Inputs and Institutions as Conservative Elements

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ABSTRACT

This essay examines economic stagnation by extending Mises' argument that capital goods are "conservative elements" to the analysis of social capital and institutions in the post-Reconstruction south. It is argued that the structure of social capital that developed in the south was inappropriate to the formal institutions that emerged as a result of the Civil War and Reconstruction. The tensions between institutions and social capital are examined in the context of racist lynching. Examples from the post-Reconstruction "lynching era" suggest that these fundamental tensions reduced the vitality of southern markets and laid the foundation for decades of poverty in the south.

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The emergence of a nation from barbarism to a general diffusion of intelligence and property, to health in the social and civil relations; the development of an inferior race into a high degree of enlightenment; the overthrow of customs and institutions which, however indefensible, have their seat in tradition and a course of long observance; the working out satisfactorily of political, sociological, and ethical problems—are all necessarily slow…Civilization, freedom, a pure religion, are not the speedy outcome of revolutions and cataclysms any more than has been the structure of the earth. They are the slow evolution of orderly and creative causes, the result of law and preordained principles.—JLM Curry, 1896[1]

1. Introduction

All societies started in the same condition: poor. Some, most notably Western Europe, the overseas extensions of Great Britain, and more recently the Asian "tigers," have grown to be fantastically wealthy. Others have been mired in poverty for centuries. A "great divergence" between modern industrial economies and the rest of the world began approximately five hundred years ago, and over the last thousand years, the gap between rich and poor countries has grown substantially. Why have some areas succeeded where others have failed?[2]

American history, particularly the history of the American south, may offer answers. While the United States has been one of history's great success stories, the relative stagnation of the southern states stood out in sharp contrast to the prosperity enjoyed by the rest of the country in the post-bellum era. The south prospered in the decades leading up to the Civil War, stagnated miserably during the decades following the war, and grew rapidly again beginning with the integration of national labor markets in the post-World War II era (Wright, 1986). The south also underwent one of the last two centuries' most radical institutional changes with the relatively sudden abolition of chattel slavery.

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[1] Curry (1896a).
[2] Details on the divergent performance of economies over time are discussed in chapter seven of North (2005:87-102).

Southern economic history provides us with a unique and attractive setting in which to examine economic change through time.

Scholars have proposed several explanations for southern poverty. These include labor market isolation (Wright, 1986), depredations during the war and Reconstruction (DiLorenzo, 2002), various manifestations of the legacy of slavery and racism (Ransom and Sutch, 1977), and the contractual arrangements that emerged in the late nineteenth and early twentieth centuries (Alston and Ferrie, 1993, 1999). One of the notable facts of southern history is that the region languished in spite of what was, at first glance, a move toward apparently superior institutions. That freedom was morally superior to bondage is without question, and theoretical and empirical evidence suggests that it was also economically superior.[3] What prevented the region from growing more rapidly than it did in the aftermath of war and reconstruction?

This essay examines how inputs and institutions act as "conservative elements," arguing specifically that the structure of social capital left over from slavery, war, and reconstruction was inconsistent with the institutional prerequisites for development. This restricted the flexibility of southern markets for capital, goods, and labor in spite of the region's movement to nominally more liberal formal institutions. Social capital in the south was more appropriate for a society based on cooperation through hegemonic

[3] Fogel and Engerman (1974) inaugurated decades of controversy with their contention that slave labor was efficient in spite of apparent intuition to the contrary. The essays in David et al (1976) offer a point-by-point critique of Fogel and Engerman's findings. Mises (1996:629) noted that "at no time and at no place was it possible for enterprises employing servile labor to compete on the market with enterprises employing free labor," arguing that "(i)f one treats men like cattle, one cannot squeeze out of them more than cattle-like performances." Thornton (1994) argues that the "profitability" of slavery owed to state interventions rather than market forces. Hummel (2001) offers a summary of the debate.

bonds—those between master and slave—rather than cooperation based on interaction through contractual bonds, such as those that would exist between free and equal men.[4]

After the war, formal rules changed radically while informal norms did not. This provoked a radical backlash against post-emancipation formal institutions, and productivity was reduced as southerners attempted to replace these institutions with the social arrangements that had prevailed under slavery. In this sense, the structure of institutions and social capital acted as a "conservative element" that restrained the performance of the southern economy through the late nineteenth and early twentieth centuries.

In the last decade the New Institutional Economics has re-oriented the research agenda on the wealth of nations. Institutions are at the heart of economic science because one of the discipline's first lessons is that people respond to incentives. Where factor-oriented theories of development have been unable to explain regional differences in productivity and prosperity, a growing body of theoretical and empirical literature is showing that the formal rules, informal norms, and enforcement mechanisms comprising a society's institutions are important. Exactly how institutions manifest themselves in wealth or poverty remains unclear, but as we will see, southern production was constrained by the "thinking, choosing, and acting of bygone generations"—particularly the thinking, choosing, and acting of racist governments and mobs.

The essence of the argument is as follows. Institutions shape returns on investments in particular types of physical, human, and social capital. The extent to which these factors are limited in their convertibility will determine the society's ability to adjust the

[4] Mises (1949 [1996]:195-198) discusses hegemonic and contractual bonds in greater detail. Coyne (2005) argues that the "institutional prerequisites" for successful post-war reconstruction include "a shared ideology and ethic of individual and private property rights, a commitment to markets and the rule of law."

structure of production to new institutions. Large-scale institutional change may produce institutions that are incompatible with a society's structure of social capital. As social capital is extremely limited in its convertibility, this generates productivity-reducing instability as societies address the incompatibility between the new institutions and the structure of social capital. Evidence for this is found in the history of southern lynching, a gruesome and tragic practice through which whites expressed their dissatisfaction with life after slavery and Reconstruction and which suggests some of the channels through which inputs may and institutions may act as "conservative elements" standing in the way of economic and social progress.

