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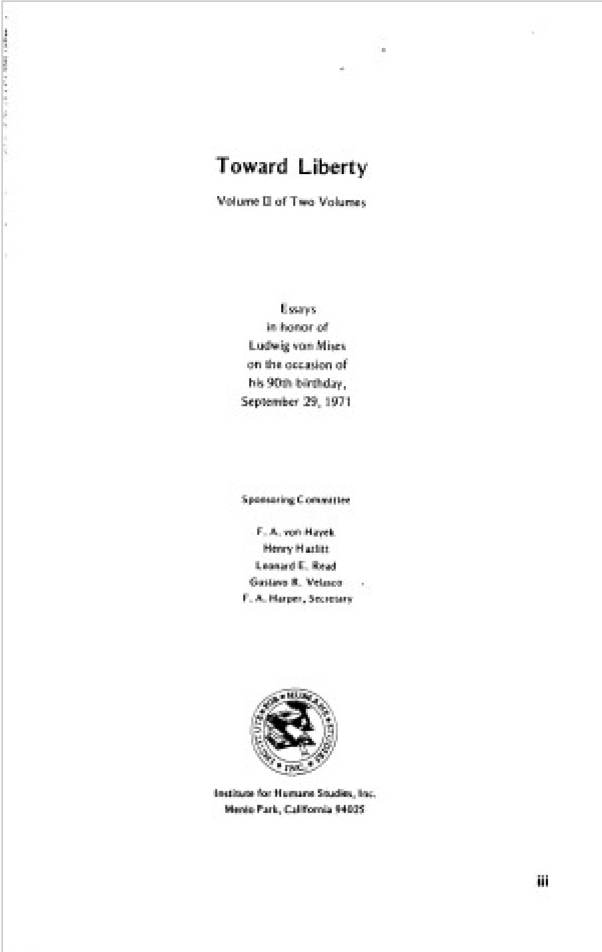

Toward Liberty

Volume II of Two Volumes

Essays
in honor of
Ludwig von Mises
on the occasion of
his 90th birthday,
September 29, 1971

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En Torno A La Funcion Del Capital
Joaquín Reig

(Algunas de las cosas que Mises nos enseñó)

"Marx utilizó, en sentido peyorativo, desde Juego, las palabras capitalismo, capital y capitalistas, al igual que hoy la mayor parte de las gentes las emplean ... Tales vocablos, no obstante, reflejan con extraordinaria justeza qué fué aquello que, primordialmente, provocó el maravilloso progreso de los dos últimos siglos, es decir, esa incesante mejoría del nivel de vida de unas masas humanas en contínuo crecimiento." (Mises).

Lo que los hombres lamentamos—sin, desde luego, la mayoría saberlo—es una capitalización insuficiente; nos quejamos de no disponer, en cuantía bastante, de aquellos medios necesarios para alcanzar los objetivos anhelados. Consumir más—a no dudar, lo deseado—exige mayor producción. Para ampliar ésta, sin embargo, preciso resulta disponer de supletorios instrumentos, merced a los cuales cabrá mejor aprovechar los recursos naturales disponibles. La obtención de tales factores presupone anterior ahorro: haber destinado parte de la previa actividad humana a la preparación de esos bienes económicos—capital—que el incremento de la producción requiere. Los problemas de nuestro tiempo, como desde el albor de la humanidad sucede, sólo a base de más capital pueden ser eficazmente abordados.

Lo dramático, sin embargo, es que el capital sólo aparece bajo una economía de mercado; en un orden social donde exista la propiedad privada de los medios de producción, los cuales, consecuentemente, pueden ser contratados, registrando así sus respectivos y correspondientes precios. El régimen colectivista tiene bienes de capital, pero no sabe qué sea capital. Porque el capital no es una cosa material, sino un concepto intelectual; es, en definitiva, el valor de mercado de los medios de producción que el sujeto económico tiene a su disposición. Y no son los factores disponibles lo importante para la producción, sino la utilidad social, el valor, en cada supuesto concreto, de aquéllos.

Hay minas, terrenos, aguas y múltiples riquezas naturales inexplotables por carecerse de los elementos complementarios necesarios para su aprovechamiento. No constituyen aquellos elementos capital; lo serán sólo cuando surjan, gracias al ahorro, los medios que permitan su explotación. El nivel de vida de un país no depende de las riquezas naturales que posea, sino de la cuantía del capital disponible. Véase el caso de Suiza, en un sentido, y el de China o la India, en el contrario.

Por eso, factores de producción, que, en cierto momento, fueron capital, pueden, después, dejar de serlo (con independencia de su desgaste). Supongamos una empresa ferroviaria, hace treinta años, con un parque de cien locomotoras de vapor, es decir, las, entonces, predominantemente empleadas. Constituían ellas, a la sazón, un capital importante. Esa misma empresa, ahora, con idénticas locomotoras, hallaríase, en cambio, totalmente descapitalizada, ya que, según todo el mundo sabe, dicho tipo de tracción resulta antieconómico, inexplotable. Las locomotoras de vapor, consecuentemente, carecen hoy de valor, de interés social, ya no son capital, aunque ayer lo fueron.

Ese instrumento mental que es el capital -basado en los precios del mercado- nos indica qué, cómo y cuánto producir, Si la organización social imperante impide recurrir a tal herramienta intelectual, la actividad económica toda se hunde en insoluble caos.

"Los empresarios -nos enseña Mises- invierten el capital, ahorrado por terceros, procurando satisfacer, del modo mejor, las más urgentes y todavía no satisfechas necesidades de los consumidores. Junto a los investigadores, dedicados a perfeccionar los métodos de producción, desempeñan los empresarios, inmediatamente después de quienes supieron ahorrar, papel decisivo en el progreso económico. Los demás no hacemos sino beneficiarnos de la actuación de aquéllos. Cualquiera que sea nuestra actividad, somo simples beneficiarios de un progreso al que en nada contribuimos.

Lo carac terístico de la economía de mercado es beneficiar a la inmensa mayoría, que recibe la parte del león de unas mejoras conseguidas gracias exclusivamente al actuar de aquellos tres grupos rectores, integrados por quienes ahorran, quienes invierten y quienes arbitran fórmulas nuevas que permiten mejor explotar los bienes disponibles."

Estas lucubraciones en torno al concepto de capital nos hacen ver el defecto básico del socialismo. El régimen colectivista, por definición, exige que ningún factor de producción quede en manos privadas. Dichos bienes son todos propiedad del estado o de cualquier otro único ente colectivo; no pueden ser contratados en ningún mercado y, por tanto, carecen de precios que reflejen su respectivo interés social.

Plantéase, en esta situación, al rector de la comunidad socialista el azorante problema de determinar cómo producir aquello que él mismo -por sí y ante sí, car tel est notre bon plaisir- haya decidido sea lo que más conviene elaborar. Se puede, desde luego, fabricar escupideras de oro o juguetes de molibdeno para los niños, cuando se desconoce el precio del oro y del molibdeno.

Mises sitúa la cuestión con su habitual claridad:

"Una ciudad puede ser abastecida de agua potable mediante transportar el líquido elemento desde lejanos manantiales a través de acueductos -método empleado desde los tiempos más remotos- o bien purificando, por unos u otros medios, el agua insalubre existente en la localidad. Pero ¿por qué no producir agua sintética? La técnica moderna ha tiempo resolvió cuantas dificultades tal producción plantea. El hombre medio, dominado siempre por su inercia mental, limitaríase a calificar la idea de absurda. La única razón, sin embargo, por la que no producimos hoy agua potable sintética -aunque tal vez mañana lo hagamos- es porque el cálculo económico nos advierte que se trata del procedimiento más caro de todos los conocidos. Eliminado el cálculo económico, la elección racional deviene imposible."

La contabilidad de capital nos permite saber si se gana o se pierde en la actividad económica; advertimos si lo que producimos vale más o vale menos que los factores invertidos. En el primera caso, nuestra actuación tiene interés social y conviene proseguirla; en el segundo, no, y debemos orientar el esfuerzo en otra dirección.

El dictador socialista, cercado siempre por las tinieblas que el propio sistema engendra, jamás puede servirse de esas clarísimas directrices con las que el mercado, a diario, en bien de los consumidores, guía al productor capitalista. La ceguera de aquél, sin embargo, hoy en día, todavía no es absoluta, pues, mal que bien, se orienta contemplando la actuación del mundo llamado capitalista. Se entera, así, de que no debe producir agua sintética, ni utilizar locomotoras de vapor, pero ha de cometer, no obstante, errores garrafales, por buena que su intención sea -cosa que jamás se discute- pues las situaciones no son nunca idénticas y cada problema económico hay que resolverlo según el momento específico y la circunstancia particular requiera.

