Capital Century
  – Brilliant but less obviously revolutionary
  – Incredibly right empirically

• The Economics of Everything
  – Field redefining
  – Particularly sociological

• But what if Frank Knight had accepted “Competition and Democracy”

• Becker as Political Scientist instead of Sociologist
A 42% Return per Year of Schooling?

Years of Schooling and GDP per Capita, 2010

Sources: Barro & Lee and The World Bank Indicators
Economic Spillovers vs. Politics

Years of Schooling, 1960 and Government Effectiveness, 2011

Sources: Barro & Lee and The World Bank Worldwide Governance Indicators
Note: Government effectiveness ranges from -2.5 (weakest) to 2.5 (strongest)
Becker and Government

• Competition and Democracy (1958)
  – Perfectly competitive democracies will cater to voters but monopoly, ignorance and tie-ins limit.

• Law Enforcement, Malfeasance and Compensation of Enforcers (1974) (Stigler)
  – “Trust calls for a salary premium...”
  – Pioneering the economics of corruption

• A Theory of Competition Among Pressure Groups for Political Influence (1983)
  – Deadweight loss reduces subsidy, small effective groups get more, competition favors efficiency
Ease of Doing Business

Years of Schooling, 1960
and Ease of Doing Business, 2012

Sources: Barro & Lee and The World Bank Doing Business Data
Note: Ease of doing business index: 1=easiest to 185=most difficult
Why would Human Capital Improve Government?

• Reverse causality, omitted variables, etc.
• Supply of political leaders/bureaucrats
• Information of Voters/Protesters
• Organization of Citizens: Human Capital is Social Capital
  – Coleman (1988) “Social capital lies in the structure of relations between actors and among actors”
• Human capital and rule of law are complements
  – A simpler economy needs less legal completeness
  – Educated become a pressure group for better or more democratic government
Democracy and Education

Years of Schooling, 1960
and Average Democracy Index, 1960-2000

Sources: Barro & Lee and The Polity IV Project
Note: Democracy index ranges from 0 (anocracy) to 10 (consolidated democracy)
Two Stories for Human Capital and Progress

• Story # 1: Scattered investment in skills builds a community able to organize itself to defeat monarchs and sometimes maintain democracy.
  – Boston 1775, Paris 1789, 1830, 1848, 1871, Tahrir Square, etc.
  – The Despot’s Dilemma: investing in education increases wealth today but creates risks of overthrow.

• Story # 2: Human capital shifts the nature of the economy from simple agriculture to complexity with many more interactions (need law), investments and innovations: demand for law.
  – Becker and Murphy on the Division of Labor.
  – Similarly despots may be more willing to return to democracy when the benefits are higher (assuming they get to live).

• Implications for the Asian Model: if story # 1 is correct, then instability seems likely, if story # 2 is correct, then autocratic competence can last.