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Civilizing Society

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Abstract
This paper attempts to answer two important questions in economics. First, what virtues are important for promoting economic progress? Second, what is the source of these virtues? To answer these questions, I rely on recent studies suggesting that the virtues of trustworthiness, tolerance and respect, and individual determination are important for understanding how civil society supports economic prosperity. Specifically, trust, respect, and individual motivation encourage and support economic freedom. I also explore competing explanations for the determinants of virtues including religion, the role of government, and the act of economic exchange for civilizing society. My analysis finds support for the latter source.

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I. Introduction

The link between economic institutions, such as well-defined and secure property rights and the rule of law, and economic development is well documented in the literature (Montesquieu, 1748; Smith, 1776; Demsetz, 1967; Hayek, 1960; Bauer, 2000, North, 1990, 2005; Keefer and Knack, 1997; Rodrik et al., 2004; Acemoglu and Johnson, 2005). North (1990, 2005) argues that institutions provide the rules of the game that structure political, economic, and social interaction. These constraints provide the incentives and information to facilitate production and exchange, investment, technological innovation, and entrepreneurship that are necessary for economic development. The empirical research supports this positive

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causal relationship between the institutions supporting economic freedom and prosperity (Gwartney et al.,1999; Acemoglu et al., 2001, 2002; Cole, 2003). Rodrik et al. (2004) summarize this robust finding as "Institutions Rule."

More recently, economists have been pinpointing specific institutions that are important for economic development. An outgrowth of this research is to separate institutions into their formal (government provided and enforced) and their informal (privately provided and enforced) components. An emerging result supports the importance of informal constraints in promoting economic development through its effectiveness in defining and enforcing rules that promote secure property rights, exchange, and the observance of contracts (Anderson and Hill, 1979; Benson, 1989a, 1989b; Greif, 1993; Greif et al., 1994; Stringham, 2002, 2003; Nenova and Hartford, 2004; Acemoglu and Johnson, 2005; Leeson, 2007a,b; Tabellini, 2007; Williamson, 2009). These constraints stem from social norms, culture, customs, and traditions. Thus, a society's virtues are at the core of any institutional arrangement and the subsequent incentive and information structure that is formed to guide social and economic behavior.

This paper attempts to understand more specifically the influence that virtues exhibit on economic development. My conjecture is that virtues promote social cooperation by reducing transaction costs and the costs of monitoring, generating commonalities and focal points, and creating broad rules to guide behavior leading to more economic exchange and production, higher investment, and more entrepreneurship. These interactions form the core or "institutional glue" necessary for the economic institutions supporting a free and prosperous society to be effective.[1]

My approach is twofold. I focus on addressing two important questions. First, which virtues promote economic freedom and development? Second, can we identify determinants of these specific virtues? To answer these questions, I rely on analysis provided in the economics literature including theoretical, conceptual, and empirical studies. My analysis is a natural extension of the institutional literature and centers on understanding how virtues help to form the necessary constraints that promote economic freedom and development.

[1] See Boettke et al. (2008).

Instead of focusing on traditional virtues such as justice, prudence, and love, as discussed by McCloskey (2006), for example, my analysis attempts to complement such studies by centering on virtues directly supporting economic exchange and production, entrepreneurial activities, and the provision of public goods. The three main virtues identified in the literature that are expected to encourage and support market activity are trustworthiness, respect, and individualism.

Section 2 provides an overview of each virtue in detail, explaining how these virtues affect and promote economic exchange and production and thus provide the foundation for freedom. Section 3 explores the second question and attempts to explain possible sources of values, beliefs, and culture. This section addresses several possible explanations in the current literature with particular emphasis on two main sources. Formal institutions and government behavior could determine and affect a society's virtues. One argument is that in the absence of a virtuous society, government may be necessary to fill the void. A second explanation is that government may be the source of the absence. I explore each in detail, finding support for the second argument. In addition, I investigate an alternative hypothesis in which engaging in market activity, i.e., trade, may enhance and nurture our virtues. Section 4 concludes with the implications of the analysis.

