

THE NONEXISTENCE OF THE CRUEL DILEMMA OR THE UNLIKELY PROSPERITY OF THE
ECONOMIC SYSTEM OF FREEDOM IN THE ABSENCE OF IT

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LA INEXISTENCIA DEL DILEMA CRUEL O LA IMPROBABLE PROSPERIDAD DEL SISTEMA ECONÓMICO DE LA LIBERTAD EN AUSENCIA DE ÉSTA

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ABSTRACT

The controversial relationship between the political system and economic growth induced Bhagwati to coin the concept of cruel dilemma to illustrate the tension that may exist between the economic freedoms and the political homonyms. Thus, and since then, the economic-institutional empirical literature has tried to outline the effect of democracy on the sustained increase in income with disparate results. However, the very absence of an undisputed conclusion also from the perspective of the History of economic Ideas has led, to the best of our knowledge, to the fact that the preference for a political system or another to achieve economic prosperity may turn into an axiologically based argument. This fact would, therefore, endorse the incorporation to the emphasis of the discussion of a double analysis, factual and theoretical-economic –owing to the classical postulates on which the central doctrinal body of the discipline is founded–, whose conjunction with the crucial importance of institutions for economic growth seemed to hide, ultimately, a simple idea. Namely: the indissolubility, on a long-term basis, between economic success and democracy.

Keywords: Cruel dilemma, economic liberties, political liberties, democracy, institutions, economic growth

RESUMEN

La controvertida relación entre sistema político y crecimiento económico indujo la acuñación por Bhagwati del concepto de dilema cruel para ilustrar la tensión que existiría entre las libertades económicas y las homónimas políticas. Así, y, desde entonces, la literatura empírica económico-institucional ha tratado de perfilar el efecto de la democracia sobre el incremento sostenido de la renta con resultados dispares. Sin embargo, la propia ausencia de una conclusión incontrovertida, también desde la perspectiva de la Historia de las Ideas económicas, ha conducido, a nuestro juicio, a que la preferencia por un sistema político u otro para el logro de la prosperidad económica devenga en un argumento fundamentado axiológicamente. Hecho que, por ende, avalaría la incorporación al énfasis del debate de un doble análisis, fáctico y teórico-económico –deudor de los postulados clásicos sobre los que se asienta el cuerpo doctrinal central de la disciplina–, cuya conjunción con la capital importancia de las instituciones para el crecimiento económico parecería esconder, en última instancia, una idea sencilla. A saber: la indisolubilidad, a largo plazo, entre éxito económico y democracia.

Palabras clave: Dilema cruel, libertades económicas, libertades políticas, democracia, instituciones, crecimiento económico.

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THE NONEXISTENCE OF THE CRUEL DILEMMA OR THE UNLIKELY PROSPERITY OF THE ECONOMIC SYSTEM OF FREEDOM IN THE ABSENCE OF IT ^{•+}

1.Introduction

The potential and controversial relationship between political system, institution of institutions, and economic growth may have induced the coinage by Bhagwati (1966) of the concept of cruel dilemma¹ to illustrate the tension existing between economic freedoms and political homonyms. And this, encouraging a discussion somehow exceeded from the perspective of the History of Economic Thought, in which both dimensions, regardless of the conclusion the reasoning may draw, constitute no more than both projections of the same worldview of the study of social reality in its material aspects (worthwhile examples are Smith, 1776/2009, Barnave, 1792/1971, Mill, 1859/1990, Marx, 1867/1984, Friedman, 1962/2012, Hayek, 1973/2001, and Sen 1999/2000).

Thus being the state of things, in recent years the economic-institutional empirical literature has attempted to outline the effect of democracy on the sustained increase in income with disparate results. On the one hand, authors such as Weingast (1995) or Rigobon and Rodrik (2004) highlight the mutual reinforcement between the rule of law, democracy and growth, synergy applicable to transition processes towards democratic regimes (Rodrik and Wacziarg, 2004). Taking an extra step, Kagundu and Martínez-Vázquez (2012) attain a superiority of political institutions against the purely economic ones regarding their influence on growth.

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¹ Also known as the "thesis of Lee" somehow attributed to Lee Kuan Yew, former Prime Minister of Singapore (Sen, 1999/2000: 32).