Esta intrínseca falla del socialismo, descubierta por Mises hace cincuenta años, aunque al principio fué ampliamente discutida, ya nadie la pone en duda. Los socialistas informados -que, por desgracia, son pocos- desde hace veinticinco años no se atreven a discutir con el maestro; pretenden simplemente escamotear el tema. Se acabó para el socialismo el blasonar de científico; se ha transformado, simplemente, en una secta religiosa, cuyos dogmas no deben ser jamás sometidos al análisis lógico. El superior no se equivoca nunca, pues es -no lo dude nadie-infinitamente sabio y bondadoso. He ahí el absurdo mito en que todo el edificio intelectual socialista se apoya.

"Las gentes -nos recuerda Mises- frecuentemente califican de religión al socialismo. Y, ciertamente, lo es; es la religión de la autodivinización. El Estado y el Gobierno al que los planificadores aluden, el Pueblo de los nacionalistas, la Sociedad de los marxistas y la Humanidad de los positivistas son distintos nombres que adopta el dios de la nueva religión. Tales símbolos, sin embargo, tan sólo sirven para que tras ellos se oculte la personal voluntad del reformador. Asignando a su ídolo cuantos atributos los teólogos a Dios otorgan, el engreído ego se autobeatifica. También él es -piensa-infinitamente bueno, omnipotente, omnipresente, omnisciente y eterno; el único ser perfecto en este imperfecto mundo.

La economía debe rehuir el fanatismo y la sectaria ofuscación. Argumento alguno, desde luego, impresiona al fiel devoto. La más leve crítica resulta para él escandalosa y recusable blasfemia, impío ataque lanzado por gentes malvadas contra la gloria imperecedera de su deidad. La economía se interesa por la teoría socialista, no por las motivaciones psicológicas que inducen a las gentes a caer en la estatolatría."

Una vez aprehendido el concepto, fácil es percatarse de que, mediante manipulaciones monetarias, huérfanas de ahorro y simplemente ampliadoras de la masa dineraria, no se crea capital, ni por tanto riqueza. (Si ello no fuera así, lo mejor sería arrojar, con un helicóptero, toneladas de papel moneda a lo largo y lo ancho del país).

La Administración amplía la cuantía de los medios de pago, particularmente, otorgando créditos baratos, que el mercado no concedería, ya sea a través de sus organismos, ya sea induciendo a ello, por unos u otros medios, a la banca. La creación de billetes tiene importancia monetaria pero, a estos efectos, podemos pasarla por alto. La banca privada, nótese incidentalmente, bajo un régimen de libertad, no puede sino limitarse a administrar, del modo más acertado posible, los factores monetarios que encuentra dados. Su propia supervivencia le veda lanzarse a ningún boom expansionista.

El bajo interés de los aludidos créditos oficiales perturba la marcha de la economía, desembocando, al cabo del tiempo, en la temida crisis económica. Dichos arbitrismos crediticios dan, en efecto, lugar a inversiones -aparentemente lucrativas, dado el bajo interés que pagan- para las que no existen, sin embargo, los requeridos factores de producción. Los que, en las producciones alentadas por el crédito fácil, son invertidos, detráense, por desgracia, de otras, más conformes con los deseos del mercado consumidor, cuyas actividades consiguientemente quedan restringidas. Y la crisis es simplemente la purga, el correctivo, que obliga a abandonar empresas disconformes con las necesidades de los compradores. En tal sentido, aquélla, como la fiebre, constituye un bien.

Dice a este respecto Mises:

"Es el proceso democrático del mercado lo que origina la crisis. Los consumidores no están conformes con el modo cómo los empresarios emplean los factores de producción. Muestran su disconformidad comprando y dejando de comprar. Los empresarios, cegados por el espejismo de unas tasas de interés artificialmente rebajadas, no han efectuado aquellas inversiones que permitirían atender del mejor modo posible las más acuciantes necesidades del público. Tales yerros quedan al descubierto en cuanto la expansión crediticia se detiene. La actitud de los consumidores obliga a los empresarios a reajustar de nuevo sus actividades al objeto de dejar atendidas en la mayor medida posible las necesidades de las gentes. Eso que denominamos depresión es precisamente el proceso liquidatorio de los errores del auge, readaptación de la producción a los deseos de los consumidores.

En la economía socialista, por el contrario, sólo cuentan los juicios de valor del gobernante; las masas no tienen medios que les permitan imponer sus preferencias. El dictador no se preocupa de si las gentes están o no conformes con la cuantía de lo que él acuerda dedicar al consumo y de lo que él decide reservar para ulteriores inversiones. Si la importancia de estas últimas obliga a drásticamente reducir el consumo, el pueblo pasa hambre y se aguanta. No se produce crisis alguna porque las gentes no pueden expresar su descontento. Donde no hay vida mercantil, ésta no puede ser próspera ni adversa. En tales circunstancias habrá pobreza e inanición, pero nunca crisis en el sentido que el vocablo tiene en la economía de mercado. Cuando los hombres no pueden optar ni preferir, en forma alguna cábeles protestar contra la orientación dada a las actividades productivas."

El intervencionismo provoca siempre efectos contrarios a los que los patrocinadores del sistema aspiran a conseguir. Tal acontece, como no podía ser menos, con el intervencionismo de tipo monetario que contemplamos. Se desea, al multiplicar los medios de pago, reduciendo el interés, incrementar la producción; y lo único que se consigue es malinvertir los siempre escasos factores de producción disponibles; o sea, disminuir, al final, el valor de lo producido.

Con todos los precios sucede lo mismo. Los máximos, aquéllos por encima de los cuales no se debería comerciar, precisamente porque el bien en cuestión es considerado de grande interés social, dan lugar a que las explotaciones marginales, al devenir antieconómicas, dejen de producir, con lo que no se amplía, sino que se reduce la producción y el número de quienes efectivamente consiguen disfrutar de la tan apetecida mercancía. Hay, por tanto, mayor escasez; talmente lo que se quería evitar.

Los precios mínimos operan igual, aunque con signo contrario. Hacen aumentar, ponendo en marcha ofertas marginales, la cuantía de unos bienes que, dadas las circunstancias concurrentes, ya resultaban excesivos y cuyos precios, por eso mismo, declinaban. Aparecen los indisponibles excedentes, con los que nadie sabe ya qué hacer.

“Existen y han existido siempre -afirma Misespartidarios de la regulación coactiva de los precios y que, sin embargo, de modo categórico, proclaman ser partidarios de la economía de mercado. El poder público puede, en su opinión, alcanzar los fines que se propone mediante la fijación de precios, salarios y tipos de interés, sin abolir en modo alguno ni el mercado, ni la propiedad privada de los medios de producción. La regulación coactiva de los precios constituye el mejor -o más bien el único-procedimiento para conservar el régimen de empresa privada e impedir el advenimiento del socialismo. Pero indígn anse hasta el paroxismo si se les refuta y se les demuestra que la interferencia en los precios, apar te de empeorar la situación, fatalmente conduce al socialismo.”

Y esto nos lleva al problema de los salarios. Todo trabajador por cuenta ajena, como es natural, desea aumentar sus ingresos, pues quiere vivir mejor (no importa si es en el aspecto espiritual o en el material). Para elevar los salarios han sido ideados arbitrios múltiples. Pero las rentas laborales reales únicamente aumentan cuando se incrementa la productividad del laborador y esto, a no ser que el interesado desee trabajar más, sólo se consigue poniendo a disposición del operario una mayor y mejor constelación de instrumentos de producción previamente elaborados; en otras palabras, más capital.

El capital, que el ahorro crea, abre la posibilidad de iniciar nuevas actividades; crece, con ello, la demanda de trabajadores. Los salarios tienden al alza y se financia ésta, sin perjuicio para nadie, con la supletoria producción que la mayor capitalización lleva aparejada.