II. The Three Virtues

Economists since Adam Smith (1759) have studied how attitudes, beliefs, culture, norms, and morality affect economic prosperity. We have a general understanding that virtues are important for supporting social cooperation, but pinpointing which ones matter and how they matter has been more elusive. My conjecture is that virtues are important because they promote economic freedom and the supporting institutions that in turn promote economic development. This section attempts to specify which virtues are identified as serving this role.

Currently, the most general attempt to provide an analysis of which virtues are important is found in the recent work on culture and development (Barro and McCleary, 2003; Licht et al., 2004; Pejovich, 2004; Francois et al., 2005; Jones, 2006; Tabellini, 2007, 2008; Shirley, 2008). This work focuses on how different cultural characteristics determine the performance of a society by framing the perceptions of individuals regarding opportunities and alternatives (North, 2005). Guiso et al. (2006, p.23) defines culture as "…those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation." Starting from this general definition, the literature has focused on several specific indicators, including values, beliefs, trust, and respect for others, which are relevant to social and economic interaction.

Drawing from several bodies of literature, I identify three main virtues as being the most important for forming the core of any society's institutional structure that guides economic activities.[2] These virtues, trustworthiness, respect, and individual self-determination, encourage social and economic exchange as well as production and entrepreneurship. I provide supporting theoretical and empirical evidence below.

1. Trustworthiness

The virtue of trustworthiness and its function in a market economy is highlighted by Smith (1759). Smith argues that trust is one of the most important virtues needed to sustain a vibrant exchange economy. Trust and reciprocity are a significant foundation for the roots of any market exchange. Through the process of joint exchange, trade relationships emerge. The process of trade can continue because of the trust relationship established. This relationship promotes increased interaction leading to a further extension of the market. Thus, the Smithian gains from trade are born. Smith also argues that as an economy continues to develop it markets, trustworthiness will become even more important to sustain and promote economic exchange.

Klein (2000) defines trust as a confidence that an individual who makes an agreement will follow through with the terms of the promise. Therefore, all economic activities that require some future involvement will need an element of trust. In fact, it can be argued that every commercial transaction involves some level of trust. Individuals with higher trust societies spend less time diverting resources to protect themselves to avoid being exploited and more time engaging in productive activities. In other words, trust reduces the transaction costs of engaging in market exchange leading to

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[2] I recognize that these are not the only important virtues for a society; however, they are the most heavily discussed throughout the economics literature.

increased market production and more efficient outcomes (Dixit, 2004). A lack of trust between individuals creates additional barriers to economic interaction resulting in individuals trading among small networks rather than expanding into anonymous market participation. This discourages innovation, entrepreneurship, and investments in both human and physical capital.

The literature on social capital also highlights the important role that trust can play in encouraging social cooperation. Specifically, the level of trust raises or lowers the productivity of a society's institutions (Coleman, 1988; Putnam, 1993; Fukuyama, 1996). According to Coleman (1988), social capital is a key productive ingredient for the achievement of certain goals that otherwise would not be attainable. Jacobs (1961) argues that informal networks present in thriving cities depend on a level of trust and reciprocity between traders, shop owners, and consumers. It is these networks that ultimately create and sustain a successful city. Trust is also needed in situations where interactions are infrequent. This includes settings such as local governments' provision of public goods, university administration, government bureaucracies, or any large-scale organization (La Porta et al., 1997).

In higher trust societies, individuals do not need to rely as much on formal institutions to enforce contracts and agreements. This becomes especially important in countries without access to formal legal enforcement mechanisms. By reducing the cost of monitoring and lowering transaction costs, trust can encourage secure property rights (Williamson and Kerekes, 2009). Interpersonal trust can partially substitute for government enforcement when governments are simplly unable or unwilling to provide it (Knack and Keefer, 1997). In addition to possibly substituting for government, social capital may also improve the performance of government by providing additional checks on government self-interest (Putnam, 1993).