On the other hand, works like those by Przeworski and Limongi (1993), Barro (1996 and 2000), Tavares and Wacziarg (2000) or Vega-Gordillo and Álvarez-Arce (2003) insist on the existence of an unfinished relationship between democracy and growth. Therefore, they are underpinning the thesis about the non-interdependence between political and economic levels and, consequently, providing evidence for the plausibility of the cruel dilemma.

Even so, the economic-institutional empirical literature described shows, as a whole, a number of limitations that invalidate a universally unquestioned assumption about its conclusions (among others, Lindert, 2003, or Arellano and Lepore, 2009). So, from the highlighted empirical results as well as from the predicable incontrovertible conclusions of the debate in the History of economic Ideas, it can be inferred how the preference for a political system or another to achieve economic prosperity would ultimately hide an axiological, and thus, normatively refutable basis.

Now if, according to historical experience, there is a combinatorial plurality between political systems and economic freedoms with respect to the sustained increase of income (for example, Acemoglu and Robinson, 2012), it is even greatly in what pertains to the impact caused by stronger economic recessions to the political formula. The addition to the discussion of the basic informant principle about efficient functioning of market economy, namely, the mechanism of free competition through the universal guarantee of economic freedoms (as in Smith 1776/2009; more recently, among others, Röpke, 1937/2007), as well as the addition of the majority political system in developed countries (Rodrik, 2011), would underpin a simple idea supported by the almost ubiquitous relationship between wealth and democracy.

The interweaving between political freedoms and economic prosperity.

2. The cruel dilemma in light of Economics

Whether the *esprit de finesse*, apart from being normatively desirable, prevails to a greater or lesser extent among scientists of any discipline, ultimately, the doctrinal body of a social science, such as Economics, encloses the culmination of some exercise, deliberate or accidental, of *esprit de système*² (one example is Hayek, 1988/1990: 33). Or, in other words, given the practical inherent impossibility for laboratory iterative validation of the entire

² While the *sprit de finesse* can be understood as "the use of reason for critical analysis and for the conscious and always provisional rejection or acceptance of a thesis," the *esprit de système* refers to the "exaltation of Reason as a builder of true intellectual systems" (Roncaglia 2011: 37).

theoretical and doctrinal body previously surmised³, there is scope for action to the ability of rhetoric to boost the effectiveness of the dominant scientific paradigm (McCloskey, 1983).

With the exception being exposed, but, in turn, unable to ignore the almost absolute theoretical and empirical consensus existing in the field of Economics around the superiority of the market system versus alternative ways of achieving a sustained increase in total income (or production)⁴, the subsequent analysis between the political system and economic growth will be restricted to the relationships between democracy or dictatorship and capitalism. At the time, the cruel dilemma is nothing but the successful combination of the latter two.

2.1 Economic Science and political system: a connection in half light

Modern Growth Theory, from seminal works such as Solow (1956) and subsequent canonical developments (for example, by Romer, 1986 and Lucas, 1988), is ultimately based on the accumulation of factors and the technical level as developmental premises (among others, Alonso and Garcimartín, 2011), so that institutional frameworks, including as regards the political system, would become neutral for that development.

However, from within the perspective of Growth Theory, it can be seen how the so-called Solow residual explains to a greater extent than factor accumulation growth differences between countries and, a fortiori, accumulation itself is persistent while growth is not (as an illustration, Easterly and Levine, 2001). And this is so, even to the point that the difference in the degree of development of similarly-starting realities in factual terms is explained by dissimilar changes to a political-institutional level. A worthy example would be the case of the two Koreas.

Due to all this, an extensive and recent literature values the capital status of the institutional framework both for its economic takeoff and for its sustainability (among others, Hall and Jones, 1999, Easterly and Levine, 2003, and Rodrik, Subramanian and Trebbi, 2004), emphasizing, above all, the essential role which the existence of inclusive economic institutions would play in the process of development (for example, Smith 1776/2009, Hayek, 1988/1990 or Acemoglu and Robinson, 2012). Not surprisingly, if institutions modulate social behavior, creating a whole incentive system, i.e., endogenizing the preferences of individuals (San Emeterio, 2011), as they are "the rules of the game in a society or, more formally , the humanly-devised constraints that shape human interaction" (North, 1990), the

³ That is, the problem regarding the non-feasibility of controlling all the elements that affect the experiment emerges.