2. Conservative Elements

The various manifestations of neoclassical economics have extended our understanding of production and economic change, but conventional treatments are lacking in that they treat output today as a function of nothing more than the available factors of production, which are in turn a function of yesterday's stock of factors, current investment, and depreciation. The neoclassical growth model is the workhorse of empirical economic research, but it fails to explain the emergence of particular productive arrangements or explain long-run change. In addition, policy prescriptions based on input-oriented models of development have failed to live up to our expectations (Gwartney, Lawson, and Holcombe 1999, 2005).

Some of these shortcomings are addressed in a large body of literature addressing the role of institutions. This work builds on the seminal contributions of Ronald Coase, Douglass North, Oliver Williamson, and other scholars who placed institutions and transaction costs at the center of their analyses; recent contributions show that institutions are important factors in long-run economic growth. Greif (2004) lays out the fundamental issues, noting that successful institutions are both contract-enforcing and coercion-constraining; in other words, they reward production and exchange rather than expropriation and redistribution. The fundamental social problem, then, is to devise institutions that reward voluntary cooperation via contractual bond rather than forced cooperation via hegemonic bond (Mises, 1996).[5]

This is not apparent from basic neoclassical price theory, the conventional textbook treatment of which maintains that the fundamental social problem is one of allocating scarce resources among competing ends. To some extent this may be true; if transaction costs are sufficiently low, market forces should be powerful enough to move society toward an efficient equilibrium regardless of the initial distribution of rights, including the right to employ force (Nye 1997, Acemoglu 2003). History (and contemporary observation) suggests, however, that inefficient policies persist in spite of what appear to be “more efficient” alternatives. Thus Nye (1997) and Acemoglu (2003) suggest that a reasonable next step is to identify the sources of transaction costs that prevent the emergence of efficient institutions.[6]

In spite of human tendency toward self-improvement, history has been clumsy, awkward, and bloody. Mokyr (1990a, 1990b) and Jones (2003) note that sustained growth has been rare, and production possibilities have long exceeded production

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[5] See in particular Davis & North (1971), North & Thomas (1973), and North (1981, 1990, 2005). Klein (2000) is a comprehensive survey of the New Institutional Economics, and Furubotn & Richter (1998) is a leading textbook treatment. The essays in Drobak & Nye (1997) explore implications of the New Institutional Economics for a variety of fields and sub-disciplines. Important recent empirical examples include Acemoglu, Johnson, & Robinson (2001), and Rodrik, Subramanian, & Trebbi (2004).

[6] It has been said that economists would no longer have any useful examples if New York City were to abandon rent control. Krugman & Wells (2005:36) offer rent control and tariffs as two examples of issues on which economists agree most widely. Adam Smith, in *The Theory of Moral Sentiments*, argued that we would converge on efficient institutions, efficient language, and efficient markets in the long run. Exactly how long it takes to move to the long run is unclear.

realities. North (1990, 2005) blames this in part on the fact that history is constrained by path-dependent processes of organizational change, arguing that "path dependence is a way to narrow conceptually the choice set and link decision making through time (North 1990: 98-99)."[7] Path dependent sequences occur when temporally remote events determine outcomes (David, 1985). "Path dependence" is relevant when particular historical factors determine the institutions, organizations, and technologies that emerge.[8] The structures of physical, human, and social capital constrain future production and wealth is always and everywhere a "residuum of past activities (Mises 1996:506)" and is thus the product of historical factors.

How do these historical factors matter? We may extend our understanding of economic change through time by viewing inputs and institutions as "conservative elements" that shape production possibilities and constrain the structure of institutions and therefore the structure of production. Mises (1996:506) made this point explicitly with respect to physical capital:

> All material wealth is a residuum of past activities and is embodied in concrete capital goods of limited convertibility. The capital goods accumulated direct the actions of the living into lines which they would not have chosen if their discretion had not been restricted by binding action accomplished in the past. The choice of ends and of the means for the attainment of these ends is influenced by the past. Capital goods are a

[7] A sentence later, North notes that while history matters for purposes of constraining future choice sets, path dependence as applied to institutions "is not a story of inevitability in which the past neatly predicts the future," as earlier historicist interpretations—such as those relying on notions of technological determinism—may suggest.

[8] The early contributions to the theory of path dependence are David (1985) and Arthur (1988). David (1985) argues that market mechanisms may "lock in" inefficient technologies. Liebowitz and Margolis (1990) disagree, suggesting that examples of market-chosen technological standards that are in any sense "wrong" (QWERTY, VHS, IBM, Microsoft) have only been inferior to other proposed standards on certain margins that consumers found less important than other margins.

> conservative element. They force us to adjust our actions to conditions brought about by our own conduct in earlier days and by the thinking, choosing and acting of bygone generations.

Limited convertibility will determine, at least in part, what is produced and how. We inherit preferences, morals, and norms from the world around us, and the wisdom of the ages will be manifested in the stock of productive resources—the stock of physical, human, and social capital—and in the institutions that determine a society's incentives. These in turn determine what we want and how we can produce it.

The extent to which inputs and institutions will be "conservative" is determined by the degree to which they are convertible. Physical capital is the most liquid of the various elements of the structure of production in that it can be readily measured and traded in price-setting markets. During the "bust" phase of business cycles, malinvested physical capital is liquidated quickly and redirected into other lines of production. Other aspects of the structure of production—human capital and social capital—are more limited in their convertibility and thus place greater restraints on the flexibility of the structure of production. In the south especially, an inflexible structure of social capital forced southerners to "adjust [their] actions to conditions brought about by…the thinking, choosing, and acting" of previous generations of southerners.