The role of trust in the empirical literature has become increasingly more important in explaining difference in cross-country performance (Knack and Keefer, 1997; Woolcock, 1998; Francois and Zabojnik, 2005; Chan, 2007). The existence and evolution of social networks and trust is a large determinant in a country's growth rate and standard of living. Also, trust has been shown to promote secure property rights, increase investment, and entrepreneurship. A lack of trust between individuals creates additional barriers to economic interaction resulting in small networks rather than anonymous market participation. When individuals do not expand market activity, we do not realize Smith's gains from specialization under the division of labor. In summary, the literature suggests that trust promotes social cooperation and encourages more exchange relationships, which translates into higher levels of economic development and growth.

2. Individual Self-Determination

The second virtue captures how individuals make choices regarding their efforts toward succeeding in life. If a person is highly self-motivated, then fewer rules are required to persuade that person to better their economic welfare. However, the more "lazy" a person becomes, it may be necessary to require a different set of rules to motivate that person. This implies that self-determination cannot be assessed without understanding the context behind the choices (Section III discusses this in more detail below). According to Smith, every individual possesses "the propensity to truck, barter, and exchange." This natural propensity will determine the extent of economic production and exchange. However, how hard individuals choose to best apply their efforts depends on the return from engaging in certain activities. If it is more profitable to seek opportunities in the marketplace, then individuals will do so, thus promoting economic advancement. Conversely, if individuals view success as a result of external events, they are more likely to have a passive, resigned, and lazy attitude toward economic activity.[3] Therefore, individual self-determination is influenced by whether individuals reap the benefits or consequences of their actions. This in large part will depend on the institutional environment in which the individual exists.[4]

Individual determination depends on the perception of how actual effort translates into actual success. Individual drive depends on the level of self-control individuals believe they have over their life choices. An extension of this argument is that individual choice

[3] Banfield (1958) contrasts a rural village in Southern Italy with rural communities in the United States. He found that the Italian peasants had developed a sense of helplessness, whereas the rural Americans seemed individually motivated.

[4] This virtue highlights the feedback process between individual attitude and beliefs and government-provided institutions. This relationship will be further discussed in Section III.

depends on how much control you feel you have over your life. When individuals think that they have control over their lives, they will be more likely to find ways that improve their welfare. The more likely an individual views economic success as being determined by one's own will, the more likely these individuals will engage in productive, future-oriented activities. These activities include things like hard work, investment in human capital, and undertaking entrepreneurial actions. However, if individuals view the likelihood of succeeding as a product of luck or political connections, they will tend not to engage in productive economic and social activities. Instead, they may choose to channel their energies toward unproductive activities such as rent seeking. This attitude towards economic activity will surely impact economic development in a country (Banfield, 1958).

A direct application of this argument can be found in Baumol (1990). He hypothesizes that individuals channel their effort in different directions depending on the type of existing legal, economic, and political institutions. This institutional environment determines the relative payoff to investing entrepreneurial energies either in market, wealth-creating activities or in wealth redistribution through unproductive political and legal activities. The incentives provided by the prevailing institutions will determine how individuals pursue entrepreneurship and whether these activities will support high rates of economic growth.[5]

3. Respect

The third virtue, defined as tolerance and respect, distinguishes between generalized versus limited morality. According to Platteau (2000), in hierarchical societies, honesty and norms promoting good conduct are often confined to small networks such as family members or tribal members. It is morally acceptable to engage in highly opportunistic and dishonest behavior outside of the group. Banfield (1958) discovered that in a rural Italian village the principle of good versus evil applied to members within the family only. Principles regarding moral behavior do not apply to outside members. Other societies may develop abstract rules to guide social interactions in a generalized sense in order to promote morality among anonymous members of society. These two distinct types of

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[5] Baumol's theory is supported empirically by Sobel (2008).

morality have economic consequences or benefits including the provision of public goods in a local community and the monitoring of political representatives (Banfield, 1958; Putnam, 1993).

The notion of respect is connected to the concept of trust discussed above. In societies with relatively high levels of social capital, individuals will be more trusting of others who are outside their direct kin and friendship networks. Abstract rules facilitating cooperation among friends and strangers may emerge, increasing the extent of social networks and the market. In contrast, in societies with lower levels of social capital, and hence lower levels of respect, the extent of the market will be limited to close kin and friendship networks. Rules that facilitate the extent of social networks and markets will fail to emerge.