“La única diferencia -dice Mises- existente entre las condiciones de trabajo de la era capitalista y de la precapitalista y, aun hoy, entre los países atrasados y los occidentales, consiste en la distinta cuantía del capital disponible. El incremento per capita de este último eleva, por una parte, la utilidad marginal del trabajo y, por otra, abarata las marcancías. Ningún adelanto técnico cabe adoptar si previamente no ha sido ahorrado el correspondiente capital. Sólo el ahorro, la acumulación de nuevos capitales, ha permitido ir, paulatinamente, desterrando la penosa búsqueda de alimentos a que se hallaba obligado el primitivo hombre de las cavernas e implantar, en su lugar, los fecundos métodos modernos de producción. Tan trascendental mutación fué posible gracias a aquellas ideas, amparadoras de la propiedad privada de los medios de producción, que, proporcionando garantías y seguridades, permitieron la acumulación de capital."

La coactiva elevación de las retribuciones salariales no eleva, en cambio, la renta de la masa trabajadora; loque produce es paro, en las explotaciones marginales. Se be neficia a algunos laboradores, reduciéndose los ingresos de otros hermanos suyos, quedando además inactiva una parte del capital disponible, lo que supone, en la práctica, evidente descapitalización.

Para quien haya logrado percatarse de la íntima relación entre capital y salarios y advierta las desastradas consecuencias sociales que lleva aparejada la coactiva elevación de las rentas laborales, resulta en verdad entristecedora la posición adoptada en estas materias por la opinión pública, que Mises, en gráfico pasaje, bien retrata:

"Propugnar un alza constante de la remuneración laboral -por decisión del poder público o como consecuencia de la intimidación o la fuerza de los sindicatos- constituye la esencia de la filosofía actual. Elevar los salarios más allá del límite que un mercado inadulterado señalaría, repútase medida indispensable desde el punto de vista económico, amparada además por eternas normas morales. Quien tenga la audacia de oponerse a ese dogma ético-económico veráse, de inmediato, menospreciado como imagen viva de la máxima perversidad e ignorancia. El temor, el asombro, con que las tribus primitivas contemplaban a quienquiera osara violar una norma reputada tabú, es idéntico al que traducen nuestros contemporáneos cuando alguien es lo bastante temerario como para, de algún modo, atreverse a cruzar "las líneas de piquetes". Millones de seres exultan de gozo cuando los esquiroles reciben "su merecido castigo" de manos de los huelguistas, en tanto que policías, fiscales y jueces o se encierran en altiva neutralidad o, incluso, pónense del lado de quienes provocan las algaradas."

Lo anterior nos lleva de la mano a aludir, aunque sólo sea de pasada, al tan manoseado tema del "asociacionismo laboral" y al no menos manido del "derecho de huelga". Dos párrafos magistrales bastan a Mises para situar ambas cuestiones en sus estrictos y exactos términos:

"La esencia del problema nada tiene que ver con el "derecho de asociación". Tan sólo se trata de dilucidar si conviene conferir a determinado grupo de ciudadanos el privilegio de impunemente recurrir a la acción violenta. Estamos ante un problema idéntico al que suscitan las actividades del Ku Klux Klan.

Incorrecto también resulta enfocar el asunto desde el ángulo del "derecho a la huelga". No se discute el derecho a abandonar el trabajo, sino la facultad de obligar a otros -mediante la intimidación y la violencia- a holgar. Cuando los sindicatos, para justificar su actuación intimidatoria y violenta, invocan el derecho de huelga, no quedan mejor emplazados que la secta religiosa que pretendiera ampararse en la libertad de conciencia para perseguir al disidente."

Y hablando de capital no es posible dejar de aludir a las exacciones fiscales.

Los impuestos son necesarios porque, para mantener el orden público, tal cual están las cosas, ineludible parece el Estado. La financiación del aparato estatal constituye un costo, es decir, un medio necesario para alcanzar un fin deseado. Conviene, por lo dicho, desde un punto de vista social, sufragar tal dispendio mediante contribuciones que incidan lo menos posible en el ahorro. (Los impuestos indirectos, en este sentido, provocan una tendencia al alza de los salarios y al mejoramiento del nivel de vida de las clases trabajadoras, al afectar en menor medida la creación de capital).

Que el Estado gaste lo menos posible, una vez debidamente atendido el respeto a la ley, es siempre beneficioso para todos y particularmente para quienes gozan de menores medios, pues lo que no sea consumido por la Administración se dedicará, forzosamente, a las producciones que desde un punto de vista social más interesen.

“Cuando la ley -dice a este respecto Mises- hace prohibitivo, por ejemplo, acumular más de diez millones o ganar más de un millón al año, aparta, en determinado momento, del proceso productivo, precisamente, a aquellos indivíduos que mejor están atendiendo los deseos de los consumidores. Si una disposición de este tipo hubiera sido dictada en los Estados Unidos hace cincuenta afios, muchos de los que hoy son multimillonarios vivirían en condiciones bastante más modestas. Ahora bien, todas esas industrias, que abastecen a las masas con mercancías nunca soñadas, operarían, de haberse llegado a montar, a escala reducida, hallándose, en consecuencia, sus producciones fuera del alcance del hombre medio. Perjudica, evidentemente, a los consumidores el vedar a los empresarios más eficientes que amplíen la esfera de sus actividades, en la medida que conforman con los deseos de las gentes, deseos que éstas patentizan al adquirir los productos por aquéllos ofrecidos. Plantéase de nuevo el dilema: ¿ a quién debe corresponder la suprema decisión, a los consumidores o al jerarca? En un mercado sin trabas, el consumidor, comprando o absteniéndose de comprar, determina, en definitiva, los ingresos y la fortuna de cada uno. ¿ Es prudente investir a quienes detentan el poder con la facultad de alterar la voluntad de los consumidores?”

La falta de conocimiento popular, en estas materias, es grande. Por eso, ni aun los gobernantes más ilustrados y mejor intencionados pueden, muchas veces, aplicar medidas, altamente beneficiosas para las masas, pero que éstas airadas rechazan, sin advertir que están laborando contra sus propios intereses.

Difundir información acerca de cómo, realmente, funciona la economía, acerca de cómo opera, en definitiva, la actividad toda del hombre, es lo que más urgente parece. Impuestas las gentes de tales verdades, cabría, sin dificultad, reducir el gasto estatal a aquello que el mantenimiento del orden público en cada caso exigiera; evitar la creación de medios de pago con créditos de carácter político y administrativo; fomentar la capitalización, a través de un sistema impositivo que castigara lo menos posible al ahorro; desterrando, en definitiva, un intervencionismo que sólo indeseadas consecuencias acarrea y que paulatinamente nos va entregando en manos del marxismo, la más grande aberración económica jamás ideada por el hombre. Se conseguiría, así, -y esto parece lo más importante- elevar, en el mayor grado posible, el nivel de vida de todas las clases sociales, particularmente el de las de menores medios.

Dice Mises, en el último párrafo de La Acción Humana, donde parece querer condensar todo su trascendente mensaje:

“El saber acumulado por la ciencia económica forma parte fundamental de la civilización; en dicho saber se basa el industrialismo moderno y en él se han amparado cuantos triunfos morales, intelectuales, técnicos y terapéuticos ha alcanzado el hombre a lo largo de las últimas centurias. El género humano decidirá si quiere hacer uso adecuado del inapreciable tesoro de conocimientos que este acervo supone o si, por el contrario, prefiere no utilizarlo. Ahora bien, si los mortales prescinden de tan espléndidos hallazgos y siguen menospreciando tan fecundas enseñanzas, no por ello desvirtuarán la ciencia económica; se limitarán, desgraciadamente, a destruir la sociedad y a aniquilar al género humano.”

Son éstas unas pocas de las múltiples verdades con que Mises amplía nuestro conocimiento. Pero, aparte de tan invaluable ilustración, el gran legado del maestro, creo yo, consiste en habernos enseñado a muchos a pensar, es decir, a mentalmente especular con el rigor máximo y la justeza mayor que a cada uno permite su personal limitación.

N. B.—Todos los subrayados del texto son del firmante.

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Reflections On The Keynesian Episode?
W. H. Hutt

In my Keynesianism-Retrospect and Prospect, 1963, I enunciated and defended the thesis that the intellectual developments for which Keynes' General Theory appeared to be responsible had caused a setback to scientific thinking about human economic relations at a crucial epoch. In doing so, I referred (in the final chapter) to a growing tendency to abandon crucial theoretical tenets in Keynes' system. Nevertheless, I maintained that concepts, analytical apparatus, and policy-implications which had been erected on those apparently discarded tenets, were surviving in the form of a new neo-Keynesian orthodoxy.