Economics has developed a large and sophisticated body of literature dealing with physical and human capital, and the relationships between these elements and development is well understood. Only recently have economists incorporated social capital and institutions into their analyses.[9] Building on Mises (1996), David (1985), and

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[9] Contentious debate rages over the epistemological problems associated with models of capital accumulation. Empirical models assume capital is homogeneous. The definitive modern treatment is

North (1990, 2005), the next section identifies the characteristics of physical, human, and social capital and institutions that make them "conservative elements."

3. Physical and Human Capital

Production has been a relatively simple process for most of history: crops were grown, animals were killed, and food was eaten. It remains relatively simple in most of the world today. The last few centuries has seen the emergence of increasingly complex, capital-intensive structures of production that allow us to produce more and more goods and services with fewer resources, less time, and less labor.[10]

Capital theory is one of the most well-developed (and at times, controversial) branches of economics. The grand treatises of the nineteenth and early twentieth centuries took great care to develop a theory of capital, and the earliest formal treatments modeled production as a function of capital and labor. Capital has also performed admirably as an analogy for education, knowledge, and general know-how (human capital) and the network of relationships that we use to accomplish our various ends (social capital). This section discusses the attributes of physical and human capital that make them "conservative," as well as the implications for southern economic history.

3.1 Physical Capital

"Capital" consists of the machines, tools, and other produced factors of production that increase the productivity of human effort. Mises (1996:260) offers a more elaborate definition of capital goods as "the products accumulated for…the purpose of increasing

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Garrison (2000). Chamlee-Wright (2005) and Coyne (2005) apply Austrian insights to the theory of social capital. Covey (1990) refers to a network of social capital as an "emotional bank account."

[10] For exhaustive discussions of the relationship between capital intensity and productivity, see Mises (1949), Rothbard (1992), and Reisman (1996).

the amount of time elapsing between the beginning of the production process and its turning out of a product ready for use and consumption" and gives as examples tools, half-finished products, and goods ready for consumption that make it longer production processes possible. Rothbard argues that any productive asset temporally removed from immediate consumption is a "capital good."[11] This includes not only the stock of machines and tools but also the stock of unused consumer goods that can sustain us through longer production processes (Strigl, 1999). Capital accumulation enjoys a great consensus as one of the most important proximate causes of increased productivity.

The capital structure shapes production possibilities, and people plan according to expectations about prices of consumer goods and inputs. Capital takes time to produce, and all capital has specific (and limited) applicability which Mises refers to as "limited convertibility." A hammer is only a substitute for a steam shovel in a limited sense, and thus the range of feasible production plans will be constrained by the available stock of capital goods. In every period, the new stock of specific, inconvertible capital goods will re-shape the structure of relative prices and therefore determine the relative returns on different opportunities. The cost of liquidating capital may be too high for some opportunities to be viable.[12] Mises summarizes (1996:507):

> The intermediary products [capital goods] available today were manufactured in the past by our ancestors and by ourselves. The plans which guided their production were an outgrowth of the then prevailing ideas concerning ends and technological

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[11] Strigl (1999) is a comprehensive elaboration of the theory of capital. Garrison (2000) offers a modern update of the capital-based theory of aggregate production.

[12] See von Strigl (1999) for a discussion of the relationship between capital and production. Garrison (2000) discusses the time element in production and extends the Mises-Hayek theory of policy-induced intertemporal disequilibrium. Short-run specificity was one reason oil shocks had such a major effect in the early 1970s.

> procedures. If we consider aiming at different ends and choosing different methods of production, we are faced with an alternative. We must either leave unused a great part of the capital goods available and start afresh producing modern equipment, or we must adjust our production processes … to the specific character of the capital goods available.

We might be able to formulate "ideal" plans of production irrespective of available capital goods, but the range of feasible plans will be limited by the structure of existing capital. Capital determines, in part, relative prices as well as the institutions that emerge in the future. It limits production possibilities and orders the path of economic change. In this sense, they are conservative elements. "Vintage capital," for example, determines the structure of relative prices and thus determines whether or not a new production process will be profitable. The conservatism that capital goods impose on the path of economic change has implications for how we understand the relationship between economic performance through time and other elements of the structure of production.

3.2 Human Capital

Capital and labor are not autonomously productive, nor are men pushed along by unyielding, unmerciful material forces of production. Goods are ultimately the manifestation of human intelligence, planning, and effort, and whether mere matter is a "resource" or a "good" depends on man's capacity to use it to satisfy wants (Menger, 2004). The application of skills and intelligence—human capital—becomes increasingly more important as production becomes more complex. It is intangible knowledge that can be used to convert resources into goods.

One of the most remarkable changes coinciding with the Second Economic Revolution was a fundamental change in the social stock of knowledge (North, 1981). This change has been so radical that a sizeable proportion of modern American wealth is in the form of human capital. Human capital is the set of skills and knowledge that enable production and make labor more productive. It is the knowledge and know-how that we use to produce goods and services and is a "produced factor of production" in that accumulating human capital requires the investment of time and resources. Investments in human capital are substantial; recently, it has been reported that American higher education is a $10 billion dollar per year industry (Twitchell, 2005).

Human capital is conservative because it cannot be converted, measured, or traded, and production possibilities are ultimately constrained by the extent of human knowledge and ingenuity. In this sense, it may be more conservative than physical capital. It is also non-rival; one's knowledge of how to fix a diesel engine does not reduce the knowledge available for everyone else.[13] Barriers to the emergence of manufacturing reduce returns to education; high barriers to entrepreneurship reinforce them. The intergenerational transfer of human capital also makes them conservative; children of illiterate parents are unlikely to become literate themselves, and generations of children learned farming, mining, or a skilled trade at the side of a parent.