⁴ Perhaps making good the claim that "the market is the worst form of labour-divided organization, all others excluded" (Roncaglia, 2011: 33).

institutional capillary action to influence in the decisions of all the economic agents implies that their effects are transferable to the whole economy (illustratively, Mill, 1859/1990, Arrow, 1972, North 1990, Knack and Keefer 1997, Acemoglu et al., 2001, Ostrom and Ahn, 2003, and Nunn, 2008).

Consequently, although the literature has identified numerous factors that enhance a qualitative improvement of institutions *lato sensu*⁵, no consensus has been reached as far as the discussion about the best political system for economic development is concerned. In this sense, and in general terms, it has been stressed how democratic systems stimulate growth by means of greater human capital accumulation (Lindert, 2003), while they promote the establishment of transfer programs for the reduction of inequality. However, this is achieved at the expense of physical capital accumulation and an increase in Public Sector consumption (among others, Tavares and Wacziarg, 2000).

Hence the coexistence of empirical studies attempting to find evidence to support the benefits (by way of illustration, Rigobon and Rodrik, 2004, or Kagundu and Martinez-Vazquez, 2012), blemishes (as an example, again Tavares and Wacziarg, 2000) and neutrality of the democratic political system regarding economic growth (among others, Przeworski and Limongi, 1993, or Barro, 1996 and 2000).

However, that literature shows, overall, a number of limitations covering the maintenance of the controversy in the debate about the possible existence of the cruel dilemma, including: restrictiveness of the concept of democracy (Lindert, 2003), homogeneous treatment of strongly dissimilar institutional realities (illustratively from Polanyi, 1944/2007, or Ostrom, 2007), temporal biases on cross-sectional studies (Chang, 2011), lack of consensus on which variables are relevant (Sen, 1999 / 2000, or Arellano and Lepore, 2009), the failure to consider the phenomenon of convergence in the comparative between growth rates of different countries, the impossibility to count on a *what-if* analysis ...

Therefore, from the discussion of the empirical results highlighted by Institutional economics, it could be inferred the existence of a combinatorial plurality between the political system and economic freedoms with respect to the steady increase in income (as an example,

⁵ In this sense, empirical studies have highlighted, roughly, factors that would take a part in the achievement of a high level of institutional quality such as the importance of the level of development (among others, Rigobon and Rodrik, 2004, or Alesina and Perotti, 1996), the ethno-linguistic fragmentation (Easterly and Levine, 1997), the degree of openness (Islam and Montenegro 2002 or also Wei, 2000, illustratively), income inequality or fairness in the distribution of wealth (again Islam and Montenegro, 2002), the origin of the legal tradition and the dominant creed (La Porta et al., 1998, as an example), educational attainment (Alonso and Garcimartín, 2011), the colonizing method (Acemoglu et al., 2001, or Engerman and Sokoloff, 2002, among others), the geography (with jobs like Sachs, 2003), the existence of an efficient tax system (Alonso and Garcimartín, 2011) and the nature and quality of bureaucracies (paradigmatically, Straub, 2000) .

for a review of the literature, Chen, 2007; recently, Acemoglu and Robinson, 2012). Not in vain, and, ultimately, the very absence of empirical evidence able to overcome the difficulty to extrapolate to a hypothetical universal time-geographical setting all effects derived from a democratic or dictatorial regime makes it possible to reach to the previous conclusion.

2.2 Political economy and freedom: a transparent relationship

In the genesis of the market system is not only the idea that "it will activate certain benign human proclivities at the expense of some malignant ones, by the expectation that, thus, man would maybe suppress and atrophy some destructive and disastrous components of human nature" (Hirschman, 1977/1999: 89; this thesis is found in Illustrated authors such as Hamilton, 1787, and subsequently embraced, among others, by Keynes 1936/1998: 432-433), but also, from Smith on (1776/2009) , that idea was developed to the point of maintaining that the individual pursuit of commercial interest would result in the subsequent beneficial outcome for society as a whole.