I had expected reasoned objections to my rigorously-stated argument following the publication of my book. None has been forthcoming. Nor has a subsequent article of mine (entitled Keynesian Revisions)1 which submitted further evidence of a retreat by major exponents of the Keynesian gospel, called forth any reply.2 In the meantime the retreat has continued although, apart from Leijonhufvud's impressive and scholarly critique,1 I am aware of no further direct attack on the Keynesian system.

The purpose of the present article is not to present additional criticisms of Keynesian economics or of the actual content of the neo-Keynesian orthodoxy which has emerged. My aim is to throw light on some of the causes which appear originally to have created, and since to have been perpetuating, the hold that neo-Keynesianism has acquired in academic circles.2 I shall refer also to the prospects of early or ultimate emancipation from the consequences of the Keynesian episode.

The reasons for the extraordinary seductiveness of the notions which Keynes' disciples gradually systematized into “Keynesianism” and later rehabilitated into “neo-Keynesianism,” concern the psychology of opinion-the genesis of intellectual fashions, creeds and ideologies. The broad topic is one which began to interest me as a young man, very soon after I had entered academic life. In 1936, I recorded the results of my early endeavors to clarify my thoughts on the subject in my Economists and the Public, a Study in Competition and Opinion. While that book was in the press, The General Theory was published. I read quickly through such parts of Keynes' book as I could then follow, and I managed to insert an additional, last-minute passage in my own book, which recorded my rapidly gained impressions. Already, in 1936, although I had been bewildered by it, I had seen clearly, and predicted,3 that The General Theory would have a quite unparalleled influence by reason of what I judged to be its demerits as a contribution to thought. For its policy implications appeared to have been chosen for their political attractiveness; its misrepresentations of the “classical” economists seemed certain to have a powerful appeal (because the teachings of the “dismal science” had at all times been accepted with reluctance by those who were unable to refute them); and its obscurities (which I have since come to recognize as due, in every case, to defective thinking), expressed as they were in the language of science, appeared likely to enhance its reputation (for all too many people in all spheres-the academic sphere not excluded-are apt to accept obscurity for profundity).1

I shall never forget the extraordinary impression left on my mind by the brilliant preface of The General Theory. Keynes' previous writings had struck me as forceful and challenging but rather superficial. I had spent more time struggling with the Treatise on Money than I had devoted to any previous book. Yet, I felt that, in spite of a masterly discussion of index numbers2 and many beautifully phrased passages, it was a badly-planned, rambling and (I came to fear) an emphemeral work. Some of Keynes' works, such as The End of Laissez-Faire, had impressed me as shallow to the point of irresponsibility. Yet I could not escape the persuasiveness of that preface to The General Theory. It seemed to be announcing a critical, revolutionary contribution of great intellectual courage. I started reading, I remember, prepared for an exhilarating challenge. As I read, my attitude changed quickly to bewilderment and dismay. I had immediately foreseen that, in spite of the obscurity and the apparent muddle of the book, it would have an unprecedented impact; and I was moved to write the prophetic passage to which I have just referred.

Austin Robinson explains how the Keynesian revolution “consisted in inducing a reluctant body of dedicated but perhaps rather cautious, critical, and conservative thinkers to abandon a large part of what they had given their lives to learning and teaching, and to accept, as one complete (or virtually complete) package, a set of new and highly debatable propositions and of new ways of handling familiar problems.”1

I am only too conscious of the fact that, through the arguments I presented in previous contributions, I also was attempting to induce equally dedicated scholars to turn back and relinquish intellectual capital into which years of study and lecture preparation had been invested. In my case such a task seemed herculean-almost quixotic; for whereas Keynes (who had confidently-almost boastfully-forecast his success in a letter to G. B. Shaw shortly before The General Theory had appeared2) was well aware of how popular the policy-implications of his teachings would be, I was just as well aware of how unpopular mine were likely to be-at least for many years to come. Austin Robinson confesses that he finds it difficult to explain how Keynes managed to bring about the revolution. But although I had forecast the unprecedented influence of that book, I find myself unconfident when I try to explain to my own satisfaction the almost irresistible pressures to academic conformity which built up after 1936. Austin Robinson was, I believe, more right than he fully realized when, in his obituary article on Keynes, he compared to “the atmosphere of the revivalist meeting.... “the accelerating conversion of economists to the Keynesian creed. It was, he wrote, “a most illuminating example of the process and psychology of conversion ... not only in Cambridge or in England but all over the world....”3

In some measure this almost fantastic phenomenon probably stemmed from the personal attributes of Keynes himself. Harrod and Robinson have convincingly portrayed him as a grand person-gentle, generous, gay, a bon viveur, witty, magnetic, venturesome, scholarly and-among his friends-loyal, kindly, and modest. He was also ambitious, impatient for influence, acquisitive (from a longing for elegant living and those noble things to which wealth gives access), ruthless and casuistic. These are dangerous qualities in an economist, especially in one who, by reason of background, personal charm and knowledge of the world, moved in influential circles.

I have come to think of him as a strange combination of philosopher, economist, and adventurer. One can discern in his writings as a whole, I believe, a concern with what may be termed "intellectual tactics," almost reminding one of his success as a gambler and poker player.1 In his campaign among economists and in his public life he was watching and calculating reactions and devising his career strategy accordingly.

As a thinker, he was original, scintillating and facile rather than profound or dedicated.2 His temperament and his burning urge to change the course of events militated against profundity. He skated brilliantly and dangerously on the surface, failing to plumb the depths. Of exceptional intellect, yet essentially a man of action, he was capable of mastering rapidly those arguments and teachings which did not clash with his settled convictions. But he treated economists who differed from him radically almost with contempt. He read their contributions hastily-if at all-and with little effort at sympathetic understanding. In his eagerness to bend policy in the direction he favored, he seems to have hidden from himself his failure really to understand what he called "classical" teaching.3 To refute that teaching he was led to dialectical tricks, recklessly imputing to the "classical" writers opinions which they could never be shown, by actual quotation, to have held.4 His references to the teachings of the "classical" or "orthodox" economists in his tract, The End of Laissez-Faire, and in the General Theory, are almost invariably flagrant misrepresentations.1 The propensity to attribute to a school of thought one is attacking opinions which any member of that school would indignantly deny is hardly a quality of the detached scholar. Yet Keynes seems to have delighted in a challenging perverseness. He seemed to revel in destroying respect for the patient achievement of sustained intellectual travail by those he felt, more or less intuitively, were somehow wrong. No man could have done more to weaken the authority of his eminent contemporaries and predecessors-to leave an impression that he was debunking them.

Supremely confident, conscious of his reputation and rhetorical skill, he appears to have been self-critical only when his previous speculations had tended to lead him away from instead of towards conclusions to which he was intuitively attached. When he discarded concepts and apparatus which he had earlier introduced, it was because he had found more convincing ways, although sometimes quite different and inconsistent ways, of stating a case which, in its essence, he had not modified. Austin Robinson thinks of him as "remarkably consistent in his strategic objectives, but extraordinarily fertile in tactical proposals for achieving them."2 I should say rather that while his convictions about policy seem indeed to have been unshakeable, he constantly changed the arguments, assumptions, terminology and formulae which could be used to justify those convictions. In other words, his fundamental ideas were subject to change only in respect of the particular concepts, formulae or jargon in which he dressed them.

Keynes' biographer, Harrod, says that one gets the feeling, from earlier works, that "he was tentatively and no doubt hurriedly searching for arguments to support a conviction, which was itself more solidly based than the supports which he outlined.

It was in fact what we have come to call a 'hunch.'"[3] I share this feeling that Keynes was "searching for arguments to support a conviction." But I have it about the whole body of his economic writings. His "hunch" throughout was that control of expenditure, via monetary and fiscal policy, could solve the problems of maladjustment expressed in unemployment. And he seems originally to have believed that this could be done without the disastrous sociological consequences of a gradual depreciation of the currency. His intellectual speculations consisted, I think, of a groping around-with great ingenuity-for ways of thinking which appeared to support his "hunch," selecting and eagerly clutching those which appeared to do so, and inhibiting those which did not. The process was unconscious. I do not impugn his honesty as a scholar.