The structure of human capital may be appropriate for one mode of production but not for another, and the fact that human capital cannot be liquidated implies that a particular structure of human capital may limit the range of possible changes in the structure of production. It may also be difficult to adapt process-specific human capital from one task to another. An agricultural society may present barriers to investment

[13] This may actually reduce the degree to which human capital displays limited convertibility.

because proximity to subsistence alters the relative returns to brawn and brains. In sum, the structure of human capital may define, in part, the path of future economic activity. [14]

3.3 Physical and Human Capital in the South

Two of the distinguishing characteristics of southern economic history are the region's failure to accumulate capital or invest in education. The structure of production in the antebellum south was relatively simple: labor-intensive agriculture dominated (Coclanis, 2000). This changed little during the war. Wright (1986) argues that cheap labor, simple production processes, and the institutions designed to maintain them shaped southern production during the century following the war. In sharp contrast to relatively rigid southern markets, northern markets were more accommodating to workers, innovators, and entrepreneurs. Inflexible markets provided a major barrier to capital accumulation and entrepreneurship south of the Mason-Dixon Line.

Two reasons for southern divergence were low wages and the persistence of an agricultural economy. These had their roots, at least in part, in an uneducated workforce. Data suggest that the south accumulated very little human capital, and what human capital the south did invest in may have been limited in its applicability because most of the human capital acquired by freedmen and their children was plantation-specific. Southern industrialization choices were also shaped by a lack of entrepreneurial expertise and labor skill (Connolly, 2004). This reduced the size of the potential technological community—the pool of scientists, engineers, and innovators—by simply eliminating members of society from candidacy, either by informal norm or by fiat. Failure to invest in human capital limited the range of technological possibilities, constrained southern

[14] Higgs (1977) and Margo (1990) discuss the economics of illiteracy in the south. Connolly (2004) provides a growth-theoretic interpretation of human capital accumulation in the region.

educational endeavors, and impeded the development of an indigenous technological community. This produced persistently low productivity and reduced the efficacy with which the region could adapt northern technology to southern needs.

4. Institutions and Social Capital

Institutions and social capital are also important, but they are more difficult to conceptualize and measure. Institutions are the formal rules, informal norms, and enforcement characteristics that define the structure of property rights and shape incentives , and the functionalist approach to social capital refers to the network of relationships that we use in order to “get things done” (Chamlee-Wright, 2005). Since they shape incentives, institutions direct investments not only in physical and human capital, but also in relationships and social capital. Institutions and social capital have played an increasingly important role in social analysis as we have come to better appreciate how supposedly non-economic factors like culture, norms, laws, and social relationships affect asset accumulation and labor productivity.

4.1 Institutions

Institutions define the structure of property rights, specifying who owns what and under what circumstances. This has implications for economic development as it determines both the rate and direction of investment. “Good institutions” reward production and exchange while “bad institutions” reward expropriation and redistribution. The extent to which rules, norms, and enforcement characteristics are uncertainty-reducing will depend on the extent to which they are credible.[15]

Institutions are conservative because they directly affect the costs and benefits of various modes of production. What we call "bad institutions" are bad precisely because they impede long-run development. Someone can be whipped enough or scared enough to induce diligence, but bad institutions hurt long-run productivity by making it prohibitively costly to alter the structure of production. If elements of a production plan are proscribed by formal law or informal norms, potential profits may go unrealized. This has been ubiquitous in history: instead of specialization and increasing prosperity, societies have lived on the brink of subsistence since the dawn of time. Uncertainty associated with bad institutions affect entrepreneurial decision-making by reducing the present value of investments, changing the feasible range of entrepreneurial possibilities, altering the opportunity cost of migration, and distorting relative prices.

Building on Coase (1937), economists have formulated the problem facing firms as the decision to "make or buy." Similarly, the problem facing societies is "coerce or contract," with the unfortunate reality being that institutions have traditionally been such that the coercion is more profitable than contracting, which brings us to the essence of the institutional problem: to establish institutions that constrain coercion and enforce contracts (Greif, 2004). Only within the last few centuries have people shifted away from coercion and toward contracting on a scale large enough to produce sustained growth.

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[15] Boettke, Coyne, and Leeson (2005) discuss various conditions under which institutions can be "sticky." In particular, institutions that arise endogenously from indigenous people in a particular area are likely to "stick" while exogenously imposed institutions are not. "Sticky" institutions will be more likely to reduce uncertainty. Coyne and Leeson (2005) discuss barriers to entrepreneurship in developing countries.

Enforcement is one of the most important characteristics of institutions. Formal rules are generally enforced by states.[16] Informal norms are generally enforced by the organizations of civil society (firms, churches, Rotary clubs, neighbors) and in many cases, by the organizations of uncivil society (the Ku Klux Klan, the mafia). Differential enforcement of formal laws may increase uncertainty, distort production, and increase the relative return to expropriation and redistribution. This may lock in low productivity relative to the "good institutions" counterfactual.

4.2 Social Capital

In a landmark study, Hall & Jones (1999) focus on what they call "social infrastructure," arguing that it is the fundamental source of income differences in international comparisons. Economists are paying increasing attention to networks of relationships and how they matter for social and economic organization (Chamlee-Wright, 2005). It is unique among inputs in that it cannot be measured, owned, or alienated. Unlike human capital, formal markets for social capital are scarce to nonexistent. Nonetheless, social networks are fundamental sources of economic and social change because strong social networks improve information flows and lower the costs of transacting.[17]

The analogy to physical capital is appropriate, but it diverges in several important respects. It is appropriate in that social networks are "factors of production" that provide conduits for ideas and information. People invest in social capital in order to increase their future consumption of both material goods and intangible goods like relationships

[16] For our purposes, "states" are organizations with a comparative advantage in violence, extending over a geographic area with boundaries determined by their power to tax constituents (North, 1981)
[17] Social capital is like human capital in that it can be depreciated, however. People can forget things; they can also allow relationships to deteriorate.

for their own sake. Unlike physical capital, however, social capital cannot be bought, sold, or otherwise liquidated. Relationships diminish over time, but there are no formal markets for social capital as there are for physical capital and, increasingly, for human capital.