However, and from Enlightened criteria, even before the publication in 1776 of *The Wealth of Nations*, many voices were raised making explicit their reservations about the hypothetical bonhomie that, for the sake of the prevailing absolutist political system, would be contained in the individual pursuit of commercial interest (one example is Barnave, 1792/1971, in Hirschman, 1977/1999: 137). Of course, immediately afterwards, other authors adopted a more optimistic attitude, keeping an open debate about the ability of the market to be a binding driving force for political development (by way of illustration, Ferguson, 1767/1966, in Hirschman, 1977/1999: 138, or De Tocqueville, 1835/2010).

In any case, the virtuous circle of the *Smithian* proposal rested on the continued observance of two essential and intimately connected conditions, namely, the *principle of sympathy* (mainly Smith, 1759/2004, on which he bases his work from 1776/2009) and the opposition to any concentration of power. Both clauses, jointly imposed by the Scottish social reformer (in turn, they were conditions inspired by the British tradition of Locke and Hume⁶, and received afterwards, among others, by Keynes, 1936/1998: 437, or Hirschman, 1981/1984: 374, as well as by the liberal tradition, for example, Röpke, 1937/2007: 38) have

⁶ Furthermore, if, from reasoning based on a rationalist natural law, the universal defense of life, liberty and property for the development of personality with immediate implications for the limitation of political power is owed to the first, the *principle of sympathy* as a general rule of action, that is, the commitment to maximize the individual sphere of liberty only restricted to moral conventions, is debtor to the idea of "tacit consent" by Hume (Roncaglia, 2011: 73).

not only material implications, but also ones that can be directly extrapolated to the field of political systems (among others, Hayek, 1973/ 2001:72).

On the one hand, the *principle of sympathy* would impose a sphere of equality and morality that would transcend the mere commercial relationship between individuals. Secondly, the opposition to any concentration of power and, therefore, to the defence of competition, entails direct referrals about the limitation of State power and commercial companies (for example, this represents a *coup de grâce* to the guild system). And ultimately, as it pertains to the configuration of the branches of government, the encouragement of competition hastens, according to the analysis on the evils of any concentration, to advocate for their separation (point at which the Political Economy will converge with the works of Montesquieu, 1748/2007).

Notwithstanding the foregoing, by the late eighteenth century, mainly from the period of Terror the French Revolution went through, many interpreters of Smith, fearful that an economic-political reading of their thesis could lead to a revolution which, as in France, would exceed the demands of enlightened despotism, greatly by extending the right of suffrage, split the *Smithian* formula into two projections: economic and political. Thus, the market would only require economic freedoms, while the political rights would be deferred (Roncaglia, 2011: 74).

In order to do so, from the sphere of Legal Theory, it was argued how nineteenth century Parliaments would not represent the will, but the interests of the Nation (Blanco Valdés, 2010: 125), paving the way for the institution of census suffrage. In other words, the constitutional clauses would be interpreted on a purely formal sense, that is, vacuous as it pertains to the pursuit of their material effectiveness⁷.

So, it is a truism to affirm that the success in most western countries of the *Smithian* “reinterpretation” was anchored in the understanding of this thesis with the political agenda of power factors shown in those countries and personified, at a European-continental level, by the effective exercise of the findings at the Congress of Vienna (1815).

However, against the consensus of the *establishment*, there were found critical economists who, like Mill (1859/1990), openly advocated for the extension of political

⁷ Thus, while Article 16 of the Declaration of the Rights of Man and Citizen (1789), pronounced how "a society in which the guarantee of rights is not assured, nor the separation of powers defined, has no constitution" paradigm of European constitutional texts to be adopted during the nineteenth century, this proclamation did not reach an effective and widespread effect until well into the twentieth century.

freedoms, claiming that it would generate greater economic value to society⁸ (in the same direction, and, more recently, Hirschman, 1970/1977, or Sen, 1999/2000). Simultaneously, other schools of thought, such as Marxism, would even reject from the beginning the overall bonhomie inserted in Smith's thesis about the outcome of the pursuit of individual interest (one example is Marx, 1867/1984).

For all these reasons, indifferent to arguments based on economic efficiency, the emergence and consolidation of democracy resulted in a tie between opposing and openly hostile groups (Hirschman, 1991/1994: 187). In this way, democracy would be delivered at the precise moment when effective and circumstantial distribution of power is in its favour (Lassalle, 1863/2001, Dahl, 1971/1990, or Acemoglu and Robinson, 2006).