A relevant implication of generalized versus limited morality is that more respectful societies will find it easier to enforce contracts and secure property rights without relying on formal legal enforcement. Stringham (2002, 2003) finds supporting evidence for this claim; he presents evidence showing that the emergence of both the London Stock Exchange and the Amsterdam stock market relied on repeated interactions and reputation effects. In the absence of government provision, these repeated dealings lead to the development and enforcement of abstract rules governing the trading of securities. This example shows that individuals will find it more profitable to engage in widespread market exchange and production even when government legal institutions are lacking. Also, more respect can lead to individuals being less likely to free ride off other members within their community. This can help to provide many key public goods such as participation in political activities (Putnam, 2000), provision of roads (Klein, 2000), and monitoring of political representatives (Banfield, 1958). If individuals lack respect for other members of their community, highly opportunistic behavior will be likely, property rights will be insecure, and public goods provision will be inadequate, leading to lower levels of economic development.

These three virtues have real consequences for the development of economically free institutions that support prosperity as each virtue promotes and encourages activities such as widespread trade, investment in human and physical capital, and innovation, which support economic development. Tabellini (2007) verifies these relationships by utilizing data from the World Values Surveys to combine all three traits into one index for each country.[6] Tabellini finds that this index displays a strong positive and significant relationship with economic development. In a cross-country comparison, a higher index (high levels of trust, respect, and determination) leads to higher levels of income. His analysis concludes that formally arranged institutions may not be the most important factor for growth because of the role played by these attributes.[7] This supports the argument that the virtues of trust, respect, and individual self- determination are important in providing the foundation for a market economy.[8]

III. Promoting a Virtuous Society

The above section presented three core virtues that are important for creating economic institutions. The next logical step is to ask what promotes and determines these virtues. Recent attempts have been made to try to understand what influences culture, values, trust, and social capital. This section summarizes these studies, focusing on two particular themes in the literature. First, what role does the government serve in directing our virtues? Second, I focus on how markets affect our virtues with particular emphasis on the role of trade.

Our virtues may not be truly exogenous. Putnam (1993) argues that trust is formed from an extended period of building relationships from commercial and civic activities. These associations are influenced by the type of structures imposed on society. For example, he states that the Catholic Church imposes a hierarchical structure that discourages trust formation. This can be generally applied to all of our virtues for which a hierarchical religion may discourage trust,

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[6] This is achieved by summing trust, control, and respect. This comprehensive measure is converted to a relative scale ranging from 0 to 10, with 10 representing the country with the strongest culture conducive to economic development and 0 representing the country with the weakest culture that encourages economic progress. Countries with the highest culture scores include Sweden, The Netherlands, and Denmark, whereas those ranking in the bottom are Uganda, Tanzania, and Algeria.

[7] Williamson and Kerekes (2009) find that Tabellini's culture measure is one of the most significant factors in explaining the security of private property across countries.

[8] Similar work on civil institutions supports the positive and significant relationship between economic freedom and development (see Knack and Keefer, 1995, for example).

respect, and individual determination.[9] La Porta et al. (1997) empirically find that trust is lower in countries with dominant hierarchical religions. This argument is similar to Weber's (1905) thesis. According to Weber, Calvinism (Protestantism) induced individuals to engage in hard work, market exchange, and wealth creation, providing the foundation to capitalism.[10] Empirically, his thesis is supported by Grier (1997), who confirms the positive effect of Protestantism on economic performance.

Knack and Keefer (1997) also undertake an empirical investigation into determinants of trust and civic cooperation. They test the effects of group memberships, polarization and inequality, formal institutions, income levels, and education rates. Their results find a positive and significant effect on trust from both income levels and educational attainment. Putnam's group membership does not display a significant effect on the level of trust, whereas income inequality does contribute to lower levels of trust and norms. As ethnic homogeneity increases, so does the level of trust within a country. The formal measure of institutions, Polity IV's Constraints on the Executive, positively and significantly impacts trust. This result suggests that formal institutional rules preventing arbitrary acts from the government are an important influence on a society's morals, norms, and virtues. This last finding highlights an important area that needs further exploration: how does the government influence our virtues?