Recall that limited convertibility was the factor making capital a "conservative element" (Mises, 1996). Social capital, though, is more conservative than physical capital because of its even more limited convertibility. Thus, investments in particular types of social capital may be appropriate to one institutional arrangement but not to another. Relationships in college fraternities, for example, cannot be bought or sold, and the fact that a student successfully pledged a particular fraternity may increase the chances that a friend or family member might successfully pledge the same fraternity (and therefore find his way into the fraternity's network of social capital).

In the antebellum era, the south developed a structure of social capital and informal norms that was appropriate to the hegemonic relations of a slave economy but not necessarily to freedom: the region made massive investments in scientific, social, religious, and ideological justifications for the slave system which are not easily reversed. The dramatic changes emanating from emancipation and Reconstruction resulted in a set of institutions that did not fit southern social networks. A reversal in cotton market trends then exposed the extent to which the structure of social capital that developed under slavery was inappropriate to a dynamic economy.[18]

[18] Wright (1976:303) contends that the high productivity we observed during the late antebellum era was a product not of any inherent efficiencies in the slave system but of "the extraordinary growth of world demand for cotton between 1820 and 1860" and particularly a spectacular year (1859-1860) for cotton growers that happened to show up in official census statistics.

Social relations in the south were plagued by fear and mistrust, and this increased segregation across racial lines. Thus, social networks were smaller and considerably less flexible than they otherwise would have been. Due to uncertainties associated with post-war social upheaval, southern entrepreneurs, innovators, and laborers relied more heavily on kinship networks and informal arrangements rather than formal markets. After the Civil War, vestiges of hegemonic slave-master relationships remained both in the structure of social networks and in the formal institutions that were devised by post-Reconstruction governments (Higgs, 1977). In many aspects of southern life, blacks and whites were separated *de jure*. Jim Crow laws meant that by the mid-twentieth century, black and white children did not attend the same schools or swim in the same public pools. In many other aspects of southern life, blacks and whites were separated *de facto*. Blacks and whites did not attend the same churches, shop in the same stores, or eat in the same restaurants.

Segregation and racist violence meant several things. First, markets were smaller and the division of labor was shallower than it would have otherwise been.[19] Second, mutual fear and distrust meant that costs of contracting across racial boundaries were higher than the costs of within-race contracting. Third, the availability of political means made it easier for whites to indulge a "taste for discrimination" by socializing the costs of doing so. Finally, segregation served to reinforce stereotypes and reduce incentives for further

[19] Public and private resources were devoted to maintaining segregation—public resources in the form of segregated public places, enforced segregation of schools, and segregated public services, and private resources in the form of informal lynch mobs, the Ku Klux Klan, and "whitecaps."

contracting. In a vicious cycle, mistrust, ignorance, and poverty bred more mistrust, ignorance, and poverty.[20]

5. Institutions, Social Capital, and Lynch-Law

How do we know? Instances of racist violence in the south offer an attractive setting in which to examine the relationships between institutions and social capital. Relations between the races were on everyone's mind as journals, newspapers, books, and fashionable salons were filled with talk of how to address "the negro problem." The source of the "problem" was the structure of social capital combined with an inability and unwillingness by the region to commit to the new property rights specified after Reconstruction. The late nineteenth century south was shaped by the radical institutional change coming with emancipation, an antiquated structure of social capital left over from slavery, and broad willingness to attempt to re-align institutions with the structure of social capital. This was reflected in the gruesome lynchings that took place during the late nineteenth and early twentieth centuries.[21]

The region had established a structure of social capital suitable to hegemonic relations between masters and slaves. This included "race etiquette," social sanctions against interracial sex, and segregated churches.[22] This structure of rules and norms was backed by large investments in ideological, scientific, and religious justifications of slavery

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[20] North (2005) discusses how people arrive at correct or incorrect mental models of the social environment. Institutionalized segregation may reinforce incorrect mental models.

[21] Wright (1974) argues that part of southern poverty could be attributed to a weakening cotton market. Weakening cotton markets should not by themselves reduce southern productivity. As cotton market conditions weakened, southerners buying and selling in well-developed markets should have moved out of cotton (or out of agriculture) and into other pursuits. Figures 1 and 2 plot the number of lynchings over time as well as the geographic distribution.

[22] See Alston (1986) for a discussion and empirical study of southern "race etiquette." Alston argues that the practice of "race etiquette" was constrained by blacks' opportunities.

before the war and in ideological, scientific, and religious “demonstrations” that blacks were inferior to whites after the war. Slavery was poor preparation for freedom: though the new system was more just in that the new freedmen (theoretically) possessed the same rights as their white counterparts, the structure of social capital left over from slavery was incompatible with the new formal institutions. This to tension led to struggle over which institutions would ultimate emerge.

Even without explicit laws mandating that blacks show deference to whites, the expectation that blacks behave as second-class citizens was an important component of the legacy of slavery, and it was often enforced in a disturbingly brutal fashion. Many blacks who either failed to show proper deference to whites were lynched, beaten, or otherwise ostracized for their indiscretion. This sent a powerful signal about the degree to which people were willing to contest the post-Reconstruction social order.

Enforcement gives “teeth” to rules and norms, and the history of southern lynching yields important information about types of rules and norms as well as the strength of enforcement mechanisms. Lynching, which Congress, the NAACP, and the Tuskegee Institute defined as community-sponsored murder with the intention to intimidate other members of particular ethnic, social, or economic minority (Waldrep 2002), was an especially brutal way of enforcing formal “Jim Crow” laws and informal norms proscribing contact between the races. Second, lynching stood in open defiance of laws against doing unto others, showing that in some respects, the law was largely impotent with respect to lynch mobs. Lynching enforced some rules and norms (sanctions against black equality) and was an affront to others (sanctions against murder).