Harrod tells us also that Keynes "had completed the outline of the public policy which has since been specifically associated with his name" as early as 1924, and that he put forward his proposals then, "before being in a position to give a full theoretical justification of them." This was, continues Harrod, no doubt "because he deemed it urgently needful for Britain to act with speed. It must not be inferred".... that his recommendations.... "were thrown out at random.... Did he in some primitive sense already know the theoretical conclusions that he was later to articulate?.... Is it possible for the mind to jump from the data which are the premises of an argument to the practical conclusions, without being conscious oneself of the theoretical conclusions, which are none the less the logical link between the premises and the practical conclusions?"[1] Is not the answer that Keynes' "primitive sense" worked to frustrate, not to promote constructive thinking?

For instance, the desirability of stimulating and controlling internal investment, with public works and limitations on foreign investment, etc., formed an important part of his contribution to the influential 1928 "Liberal Yellow Book." Even in the midst of 1928 (which some would regard as a boom year in Britain), he was continuously advocating capital expenditure on public account (to rectify the chronic unemployment which, under the paradoxical situation created, had persisted in spite of phenomena which suggested prosperity). As early as 1924, he had advocated a public works policy, and in 1928, when Lloyd George and his advisors thought that public works would be a good plank for the coming election, he gave them his full influential support.

Again, his Treatise on Money (1930) was an attempt to find methods of eliminating cyclical fluctuations under conditions of price stability. It was an essay in intended refutation of the "classical" view that, for the prevention of depression under currency convertibility, it is essential to prevent the boom. In the General Theory, however, he quietly abandoned any suggestion that his proposals were consistent with long-run price stability, which could be broadly assumed in the Treatise. In doing so, he misdirected attention from all the issues which arise when monetary or fiscal steps taken in the interests of stability of employment have to be limited by the necessity to honor convertibility obligations.

The word "genius" has often been applied to Keynes. But his genius was compounded, I judge, of forensic and diplomatic powers, rhetoric, wit, close range logic, flair for publicity, vitality and charm of manner. He virtually hypnotized most economists who came into close contact with him. In conversation the critical abilities of those who had dealings with him seem often to have evaporated.1 He could move people by talk where he could never have moved them by the printed word. He won the devotion, indeed idolatry, of his disciples. When I think of the extraordinary effect he had upon some who were once my intellectual friends, I am inclined to feel that I also should have succumbed had I known him personally.

And he was a master of prose. When he was thinking clearly no writer could express himself more aptly, more lucidly, or more gracefully. He was capable of expressing great nobility of ideas, often with almost poetic eloquence. But in his theoretical analyses, in the prose passages which link together his passages of mechanical or mathematical exposition, there is much obscurity; and in Keynes' case, verbal obscurity nearly always meant intellectual confusion. The passages in the Treatise on Money and the General Theory which caused so many headaches to his readers are just those passages in which, I have maintained, his thinking went seriously astray-cryptic sentences or paragraphs which cannot be explained but only explained away. In the intervening passages, in which his hypotheses are largely conclusions invalidly reached, his exposition is as easy to follow as anything which has ever been written in economics.

Even those who regard The General Theory as a work of genius sometimes agree (Samuelson's words) that it “is a badly-written book, poorly organized.... arrogant, bad-tempered, polemical.... It abounds in mares' nests and confusions.”1

“Arrogant,” “bad-tempered,” “polemical”-these words do not overstate the tone of Keynes' attack on economists whose authority he wished to destroy. To “blast the classical foundations” (as T. Wilson, once put it),2 he set up (in the words of F. H. Knight) “the sort of caricatures which are typically set up as straw men for purpose of attack in controversial writing,” his writing at times being “more like the language of the soap box reformer than an economist writing for economists.”3 And his methods of ridicule and misrepresentation have at times been borrowed by his followers. Moreover, the neo-Keynesians are certainly following his example in constantly changing the grounds on which they support given policy-implications.4

During the decade following the General Theory, most of the conventional economists who discussed this work seemed to suspend their normal critical approach-almost as though they were afraid of its author. It had been known for some years that his magnum opus was on its way, and I am certain that no work on economics was ever so rapidly or eagerly purchased on its publication. Having obtained the book, economists generally endeavored patiently to find every possible new insight, every new concept, or every new and workable apparatus in his contribution. This was in spite of its distressing obscurities, its slovenly plan, its apparent resuscitation of long discarded fallacies and the indignation it aroused by its misrepresentations. If Keynes' readers could find any point of detail on which favourable comment was possible, they usually went out of their way to praise it. Even his strongest critics tended on occasion to give him unmerited credit for novelty.

Harrod refers to a "rabble of detractors" of Keynes and contends that they have falsely accused him of inconsistency.[1] I wish Harrod had named the rabble. Those economists who had the intellectual courage to resist the strong pressures to conformity have never, I believe, been accused of having misrepresented Keynes' arguments when they have tried to show that they are untenable. And I do not think that any economist of the old school would ever have disparaged another for changes of intellectual conviction. The only kinds of inconsistency with which I can recall Keynes having been explicitly charged, are those which concern (a) definitions,[2] and (b) changes in argument to support unchanged conclusions which disciples like Robinson and Harrod himself, have admitted (see above, pp. [Editor: illegible words]..

And other Keynesians have referred, also in emotive language, and without mentioning names, to those who have dared to criticize their leader. E.g., Seymour Harris suggested about twenty years ago that the reaction against Keynesianism then discernible consisted of "unfriendly interpretations and destructive criticisms."[3] He wrote of "Keynes' baiters."[4] I am about to examine this change. But surely, if the term "baiter" can be appropriately used of any economist it must be applied to Keynes himself. Austin Robinson describes him as "the great iconoclast."[5] And Harrod also, refers to "a streak of iconoclasm. To tease, to flout, finally perhaps to overthrow, venerable authorities-that was a sport which had great appeal for him."[1] Harrod excuses Keynes' "barbed utterances,"[2] his "mischievous pleasure.... in criticizing revered names," on the grounds that "this was done of set purpose. It was his deliberate reaction to the frustrations he had felt, and was still feeling, as the result of the persistent tendency to ignore what was novel in his contribution. He felt that he would get nowhere if he did not raise the dust...."[3]

But were Keynes' "novelties" ignored? Even before The General Theory no economist at any time had ever had his contributions examined with greater care and sympathy,[4] and a more obvious desire to find acceptable developments in them. After a survey of the general tone of the critical literature, I am very doubtful whether Seymour Harris' charge of "unfriendly" interpretations and "destructive" criticisms can be substantiated. At any rate, the only criticisms which made any impression on my own thinking stand in the sharpest contrast to Keynes' own references to the "classical" school, in that they were sober, lenient, tactful and respectful analyses.[5] Keynes' critics never hit back with his own weapons. On the contrary, they apparently strove to give every possible grain of credit to his viewpoint and that of his followers. If the exposure of error is to be regarded as "unfriendly" or "destructive," academic discussion can hardly proceed.

On the other hand, Keynes' disciples loaded him with almost idolatrous praise. They excused the slipshod exposition of the book which is supposed to have revolutionized economic science on such dubious grounds as: "His instinct was ... to get his present thinking into the hands of readers before the policies that he was seeking to influence were crystallized. He was a phamphleteer rather than a procrastinating pedant."[1] And they explained away his extravagances with a tolerance which would never have been extended to a writer with a lesser reputation. We were told that his misrepresentation and ridiculing of orthodoxy-described by Tarshis as emphasizing "his break from the earlier doctrines, ... must be regarded as a tactic of persuasion rather than as an objective statement of the relation between his own work and conventional doctrine.”2 The offensive parts of his work are described as its “satiric aspect,” an aspect which enhances the “entertainment value” of the General Theory,3 —his “showmanship,”4 mere “sport” on his part,5 his deliberate attempt to “raise the dust.”6 We are asked not to reject his “theory” because we are forced to reject his “personal opinions,” i.e., his obiter dicta.7

There was no need for Harrod to apologize for Keynes' “criticism” of revered names, or even for the “mischievous pleasure” it afforded him, had it merely been criticism. But Keynes'“deliberate reaction,” his ridiculing of disinterested scholars in order to “raise the dust” was his method of dealing with those whose writings he felt instinctively (rather than by force of reason backed by careful study) were untenable. Harrod tells us how Keynes could make the most reckless, preposterous and unjust assertions.1 Yet he is almost naive in his excuses. He describes Keynes' impetuosity and his tendency to speak beyond his book as “minor failings.”2 They are major failings in a person on whose responsibility and insight the intelligentsia are prepared to place the greatest reliance. Harrod says that Keynes, in the latter part of The General Theory, “may have allowed himself to be carried too far by the exhilaration due to emancipation from old fetters.”3 That Keynes was exhilarated is understandable. He had found arguments to support policies which he knew4 were bound to be extraordinarily popular and influential, and his small trusted group of brilliant young advisors had been unable to see serious flaws or unable to convince him of the flaws. No wonder he was exhilarated! But Keynes' attempt to “shake up” the economists, somehow led a whole generation of students of economics to despise rather than examine the great tradition which constituted “classical” economic science (as Keynes used the word “classical”).5

In his editorial introduction to a recent evaluation published about six years ago (by nine leading economists) of Keynes' General Theory, Robert Lekachman remarks quite casually, “everybody is a Keynesian now.”6 Well, the Keynesians have been claiming this, from time to time, ever since it began to be obvious that the very roots of Keynes' teachings were being cogently challenged, and in spite of the clearly observable retreat to which I referred at the outset.1 Lekachman should have added the words, “although they are no longer prepared or able to defend Keynes' revolutionary propositions from devastating criticisms.” For since 1946, Keynes' followers appear to have been spasmodically relinquishing reliance on the theoretical structure of The General Theory while mostly clinging to its terminology, to its form and to its policy-implications.