Not surprisingly, the unique American constitutional experience of 1787, previous to the U.S. capitalist development in the strict sense of the term, shows how, at the height of enlightened ideas, from a certain distribution of power, it was not only possible to have a theoretical reading of the *Smithian* thesis from a political-economic point of view, but also its implementation. In fact, the spirit of the text of Philadelphia hosted almost simultaneously, in accordance with eighteenth century standards⁹, the inextricability between economic and political freedoms¹⁰, their protection¹¹, as well as a constitutional structure that sanctioned a system of *checks and balances* counterbalancing the branches of government to prevent, including the electoral system¹², the setting-up of even majorities (Blanco Valdés, 2012: 57).

That being so, under the European scenario, the consolidation of processes of industrialization led to a new distribution of forces that, in the span of time between the *Pax Britannica* and the Second World Postwar, precipitated the gradual granting of political rights to progressively larger shares of the population¹³ to finally achieve discarding the discussion between economic and political freedoms in the West. Henceforth, democracy would be considered axiologically an inalienable *prius* and not an accessory political system.

⁸ Specifically, Mill says how "in proportion to the development of his individuality, each person gains more value for himself and is, therefore, able to gain a greater value to others. There is a greater fullness of life in its own existence and when there is more life in the units there is also more life in the mass which is composed of them" (1859/1990: 135). In short, human beings become closer "to the best they can be" (Mill, 1859/1990: 136).

⁹ This nuance refers to the position of women or tolerance of the institution of slavery.

¹⁰ The original text of 1787 was amended as early as 1791 in order to incorporate fundamental rights, fundamentally the ones contained in the Declaration of the Good People of Virginia, 1776.

¹¹ As of the Supreme Court decision which aired *Marbury vs. Madison* case (5 U.S. 137 1803), the material superiority of the Constitution was enthroned (*judicial review of legislation*).

¹² Usually at this point, it is paradigmatically cited the Connecticut Compromise, which allowed to conclude a matter of deep conflict during negotiations of the Constituent.

¹³ A paradigmatic example of the evolutionary process is the British case and the subsequent laws extending the right of suffrage.

Having said that, the discussion between the potential tensions between economic freedoms and political homonymous would be resumed, by the mid-twentieth century, regarding the new-born processes of development. From those, Bhagwati (1966) will coin the concept of cruel dilemma to describe contexts in which political and economic freedoms did not evolve together. In this sense, and, as a contemporary example, Hayek (1966/2001: 35) will explicitly state how the goals of liberalism and democracy are different¹⁴.

All of which, in a way, seemed to reassert the thesis about History suggesting, overall, that capitalism, if not sufficient, is a necessary condition for political freedom (among others, Friedman, 1962/2012: 23, and Chang, 2010: 4)¹⁵. And that, since capitalist development affects both to the dynamics of the distribution of power as to what pertains to the creation of new political-economic incentives for ordinary citizens and elites¹⁶. That is, while the first ones consent to the introduction of universal suffrage and transfer programs to reduce inequality, the latter acquired stimuli for the defense of the market system (worthy respective examples are the manifesto of the German Social Democratic Party¹⁷ of the Gotha Conference held in 1875 and Olson, 1993).

However, the lack of a universal developmental pattern between economic and political freedoms to achieve economic success, as specified by the results obtained by institutional economics highlighted in the previous section, has guaranteed that the debate on the cruel dilemma, from the subjective perspective inherent to the development of Political Economy, can not find, by its own nature, an unequivocally conclusive ending.

3. From the cruel dilemma to the democratic inevitability: *Smithian* foundations and economic-political praxis

To the neutrality of the political system for economic development deduced from the Modern Growth Theory and the absence of a universally extrapolated pattern between growth

¹⁴ Furthermore, the author (1944/2008) is concerned about the possibility that an increase in the power of government, even democratic, could lead to totalitarianism.