In part because of state monopolies on court systems, blacks had difficulty obtaining justice. Governments were rarely inclined to go to the defense of mob victims, and on some occasions when they did, they faced violent community backlash and difficulty finding ways to bring lynchers to justice. Even in situations when members of the mob went about their business in broad daylight, victims were said to have died “at the hands of persons unknown” (Dray, 2002).

The culture of fear created by racist violence burdened the post-Reconstruction south. Lynching served two important purposes. It provides “an excellent index of the backwardness of the lower south (White, 1929)” as it pertained to social relations, and it also signaled the extent to which a region was willing to contest the structure of property rights in which blacks nominally had the same rights as whites. In some respects, lynching had its roots in social proscriptions against sexual congress between black men and white women, and accusations of rape preceded many lynchings. As Glaeser (2005) notes, lynching was often a form of revenge against violations of sexual mores.[23] It was alleged that the white man’s responsibility was to defend the virtue and integrity of virtuous white women, and so lynching persisted. This reinforced low productivity as educated blacks—those who had the most to gain—left the south, and other blacks tried not to attract the attention of “thundering lynch mobs” (Bell, 1978).

Uncertainty about institutions also meant that markets were slow to respond to changes in relative prices. Southern labor markets were considerably more fluid than traditional interpretations supposed them to be (Higgs 1977, Wright 1986); however, the relevant counterfactual is the fluidity of southern labor markets relative to what they

[23] There is some debate on this point. Finnegan (1998) argues that many accusations of rape were pretexts for mobs to murder blacks to prevent competition.

would have been with better institutions. Bad institutions, racism, and high transaction costs embodied in Klan terror and lynching reduced the fluidity and dynamism of southern markets and locked in low productivity.[24]

What were the implications of mob violence? Curry (1896b:1291) argued eloquently that

> (a) mob is a sudden revolution. It is enthroned anarchy. It is passion dominant, regnant. It usurps all the functions of government. It concentrates in itself all the rights and duties of lawmaker, judge, jury, counsel, and sheriff. A mob does not reason, has no conscience, is irresponsible, and its violence is unrestrained."

Lynching was the outward manifestation of a disintegrated social order. It represented a massive failure on the part of the government to enforce the law, and it also indicated that popular bombast about race was more than empty rhetoric. People are also willing to pay high prices to satisfy ideological convictions or religious beliefs, and lynching was an example of one of these situations. This was evident during the lynching era as lynching was often seen as "protecting the virtue of white womanhood." It was apparent that some were willing and able to pay a price to indulge their understanding of a "proper social order." This had implications for labor productivity in a broader sense: lynching was a way that racists credibly committed to their ideological convictions.

5.1 Sex and Violence: Examples

Over 5,000 people have been lynched since the Chicago *Tribune* began keeping statistics on the practice in 1882. Figures 1 and 2 illustrate the extent and geographic

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[24] Weiner's (1978) study of change in Alabama gives illuminating examples of Klan activity that hampered markets. The most comprehensive study of lynching is Tolnay & Beck (1995). Ransom & Sutch (1977) devote considerable space to credit constraints in the south.

distribution of lynching over time. Lynching extended well into the twentieth century, with the last lynchings occurring in the 1950s and 1960s. Lynching was also a disproportionately southern phenomenon, suggesting that studying lynching may yield insight into why the region was poor for so long.[25] Lynchers and lynching-apologists were often clear on their motivations: speaking on problems of race relations, a small-town mayor argued that “[t]he only way you can teach these Niggers a lesson and put them in their place is to go out and lynch a few of them, and the others will trouble you no more. That is the only thing to do—kill them, string them up, lynch them!” (Markovitz 2004:3).

(Figure 1 here)

(Figure 2 here)

Examples are illustrative. This sub-section reports on several lynchings related to breaches of “race etiquette,” sexual norms, and business success. In three of the examples offered here, government officials attempted to stop the lynchings. In one of the cases, law enforcement officials were actually complicit in the lynching. These are only a small selection of the lynchings chronicled by scholars of the subject, but as our received understanding of lynching is that it was “community-sponsored murder” (Waldrep, 2002), they are sufficient to demonstrate that lynching was indicative of a chaotic social order.

[25] “The lynching era” broadly defined covers roughly the period of prolonged southern stagnation. While there were occasional lynchings in the 1950s and 1960s, lynching largely disappeared at the same time that the southern economy began its rapid convergence to income levels consistent with those in the rest of the country. Carden (2005) shows that the decline in lynching in the early part of the twentieth century coincided with an acceleration of economic growth between 1900 and 1920. The Historical American Lynching Data Collection Project contains an inventory of southern lynchings drawn from Tolnay & Beck (1995). The HAL researchers are attempting to compile an inventory of lynching victims outside the south and from before the “official” data begin in 1882.

Daniel Edwards of Selma, Alabama was lynched in 1893 for his breach of racial etiquette. Edwards sired the child of a white woman after a year-long consensual relationship. In spite of the fact that this was clearly a consensual relationship, he was arrested for rape and riddled with bullets by a mob. To his body was attached a note reading “Warning to all Negroes that are too intimate with white girls. This the (sic) work of one hundred best citizens of the South Side.” (Markovitz, 2004:1).