To some extent the theoretical retreat has been forced by the expression of spontaneous philosophic scepticism from within what has appeared to be the Keynesian camp. In part it has been induced by the need to answer obviously non-Keynesian objections. But in my judgement the main pressure has come through the march of events as they have seemed to contradict the Keynesian thesis. The convictions of the “classical” economists in the 1920's and early 1930's that recourse to the “cheap money” that Keynes had been advocating as a means of restoring activity was a reform in the wrong direction-their warnings that it would lead to the gradual depreciation of the measuring rod of value, the emergence of a proliferation of centrally imposed controls, and the magnification of State power-although fiercely denied at first by Keynes' disciples,2 have been justified subsequently in every detail.

For instance, in October, 1933, Roosevelt inaugurated a monetary policy which can be said to have embodied the policy recommendations of Keynes' Treatise, which had appeared three years previously. The aim, declared Roosevelt, was to "maintain a dollar which will not change its purchasing power during the succeeding generation."1 And events continue to mock at Keynesian teachings. During 1958 cheap money and rapidly rising prices in the United States were accompanied by worsening unemployment. Thereafter, almost uninhibited reliance on every conceivable form of Keynesian apparatus, brought no success in eliminating the chronic unemployment of more than five and a half per cent of the labor force until the more rapid inflation inaugurated in 1965 and subsequently maintained. Unemployment in the U.S. had then been maintained at above this figure for nearly seven years. Yet, commented P. W. McCracken in 1964, "one can find no period in the so-called 'boom-bust' days, before we exercised our business-cycle taming talents, when unemployment was this high for such a long span."2 Under Keynesian experience, "the tolerable level" of unemployment has indeed (in Lekachman's words) shown "a secular tendency to rise."3

The failure seems to have been abject; and without a more rapid drift towards totalitarian government, it is unlikely, I suggest, that Keynesian policy will again achieve the appearance of success in the western world; for it will be necessary for government to suppress reactions to the expectation of inflation over an ever-expanding area of the economy. The suppression of such reactions ought by this time to have been clearly recognised as the ultimate raison d'être of each Keynesian "persuasion" or "control." Let the reader ask himself whether every "success" achieved by cheap money in the past has not been due to the mass of people not expecting it, or not expecting its duration or the speed with which it has occurred; or being prevented, by authority, from behaving rationally in the light of their predictions.

It may well be that if Keynes had never lived, contemporary history-of thought and action-would hardly have differed. If he had not provided a supposed justification for the various media through which inflation can be engineered, with the whole range of "central controls" needed to make the chronic, creeping, crawling rise of prices politically acceptable, some other prophet could conceivably have provided supposedly scientific authority, with a different jargon and formulae. To retain office, governments had to compete with policies which were both plausible and not unacceptable to the more powerful pressure groups, such as labor and organized agriculture. Keynesianism has proved to be a stratagem which enabled governments to do this without early disaster. "A great change in outlook was required ...," says T. Wilson. It was Keynes' "rhetoric and new mystique which carried the day."1

So severely have Keynes' doctrines been treated, however, that some economists, although seemingly reluctant to renounce the Keynesian approach, have nevertheless been suggesting during the last decade that all these controversies belong to the past.

We are now “well into the post Keynesian era,”2 they are apt to say. Yet others (speaking rather from the non-Keynesian camp) sometimes declare that “we are all Keynesians now.” The truth is, I think, that most economists feel themselves forced to talk and teach in what has become the modern economic language in order to retain respect and get a hearing, in spite of the unsatisfactory concepts and misleading terminology to which they are, I have tried to show, thereby committed. Through a powerful urge to follow well-worn trails in post-war academic discussion, economists have found themselves trapped in a dense Keynesian undergrowth. They mostly realize now that they have for too long followed a leader who was himself lost; but many appear to be resigned to their fate-unwilling to make the effort of hacking their way out of the conceptual jungle in which they are entangled.

The aversion to confessions of past error is understandable enough, especially when the first to confess may suffer in status and prospects. But some perhaps tell themselves that after all, however fallacious Keynesian theory may be, the policies it implies are, for political reasons, wiser than “classical” policies. Even so, if that is an economist's conviction, it is still his duty to explain why “classical” remedies must be held to be defective from the angle of political acceptability.1

We can consider the position of H. G. Johnson, who, like so many former Keynesians, appears to admit that the vital originality of the General Theory-the unemployment equilibrium thesis-is untenable. He does not argue that Keynes' economics is defensible but that his “polemical instinct was surely right....”; for, says Johnson, “neo-classical ways of thinking were then” (i.e., in 1936) “a major obstacle to sensible anti-depression policy.”2 In other words (I hope this interpretation is not unfair), in spite of the fundamental fallacy on which, he agrees, Keynes' thought was based, it did serve a beneficial purpose; for the authority of “classical” anti-depression thought, which Johnson holds had not been “sensible,” was dealt a deadly and necessary blow.

But exactly how can it be held that the policy implications of “classical” thought were not “sensible?” After all, they were never put to the test. Does Johnson perhaps mean that, although “classical” remedies could undoubtedly have restored prosperity in the thirties, it was hopeless to expect an electorate (and hence politicians) either to understand or to adopt those remedies? Certainly economists who regard pre-Keynesian teachings as not being “sensible,” may be thinking simply of the admitted difficulty or the supposed impossibility of winning political consent for the reforms to which those teachings were pointing. That being so, they may believe Keynes' polemics to have helped persuade the community to be “sensible,” in the sense (i) of acquiescing in inflation whenever unemployment or recession is threatening, as a crude means of confiscating the real gains from money wage-rates forced above the full employment value, or (ii) of acquiescing in authoritarian “incomes policies,” “controls,” “ceilings,” “persuasions” and “guide-lines” intended to curb the traditional tendency of labor unions to reduce the flow of uninflated wages, so as to render inflationary co-ordination less essential. If that is the case, the neo-Keynesians should make it clear beyond doubt.1

It is possible, however, that “classical” remedies are held not to have been “sensible” because of some radical weakness (which Keynes himself did not discern) in the abstract reasoning which inspired them. That is a quite different point. Pre-Keynesian anti-depression teachings are to the effect that unemployment (as a short-term phenomenon) and depression are due to a contraction of the flow of wages and other income through some disco-ordination of the pricing system. The most important case of this disco-ordination is thought to be caused by wage-rates (and hence final prices) being fixed too high in relation to income or inconsistently with price expectations. Labor unions and, in some countries, a form of subsidized unemployment "insurance," are usually diagnosed as the major factors which encourage the pricing of the flow of productive services inconsistently with full or optimal use of men and other resources. More generally, "classical" thought implies that the avoidance of depression is to be most wisely achieved through (a) the avoidance of inflation which, under any system in which the money unit has some defined value (or some politically expedient value), will have to be corrected by deflationary rectifying action and (given rigidities in the wage and price system) a decline in activity; and (b) the deliberate planning of institutions conducive to market-selected price and wage-rate adjustments in response to economic change, in order to maintain or enhance the flow of uninflated wages and income. But once the persistent ignoring of "classical" precepts has precipitated chaos, and insurmountable political obstacles obviously block the way to non-inflationary recovery, only a pedant would oppose inflation.[1]

Now there may be one or more serious flaws in the theory which I have so briefly stated. If so, I know of no serious exposition which sets out to indicate the flaws, apart from the Keynesian unemployment equilibrium thesis, which appears now to have been discarded. Yet the neo-Keynesians seem prepared neither to provide new (non-Keynesian) criticisms of the "classical" case nor overtly to return to it.