1. The Role of Government

The relationship between formal institutions and virtues is complex, with each influencing one another, suggesting that virtues may not be completely exogenous. This subsection attempts to understand this relationship in more detail.

In the absence of a virtuous society, it may be necessary for government to take a more active role in creating and sustaining rules and regulations to support economic growth. The operation of a market economy depends on the ability of individuals to develop relationships built on trust. In order for people to enter into contracts and engage in exchange, some element of trust must be present.

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[9] Hierarchical religions included Catholicism, Eastern Orthodox, and Muslim.

[10] For an extension of Weber's work ethic applied to the Junkanoo ethic in the Bahamas, see Storr (2006).

However, when these virtues are not present, government may find it beneficial to establish more rules to govern our lives.

This idea behind Putnam's arguments was first presented in *Bowling Alone: The Collapse and Revival of American Communities* (2000). Putnam contends that the market economy, essentially anonymous trading, is undermining American civil society and driving individuals to become more isolated, weakening democratic governance. As Putnam, and in general communitarian political philosophy (see Hodgson, 1998, for example), argues, what is needed to counter this dehumanizing process of the market is more civic engagement and participation in democratic festivities. This line of reasoning implies that government should intervene and provide public policies encouraging activities that foster a sense of community. Democracy is needed to civilize society, as the market process will undermine those virtues, such as trust and respect, that are necessary for contract and property rights.

While this argument may seem plausible on the surface, a deeper analysis suggests that governments are often a source of extortion and interference rather than a productive unit providing necessary rules to promote increased market interactions. Governments do not always make decisions based on public interest, but often choose policies more in line with politicians' interests and those of special interest groups. When governments behave in such predatory behavior, individuals living under those rules may begin to alter their views, culture, and values. As such, the informal rules guiding social and economic interactions may begin to break down. For example, governments may have written formal political constraints, such as a constitutional rule preventing public expropriation of private property. However, if officials fail to actually abide by these institutional rules, different informal beliefs and customs, such as lower levels of trust among individuals, may start being adopted.[11]

As a consequence, societies may become more corrupt due to government actions and regulations. For example, Garrett and Sobel (2003) illustrate how political favoritism and pressures play a significant role in government natural disaster relief efforts and

[11] Ricketts (2000) attributes the decline of reputational mechanisms and ethos in the financial sector to an increase in government regulation. As government has taken over regulation of lending practices, lending institutions do not have the incentive to compete on character and reputation, leading to a decline in corporate responsibility.

financial support. In a follow-up study, Leeson and Sobel (2008) attribute part of U.S. corruption to the new opportunities created for theft from FEMA-provided natural disaster relief. This argument is similar to results emerging from the literature examining the effects of foreign aid on government quality. Svensson (2000), Knack (2001), and Djankov et al. (2006) provide powerful evidence that aid destroys democratic institutions in recipient countries. According to this argument, foreign aid shifts the incentives away from productive behavior to unproductive activities such as rent-seeking, political corruption, bribery, and political fighting. The result is a deterioration of democratic and economic institutions including a society's norms, values, and culture that guide everyday interactions.

Leeson (2005) provides another example of how government institutions can create a distrustful, more fractionalized society. He explains how the imposition of formal institutions not in line with informal norms and values in pre-colonial Africa resulted in a fractionalized continent. Colonial institutions created noise in preestablished signaling devices, inhibiting widespread cooperation and eliminating any economic and cultural benefits from widespread exchange. By stifling trade between diverse groups, formal colonial institutions caused groups to have a lower tolerance for other tribes, lowering the amount of trust and respect between groups, and contributing to Africa's poor economic growth.

Meadowcroft and Pennington (2007) provide an explanation as to how governments may do more harm than good when trying to "supply" virtues. The development of "bridging" social capital requires a level of generalized trust between parties. This code of conduct will be built from a common set of *morals*, generating a higher level of tolerance and respect for other individuals who may be very different from oneself. This emerges as a result of many social and economic interactions in which individuals find it in their self-interest to figure out ways to cooperate with each other. If government attempts to step in and provide and enforce a common set of *goals*, this more than likely will lead to conflict and social disintegration as government typically does not have the right incentives or the necessary information to supply generalized rules. Instead of providing and enforcing abstract rules that apply to everyone, governments typically fall prey to political interests such that rules targeted at specific groups and specific ends are more likely to materialize.