The Edwards lynching was a clear miscarriage of justice, but even in cases where claims of “justice” may be warranted, many lynchings were gruesome displays of inhumanity. The lynching of Sam Holt (known in some accounts as Sam Hose) was one such instance. Holt was, according to the Springfield (MA) *Republican* of April 28, 1899, “deprived of his fingers, ears, and genital parts” before his burning commenced. The paper reported that 2,000 people surrounded the tree where Holt was lynched. People snatched up burned body parts as souvenirs when the lynching was completed, with the NAACP (1969:12-13) recording that “small pieces of bone went for 25 cents and a bit of liver, crisply cooked, for 10 cents.” Holt was lynched out in the open, his assailants making no effort whatsoever to conceal their activities. The law was no help: in spite of the protests of a former governor and a judge, the mob tortured Holt mercilessly before burning him alive. To a nearby tree was attached a sign reading

WE MUST PROTECT OUR SOUTHERN WOMEN.

The Holt lynching was particularly compelling in that it led to another lynching, this time of someone who was presumably innocent. When Holt confessed (under extreme duress), he implicated Palmetto (GA) preacher “Lige” Strickland, who had allegedly paid him $20 to commit murder. Shortly afterward, the mob went after Strickland. To

Strickland's body—which was found hanging from a persimmon tree—was attached a note which on one side read "We must protect our ladies" and on the other side read "beware all darkies! You will be treated the same way!" According to the *Weekly Republican*, Strickland was lynched even though his employer, an ex-state senator who was "one of the most distinguished citizens of Coweta county," pleaded with the mob to spare his life.[26]

Wilder McGowan, a successful entrepreneur, was lynched near Wiggins, MS in 1938 on the accusation of raping and robbing a 74 year old white woman, but according to an NAACP investigator his innocence was known throughout the area. It is said, then, that McGowan attracted the attention of the mob precisely because he was successful—McGowan owned a moving and hauling company that did quite well—and also because he "repeatedly resisted the violent intimidation of local whites," having fought on several occasions with mobs attempting to intimidate blacks. One morning, McGowan was working on his truck when he was abducted by a mob (which included the sheriff and his deputies), taken to a wooded area, and hanged without accusation, trial, or investigation (Finnegan 1998:244).

A particularly tragic instance of a black man being lynched for his success was the case of Anthony Crawford of Abbeville, South Carolina, a literate former slave and landowner who had build a reputation for "challenging white sensibilities about blacks" and who was lynched in 1916 in spite of efforts on the part of local law enforcement to prevent the lynching.[27] The Crawford lynching illustrated the dangers of certain forms of

[26] Reproductions of primary sources related to the Holt and Strickland lynchings are discussed in Ginzburg (1988:11, 15).
[27] The Crawford lynching is discussed in greater detail in Finnegan (1998). It is also summarized in a story in the June 30, 2005 issue of Northwestern University's *Daily Northwestern* on Crawford's great-great-

social entrepreneurship: editors of newspapers and white community leaders opined that Crawford's insolence toward whites had earned him a beating, and Crawford had drawn the ire of white landlords because he hired black laborers and always had labor even when it was scarce.

This was particularly unfortunate because race relations in the area had been tense. In March of 1910, whites had burned a local black college, killing three students. In 1913, a black young man was castrated on the accusation that a white woman had thought he was going to insult her. A few weeks before Crawford was murdered, a young black man was whipped on the accusation of insulting a white clerk. Finally, on October 21, 1916, the mob lynched Anthony Crawford.

Crawford had gotten into an argument with store owner W.D. Barksdale over the sale of some of Crawford's cotton seed. Barksdale offered 85 cents per pound. Crawford, knowing that the market price of seed was 90 cents per pound, told Barksdale that he had gotten a better offer. Barksdale accused Crawford of lying and Crawford cursed Barksdale for trying to cheat him, raging that he would not sell cotton "to any damn white man" at the price Barksdale had offered. After some of Barksdale's employees tried to beat him, Crawford was arrested. He was released shortly after paying $15 bail, but not before police had to disperse a gathering mob. Crawford was found hiding in a boiler room and was beaten into unconsciousness by the mob, saved only by the intervention of the Sheriff, who arrested Crawford for a beating he had administered to an attacker. The mob, fearing that Crawford would be put on the 4:00 train out of town for protection, stormed the jail and killed Crawford. His dead body was then dragged

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grandaughter Doria Johnson, who attended the Senate's recent voice-vote resolution to apologize for not making lynching a federal crime.

through the black part of town as a warning. Many local blacks took the lynching as a cue to leave the area.

The Crawford lynching is instructive because it illustrates some of the attitudes about race relations in the commercial as well as the political sphere. Various local commercial interests agreed with the Crawford lynching at least in principle. J. Allen Smith, president of the National Bank of Abbeville, asserted that “Crawford was insolent to a white man and he deserved a thrashing.” Another bank president said that he should have been lynched because that was how such matters were handled in the south. Finally the president of the Farmers’ Bank (one Dr. Harrison) argued that while the law should be upheld, Crawford got what he deserved and that “a white man’s right to whip a negro once in a while” should not be “interfered with” (Finnegan 1998:252).

Southern lynching was an unpleasant by-product of a structure of social capital that was ill-suited for contractual relations among free and equal men, especially given that governments were unable to credibly commit to the new institutions. It was also a powerful signal of the degree to which southerners were willing to contest the rights blacks had acquired as a result of emancipation and Reconstruction. The social and economic consequences were indeed dire: the productivity of southern labor fell dramatically as a result of the war but stayed well below the productivity of the other regions for almost a century. In addition, race relations remain an explosive issue for the south and the nation.