The chief tragedy of what, I believe, will ultimately come to be regarded as the Keynesian episode in the history of academic economics, is that it has hindered the development or refinement of theory during an epoch in which institutional changes have been demanding a sharpening of the tools of analysis. What seems to have been happening since 1936 is that "fundamental economics" (which had been concerned with the devising of tools for studying the causes of observable economic phenomena) has been branching-not improperly-into "operational economics," that is, towards formulations of economic analysis suitable for application in already-adopted governmental economic policy, making abstraction of the rationality of that policy. But the emergence of "operational economics" has degenerated all too easily-via Keynesian influences-into "economic apologetics." By that, I mean the devising of concepts and theoretical constructions which can be used to justify policies which have the virtue (or the reverse) of being politically acceptable. Future historians of economic thought will, I predict, give Keynes chief responsibility for having inaugurated-I do not suggest intentionally-the flood of economic apologetics in which neo-Keynesian economics has become submerged.

I should be the last to decry the development of the State's sphere in the acquisition and interpretation of the data relevant to the guidance of its own co-ordinative activities and those of private entrepreneurs.[1] This is the valid role of "operational economics." Much of the effort expended in the collection of the information utilized in national accounting is of value not only to the administrators of the credit system (especially if they are contractually bound to maintain a money unit of some defined value), but to all decision-makers in whose calculations the future money valuation of income is important.

The fulfillment of this task requires a supply of economist-technicians, and not unnaturally the faculties of economics of the major universities of the western world have been under pressure to become schools for the training of such “economists” or “economist-statisticians.” But are the students who receive this training being taught to perceive clearly the co-ordinative role of the pricing system? Or are they being indoctrinated with the view that it is their task to help use the data collected to correct, through the “control of expenditure,” an inherent tendency to equilibrium with unemployment in a free market system, or to offset discoordinations caused through the pricing of labor (or other sources of output) having been exempted from the sanctions of social (i.e., market) discipline?

The defensible scope of central direction and leadership (“indicative planning”) in a free market economy cannot be perceived, nor can the techniques employed be made fruitful, as long as Keynesian notions are allowed to cloud the issues. But it seems to me that today, in almost all the universities everywhere, we find the inculcation and perpetuation of the Keynesian approach, together with the exclusion of competing ideas.

I attempted to arouse interest in this situation in 1964. I wrote: “It was about 25 to 30 years ago that most of the younger sceptics who expressed misgivings about the ‘new economics’ began to be eliminated from academic life. There was no inquisition, no discernible or intentional suspension of academic freedom; but young non-conformists could seldom expect promotion. They appeared rather like young physicists who were arrogant enough to challenge the basic validity of revolutionary developments which they did not properly understand. To suggest that Keynes was all wrong was like questioning the soundness of Einstein or Bohr. The older economists could declare their doubts without serious loss of prestige, but any dissatisfaction on the part of the younger men seemed to be evidence of intellectual limitations.”[1]

The position today is that a relatively small group of economists, scattered through the universities, adhere pertinaciously-not dogmatically-to the time-honoured traditions of “classical” economics. But even they tend mostly to use Keynesian terminology to the detriment (I believe) of their own and their students' thinking. Moreover, the majority of the teachers of economics of the contemporary generation seem never really to have learned, or to have forgotten, what the pre-1930 economists were explaining. For the younger economists now to question the currently fashionable approach demands not only a rare insight but intellectual courage, and I have an uneasy feeling that, for those of junior status, it may demand also a willingness to sacrifice professional prospects in the interests of scientific integrity. I do not of course imply that there are no outlets for the expression of dissenting thought. But there is no longer, I believe, anything resembling equality of opportunity in the communication of ideas in academic circles generally.

The economists of the great universities ought, I suggest, to be asking themselves whether, in their field, academic freedom is really being effectively preserved. Are they certain, for instance, that junior staff who might feel some sympathy with ideas such as I have expressed in my book on Keynesianism or even with Leijonhufvud's analysis (which is less iconoclastic than mine) could openly confess to that sympathy without damaging their academic prospects? In some cases they might well answer affirmatively. There are a few universities in which such confidence would be fully justified. But discussions with economists who share my fears convince me that, in Britain and the United States at any rate, the set-up is seldom conducive to the expression of unorthodox (i.e., non-Keynesian) ideas. Even senior economists have confessed to me that they are subject to powerful pressures to conform to fashion. Some say that they feel under an obligation to train their most promising students along lines which are likely to make them acceptable as teachers in other universities, or as public servants in administrations dominated by Keynesian convictions. Others feel that any existing consensus of opinion carries its own authority. A young British economist with whom I was discussing some of my ideas a few years ago made no attempt to answer any of the points I was making. He simply asked, “How many economists would agree with you today?” Others still are intimidated by the power-holding establishment. In 1964, I asked a distinguished middle-aged American economist who seemed to appreciate my misgivings on many issues, whether he would not express his views in writing. He answered, “I dare not. I should probably be black-listed.” And about the same time I asked a brilliant youngish economist in Britain, who, I had good reason to believe, would have been inclined to accept the heresies I have been propounding, why he did not himself openly challenge the Keynesians. He replied, “I am scared. They are much too powerful.”

Furthermore, the editors of the more important journals are, on the whole, pillars of the dominant orthodoxy. It is understandable that they should tend to reject contributions which directly challenge the currently fashionable analysis. Young economists have confessed to me that they have felt it essential, in submitting contributions to certain leading journals, carefully to exclude or rewrite passages which might suggest non-conformity. There are reasonable grounds for uneasiness here. But it is in the content of undergraduate and graduate teaching that the widespread exclusion of competing modes of thought appears to me to be having the most grave consequences.

The modern emphasis on macro-economics, the validity of which depends—as few writers in the field seem to realize—upon its reconciliation with micro-economics, aggravates the situation. For macro-economics, which is particularly amenable to mathematical enunciation, is now being taught at an early stage in the typical curriculum; and the young student tends, I fear, to spend more time grappling with mathematics than with economics, the difficulties of which are not mathematical. His attention is diverted from rigorous thought about the phenomena of scarcity and price, and the stabilizing and co-ordinative role of the price system, to the study of complex truisms. When he graduates, he may have learned very little of basic economic science. If he tries to resolve in his mind the apparent conceptual confusions which most macro-economists elaborate,[1] he is likely to prejudice his academic record. Students with a lively and critical intelligence have admitted to me that they have felt it expedient (in the struggle for good symbols) to echo current texts and teachings mechanically, inhibiting all concern with their validity.

Despite my conviction that an economic creed has become entrenched within most of the universities, a Keynesian priesthood determined to retain its hold, I have no doubt that the majority of economists in all the universities are sincerely convinced that the greatest possible opportunity for the free expression of divergent ideas by those whom they regard as competent critics has been preserved. But critiques of Keynesian concepts which have appeared during the last decade do render purposeless an enormous collection of apparatus, constructed through the expenditure of formidable, scholarly effort since 1936. This alone must have created powerful motives for resistance to the expression of competing teachings which threaten to precipitate widespread obsolescence in academic capital.[1]

But the genuineness of the ever-present resistance to heresy does not weaken the force of my charge. And are not the dangers to academic freedom to which I have referred magnified when university economists are hoping for influence as advisers of governments? Even if we assume that there is no question of bias due to pecuniary interest, a more elusive problem remains. Governments tend notoriously to disregard economists whose advice they believe it would be politically inexpedient to follow; and in the endeavour to exercise at least some guidance on the course of events, economists may all too easily be led to a compromise which ultimately weakens the force of disinterested and expert teachings.[2]

A barrier to the communication of ideas needs to be broken. This might happen through initiatives from among the economists themselves; through deliberate action on the part of the governing bodies of universities anxious to avoid the slur of indoctrination; or through growing pressure from independent-minded graduate or undergraduate sceptics who recognize and resent an indoctrination which has remained too long without potent challenge.[1]

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Ludwig Von Mises And The Market Process
L. M. Lachmann

I.