For example, McChesney (1990) highlights what can happen when government uses its powers to regulate specific groups. From 1887 to 1934 the U.S. government chose to allocate Native American rights to reservation land based on a large, complex system that defined land inefficiently in order to maximize bureaucrats' budgets. The beneficiary from both the process of privatization and the end of privatization was not the Native Americans; it was government politicians. The result of taking informal land rights and creating a formal land structure did not enhance social welfare but political welfare. The implications of such policies will more than likely have lasting effects on Native American attitudes and belief systems, complicating future transactions.

In summary, the government's attempt to provide social capital, morality, and virtues will more than likely lead to the destruction of a virtuous society instead of the creation of one. Even if a society's virtues are not at their "optimal" levels, the state having the correct incentives and adequate information to fill in this gap is highly unlikely. The government's ability to culturally plan will fail on the same grounds as economic planning. A government's productive role in enhancing society is based on providing fundamental institutions and limiting regulations and interventions in a market economy, allowing civil society to evolve on its own.

2. The Role of Free Trade

> "The crossroads of trade are the meeting place of ideas, the attrition ground of rival customs and beliefs; diversities beget conflict, comparison, thought; superstitions cancel one another, and reason begins."
>
> –Will Durant, *The Life of Greece*

Instead of emphasizing how governments can "culturally plan" and build our social capital, in this section I argue that we should focus on another avenue for positively enhancing our virtues. This avenue is one of participation in production, exchange, and trade relationships. Although some critics argue that it is actually the market that erodes our morals (for example, see Plant, 1999), this section focuses on how engaging in market transactions increases our tolerance for others, builds trust and respect, and enhances other virtuous attributes. In addition to the gains associated with economic exchange, the exchange of ideas has the impact of shaping the values, perceptions, and beliefs of those participating in these interactions. These changes in values subsequently impact the evolution of social and economic interactions. In other words, a market economy not only provides economic benefits but it actually creates a more civilized society.

Hayek argues that one of the most important components to civil society is participation in markets. The exchange order, or the catallaxy, means to bring a stranger into friendship. Through the process of exchanging, individuals learn how to communicate, cooperate, and trust one another. As the economy moves from small group interaction to one built on anonymous market participation, a society also transitions from uncivilized to civilized. Bauer explicitly makes this argument for the process from a subsistence economy into an exchange economy, which creates not only wealth-enhancing opportunities but also a transformation of traditions, norms, and values.[12]

Whereas Putnam views the market as undermining civil society, Hume and Smith state that commerce will be a civilizing force contributing to social cooperation. Market interactions are based on general rules that reward productive, cooperating individuals and punish those who engage in predatory behavior. Our interactions in the marketplace teach us habits and values such as hard work and honesty. Trade not only provides economic benefits through specialization and the division of labor, but it also provides us with cultural benefits (see Storr, 2009, for example). Trade leads to new opportunities for interaction and increases the market for ideas, beliefs, and values. Through market participation, individuals gain exposure to knowledge, innovation, and alternative ways of life. This allows for cultural and institutional competition, experimentation, and evolution.[13]

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[12] Openness to trade has impacted culture for centuries. In his detailed history of trade, Bernstein (2008) traces the non-economic influences of trade to ancient Mesopotamia.

[13] To illuminate this point, consider the markets that developed in Antwerp and Amsterdam in the late 17th and early 18th centuries. Although there were thriving markets in economic goods such as herring, salts, spices, and wool, there was also a flourishing exchange of published materials containing ideas regarding free and critical thought as well as alternative religious views (Bernstein, 2008).

McCloskey (2006) contends that markets and exchange nourish and cultivate individual character, virtues, and ethics for the better. Most critiques of capitalism attack it on a moral basis, arguing that markets alienate us from one another and destroy the communal spirit. McCloskey argues the exact opposite. Specifically, the values created from an exchange economy not only serve as a vehicle for material progress but also as a medium for human flourishing. She explicitly argues that "participation in capitalist bourgeois virtues has civilized the world" (p.26). She notes that markets are frequently an "occasion for virtue, an expression of solidarity across gender, social class and ethnicity" (p.4). In short, capitalism is good for the soul.