6. Concluding Remarks

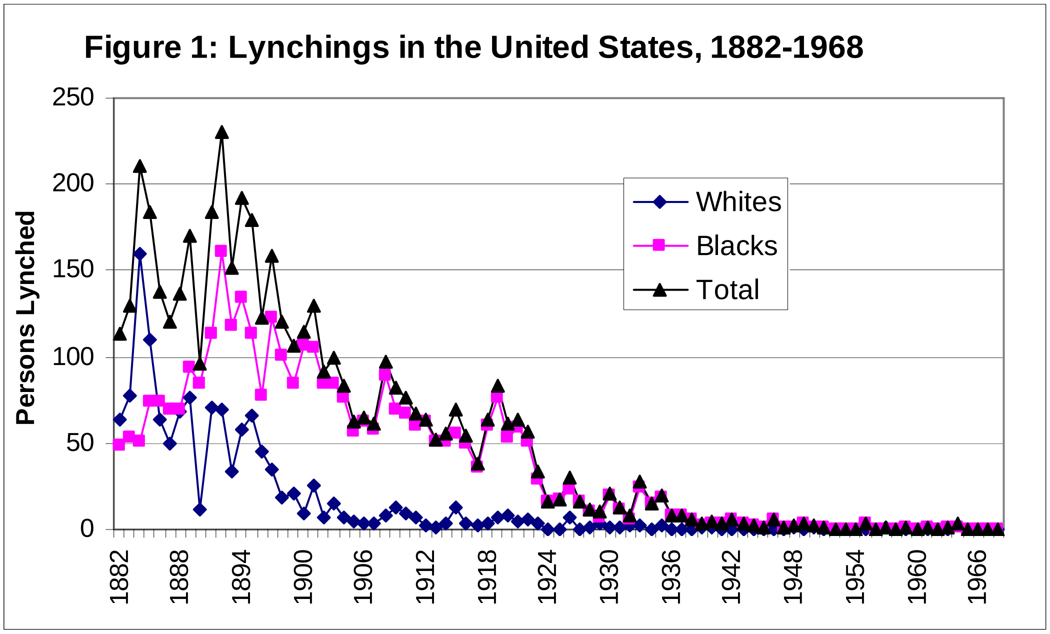
History matters, and the channels through which the “thinking, choosing, and acting of bygone generations” influence current economic conditions are several. Inputs and institutions that are limited in their convertibility act as “conservative elements” which constrain the path of economic and social change. In particular, the structure of social capital in the south, originally based on hegemonic master-slave relationships, was inappropriate to the proper functioning of a market economy. On one hand, the new institutions did not match the social context in which property rights to labor had rested in the hands of planters; on the other, a vicious backlash as whites attempted to re-establish the “old system” caused problems for the south for decades.

It is important to note that these conclusions are explanatory, not prescriptive. They provide an explanation for why changes in institutions—even changes from inferior to superior institutions—may lower productivity over time. Change imposes limitations on human foresight and requires that we constantly adapt our expectations and re-appraise different elements of the structure of production. The market is a process by which this information is continually updated: new information is revealed through and reflected in the ever-changing structure of relative prices, and while an increasingly complex post-industrial economy may very well increase our understanding of what is known as well as what is knowable, it also generates widespread fundamental uncertainty in the social environment.

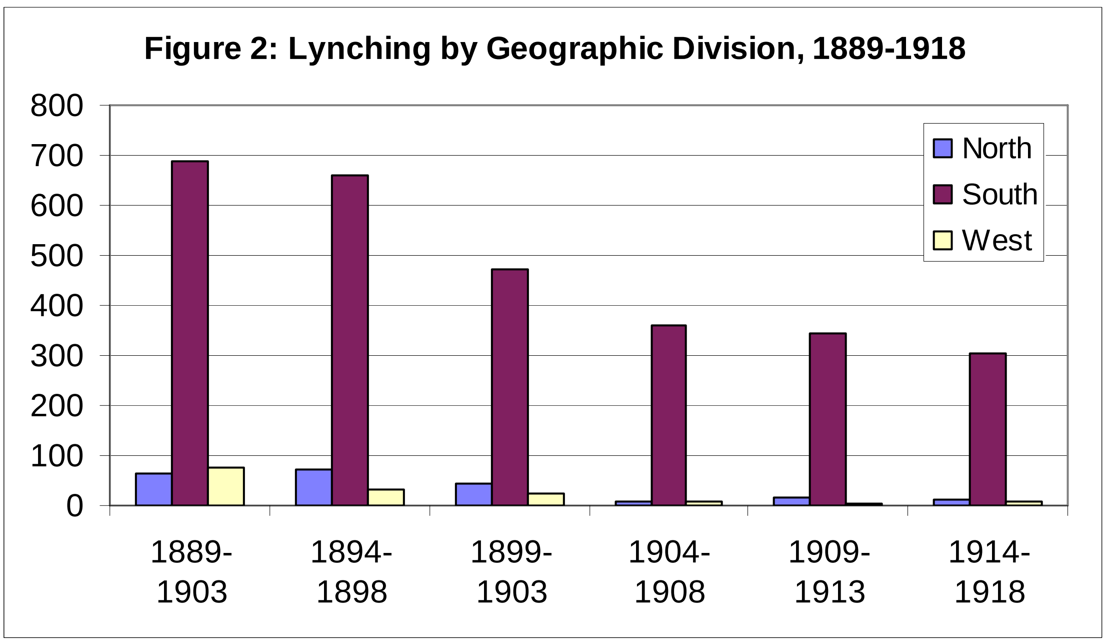
This study suggests intriguing avenues for further research. An obvious next step is to examine the relationships empirically to the extent that data and techniques will allow. Other important implications of this study concern the relationship between social capital, institutions, and development. Further work continuing to clarify and highlight the distinctions between these elements and the relationships between them is clearly needed.

In summary, inputs and institutions may act as “conservative elements” that keep societies from reaching their full potential.

Figures



Source: "Lynching in America" database: http://www.law.umkc.edu/faculty/projects/ftrials/shipp/lynchingyear.html.



Source: NAACP (1969).

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