¹⁵ Thus, the reduction of social inequality with respect to pre-existing levels of economic development motivates the claim that "the more inegalitarian societies have been throughout history, the more partial –and the more partial, the more disfiguring–their representation has become, as less have counted the stories of those who have been reduced to the status of mere expelled: the miserable, the dissidents, the subjugated, the different"(Blanco Valdés, 2010: 35)

¹⁶ *In extenso*, "economic development motivates institutional change through three distinct channels. On one hand, the increase of wealth creates greater demands for qualitative improvement of institutions. Second, economic growth contributes to the implementation of better institutions. Finally, development itself encourages the demand for new institutions" (free translation from Chang, 2010:4).

¹⁷ The term referred was officially adopted in 1890.

and democracy from the results obtained by empirical approaches of Institutional Economics adds, as well, the impossibility to come to an unchallenged conclusion in the debate on the cruel dilemma from the subjective perspective of Economic Thought.

Consequently, it seems plausible to claim that the link between political formula and economic growth will not be predetermined in one way or another, but constructed (in general terms, Popper, 1984, in particular, by way of illustration, Hirschman, 1995/1996: 260, Bhagwati, 2002, and Cardoso, 2004: 11). In other words, both from the proposals of the History of economic Ideas as well as from the empirical results highlighted by Institutional Economics, it might be concluded that the preference for a democratic or dictatorial political system as a premise for economic development would hide an entirely axiological foundation.

Nevertheless, from the economic point of view, and, regardless the result of the balance of forces of power in a society determining the adoption of a political system or another, two main reasons motivate the claim about the inevitability of democracy and hence, the absence of the cruel dilemma.

For one thing, the theoretical framework revealed by Adam Smith about the evils of power concentration and, therefore, about the benefits the stimulus of competition may bring. For another thing, unrefuted by the analysis of Economic Theory in terms of well being, it allows a favorable reading of the democratic systems, in which the separation of powers becomes in an institutional quality by law. In this sense, the American constitutional experience is revealed as paradigmatic.

Furthermore, regardless of the actual degree of electoral competition in each singular State, it is also true that the very existence of this is revealed as a differential quality of democracy. In other words, the ability to unseat the ruling party would reflect, commercial transcript included, an approach to the stage of perfect competition, at the time, the ideal balance point for welfare maximization with respect to the monopolistic position played by a dictatorial government.

Additionally, political freedoms associated with a democratic regime also have an impact as regards the performance of the human capital of a State, enhancing efficiency. And this is done by two means.

On one hand, the absence of purging, rights restrictions ..., especially with regard to freedom of expression and of inquiry, permit the full use of human resources (as in Mill, 1859/1990: 136; recently, Sen 1990/2000). That is, to get to a situation of permanent position on the static Production Possibilities Frontier, at least as far as human capital is concerned. Not surprisingly, democracies exhibit higher levels of social capital (quoted as an example,

Young and Lindstrom, 2009), essential for growth (Putnam et al., 1993 or Knack and Keefer, 1997).

On the other hand, efficiency would meet democracy halfway thanks to the unrestricted mobility of human capital in democratic systems. Thus, taking the *hirschmanian* idea of *exit* (Hirschman, 1971/1977), it can be expanded in terms of job relocation within the same State with minor prohibitions, as far as the sectoral-geographical mobility is concerned (especially in areas such as Arts or Research).

Secondly, by extending the time frame of the empirical analysis of institutional economics (in its defense, it is worth alleging the dependence of some data bases dating shortly back in time), the almost ubiquitous relationship between wealth and democracy (Rodrik, 2011, a fact that also follows from the dominant political system of States that shape the G20), and the pro-democratic mimic effect exerted by any population with the capacity to undertake it (effects from the well-known *Arab Spring* are paradigmatic), underscore the intimate connection between prosperity, both in renta per capita and in terms of human development (UN, 2013), and democracy.

However, as a corollary, an additional point should be emphasized. While the scale of human needs motivates, if necessary, a sacrifice on the sphere of political freedom for the promise of material well-being (Maslow, 1943), the Great Recession is spotlighting just the contemplation of the antithetical phenomenon befallen as a result of the Second Great Depression in the decade of the Thirties of the Twentieth Century: the hysteresis of freedom.

That being said, a different issue is that, for the consolidation of democracy, it would be necessary to undertake an analysis of the ability of the former to survive within virulent political-economic environments and, therefore, of the democratic procedures to be put to that service¹⁸. But that's another story...

¹⁸ Illustratively, Sanz Arcega (2012).

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