In terms of the social capital literature (Meadowcroft and Pennington, 2007), global expansion of markets has allowed communities that have little in common to become connected by trade, thus leading to the development of a more inclusive "bridging" social capital. In addition, a market-based economy can support both "bonding" and "bridging" capital, further reducing transaction costs. People involved in such trading relationships must obey a set of moral rules even though they may have little in else in common.

Economic exchange contributes to a more civilized society through enhancing our three main virtues discussed above. For example, trade provides individuals with new alternatives and opportunities. Therefore, it is a way to increase self-autonomy and "locus of control," thus increasing individual self-determination. The market increases the choice set facing individuals, giving them increased control over their lives and empowering individuals. A related benefit of economic exchange interactions is that integration reduces transaction and information costs. As individuals build economic relationships, this creates commonalities that reduce the costs associated with interaction and exchange. These reduced transaction costs lead to increased interaction, which fosters trust and respect, thus contributing to the growth of social networks and the extent of the market. In addition, as trade networks evolve, abstract rules and expectations governing interaction and cooperation emerge. These general rules may begin to displace the insider-outsider mentality, fostering a more generalized morality and increasing the level of respect.

Cowen (2002) captures the essence of this view when he notes that individuals engaged in exchange "…expect those transactions to make them better off, to enrich their cultural lives, and to increase their menu of choices" (p.12). His claim is not that values are never eroded due to economic exchange, but rather that the process of "creative destruction" has the overall effect of enhancing our attitudes, cultures, and virtues. Stated differently, economic exchange and development have real effects on a country's culture, and on net those effects are beneficial. According to Cowen, economic exchange has both negative and positive spillovers on the non-economic aspects of a society, including values due to the exposure to new ideas, values, and beliefs. However, overall, he still views trade as a mechanism contributing to cultural enrichment.[14]

In summary, in addition to increases in material wealth, access to markets and economic exchange provides individuals with the potential to foster and influence other aspects of society. As individuals participate in anonymous market transactions and engage in exchange, they build relationships that in turn expose individuals to new knowledge, ideas, values, cultures, and virtues. These include trust, respect, hard work, and honesty. As a result, transaction costs are reduced, commonalities are created, and social cooperation is encouraged and sustained.

IV. Concluding Remarks

The "Institutions Rule" literature provides a framework for understanding how the rules of the game matter significantly for promoting economic development. In this paper, I present an argument in which virtues play an important role in structuring and forming any institutional arrangement. A society's ideas, beliefs, morals, and culture structure everyday social and economic interactions. These interactions cultivate general rules that promote social cooperation by reducing transaction costs, generating commonalities and focal points that lead to more economic exchange and production, higher investment, and more entrepreneurship. Therefore, virtues provide the foundation for economic freedom and development.

Virtues do not emerge in a black box. A society's morals are context dependent, indicating that individuals' attitudes and beliefs will respond to the institutional environment in which they operate.

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[14] Empirically, this relationship is explored by Coyne and Williamson (2009). This study supports the conclusion that trade openness is a determinant of culture beneficial for economic development.

Particularly, individuals respond to formal rules and government behavior. My analysis indicates that government's attempt to provide social capital, morality, and virtues will more than likely lead to the destruction of a virtuous society instead of the creation of one. A government's productive role in enhancing society is based on providing fundamental institutions and limiting regulations and interventions in a market economy, thus allowing civil society to evolve on its own.

Virtuous behavior will spontaneously arise because individuals will find it is in their self-interest to discover ways of cooperating with one another. In a commercial society in which individuals are engaging in economic exchange, the exchange of ideas, knowledge, and values will also result. During this process, relationships based on abstract rules, higher trust and respect, and a greater sense of self will emerge. In other words, a market economy not only provides economic benefits but actually creates a more civilized society. The invisible hand of competitive markets not only guides economic exchange, leading to the improvement of goods and services, but also provides the incentives for cultural exchange and improvement, which promote a more virtuous and free society.

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