In the thickening gloom of our age, an age of declining standards, rampant inflation, and egalitarian ideology, it is perhaps too much to hope that the realm of economic thought alone will remain unscathed and at least this province of the human mind escape invasion by our contemporary follies. In fact, what we find to-day is very much what one might have expected. We see a few thinkers engaged in a valiant but desperate struggle to defend and strengthen the great tradition they have inherited. The large majority of economists have to-day adopted an arid formalism as their style of thought, an approach which requires them to treat the manifestations of the human mind in household and market as purely formal entities, on par with material resources. Not surprisingly, the adherents of this style of thought have come to find the mathematical language a congenial medium in which to give expression to their thoughts.

They are fond of referring to themselves as "neoclassical" economists. This label is, however, rather misleading. The classical economists, in their great day, were concerned with human action of a certain type, the forms it takes in varying circumstances and the results it is likely to produce. They took the market economy of their time as object of their thought and asked why it was what it was. Gradually they built up a formal apparatus of thought in order to deal with these problems.

The "neoclassical" economists of our time have taken over, developed and considerably refined this apparatus of thought. But in doing so they have taken the shadow of the formal apparatus for the substance of the real subject matter. It will not surprise us to learn that when confronted with real problems, such as the permanent inflation of our time, neoclassical economics has nothing to say. "Late classical formalism" appears to us a much better designation of the style of thought currently in fashion in these quarters.

A prominent economist of this school has recently told us, "Until the econometricians have the answer for us, placing reliance upon neoclassical economic theory is a matter of faith." What a faith! Economics is by no means exclusively concerned with what happens, but also with what might have happened, with the alternatives of choice which presented themselves to the minds of the decision-makers. In fact, it is in terms of these alternatives alone that the decisions can be rendered intelligible, which is after all the main purpose of a social science. Statistics, as Mises has often explained, merely record what happened over a certain period of time. They cannot tell us what might have happened had circumstances been different.

Thirty years ago Mises warned us of the futility of late classical formalism. Characteristically he thrust his blade into his opponents' weakest spot. He showed the inadequacy of the main tool of the formalists, the notion of equilibrium. “They merely mark out an imaginary situation in which the market process would cease to operate. The mathematical economists disregard the whole theoretical elucidation of the market process and evasively amuse themselves with an auxiliary notion employed in its context and devoid of any sense when used outside of this context.”[1] And he added “A superficial analogy is spun out too long, that is all.”

In voicing these strictures Mises gave pointed expression to that opposition to the work of the school of Lausanne in general, and its fundamental concept, the notion of equilibrium, in particular, which has for long been a characteristic feature of the whole Austrian School. From Menger's letters to Walras to the work of Hans Mayer and Leo Illy a succession of Austrian writers have expressed their distrust of the Lausanne approach and criticised the theory of general equilibrium. Schumpeter is the obvious exception, but in the sense relevant to our problem, as in several other senses, he may be said not really to have belonged to the “inner core” of the Austrian School. Mises, by contrast, established his claim to this title by his rejection of the equilibrium concept and thus showed himself to stand firmly in the true line of the Austrian succession. But he did not confine himself to criticism of the work of the School of Lausanne. He took an important step forward. He replaced the notion of equilibrium by the concept of the Market Process. We shall have more to say later on about this fundamental concept and its significance within the structure of Mises' thought. But there is another matter to which we must turn first.

In the 30 years which have now elapsed since Mises made his attack on the late classical formalism of our age and its notion of equilibrium a certain re-orientation of modern economic thought has taken place. Less is heard to-day of what Mises called the “evenly rotating economy” (Kreislauf) as the framework of the equilibrium concept. Instead the notion of “growth equilibrium” or “steady state growth” has come to acquire a place of prominence in contemporary thought. We shall therefore have to ask ourselves whether, and how far, this metamorphosis of the notion of equilibrium has affected the validity of Mises' criticism of 30 years ago.

In this essay we set ourselves two tasks: in the first place, to examine the question whether the new notion of equilibrium growth may be regarded as exempt from the criticism of the old variety of static equilibrium which Mises has presented. In the second place, Mises' hints about the Market Process as an alternative to equilibrium as a fundamental concept will have to be worked out more fully. We shall have to ask what are the conditions of the continuous existence of such a process. We shall also have to ask, what is, within the framework of the market process as a whole, the status of those equilibrating forces which tend to produce at least partial adjustments.

II.

In this section we propose to show that the new notion of “growth equilibrium” which has come into fashion in the last quarter of a century is even more inadequate than was the older version which Mises so trenchantly criticised. Though the new variety acquired fame and came into fashion as a feature of the Harrod-Domar model of economic growth, its origin has to be sought in Cassel's work in the second decade of this century. Cassel was critical of Wicksell's work, and in particular of the latter's attempts to analyse dynamic processes in terms of concepts, such as the "natural rate of interest", which can be given little meaning outside an unchanging world. He realised that economic processes in an industrial society subject to continous change could not possibly be analysed with the help of such instruments of thought. But he remained enough of a Walrasian to want to retain the notion of general equilibrium and the static method. So he proposed the "uniformly progressive economy", the model of an economy in which output of all goods and services increases at a uniform rate all over the system while relative prices and the relative marginal products of the factors of production remain unaffected. Thus our economic system can remain in a state of general equilibrium all the time while output, population and the stock of capital grow steadily. We now have equilibrium persisting in a world of steady change. The static method remains applicable to a world which is not stationary. In a sense we might say that here we have another type of an "evenly rotating economy", only that the economic system as a whole achieves motion while it is rotating. Harrod and Domar, when they worked out their model, appear to have been quite unaware of Cassel's contribution.1)

It is noteworthy that the protagonists of modern growth theories appear to believe that their models bear at least some resemblance to reality. Professor Solow asks, "What are the broad facts about the growth of advanced industrial economies that a well-told model must be capable of reproducing?" and, following Kaldor, then proceeds to state six "stylized facts". The first of them is according to him: "Real output per man (or per man-hour) grows at a more or less constant rate over fairly long periods of time. There are shortrun fluctuations, of course, and even changes from one quarter-century to another. But at least there is no clear systematic tendency for the rate of increase of productivity in this sense to accelerate or to slow down. If, in addition, labour input.... grows at a steady rate, so will aggregate output....". The second is stated as "The stock of real capital, crudely measured, (our italics) grows at a more or less constant rate exceeding the rate of growth of labour input".2)

That some fascinating games can be played with "macro-economic" aggregates, and the size of the capital stock in particular, is not a new discovery. When Cassel presented his model, at a time when macro-economics had not been thought of, he had to stress the need for a uniform rate of progress in all sectors. In our age this implication is conveniently forgotten together with the Cassellian original.

If the equilibrium of a stationary economy is an unsatisfactory tool of analysis for an industrial economy, growth equilibrium of the kind we described above is readily seen to be even less satisfactory. When real incomes per head increase, income recipients do not spend them in the same proportion as before. They will begin to buy some goods which previously had been entirely beyond their reach, buy more of some other goods, but less than in proportion to their higher incomes, and may actually reduce their consumption of some other goods they have come to regard as "inferior". The pattern of relative demand will certainly change. For the pattern of relative supplies to adjust itself INSTANTANEOUSLY we at once have to assume that producers foresaw this change correctly as well as the time pattern of the change. We also have to assume that costs are constant over the relevant ranges of output in all industries affected and that wage rates do not change, otherwise relative prices will change. Such assumptions about constant costs and wages when relative output changes must be regarded as being already somewhat unrealistic. But the degree of lack of realism inherent in such assumptions pales into insignificance when compared with that of perfect foresight on the part of the producers without which we can have no instantaneous adjustments of supply to demand. In fact it is this assumption of perfect foresight that deprives the model of growth equilibrium of any resemblance to the market processes of the real world.

Yet, without such foresight the adjustment of supply to changes in demand will certainly be delayed, and during the delay there will be disequilibrium in the markets affected. If any transactions take place during the period of disequilibrium (and, in a continuous market, how could this fail to happen?) the conditions of our moving equilibrium will be changed for the very same reasons for which Edgeworth and Walras had to introduce “re-contract” to safeguard the determinate character of their final equilibrium position. To our knowledge, however, none of the many economists who have presented to us equilibrium growth models in recent years has attached the condition of re-contract for transactions during periods of disequilibrium. They have all, of course, assumed continuous and uninterrupted existence of equilibrium. It is this which, without instantaneous adjustments of supply to changes in demand, is impossible.

Similar problems arise in connection with the composition of the stock of capital. The maintenance of a constant capital—output ratio (whatever this vague notion may mean and imply) is, of course, not a sufficient condition of the maintenance of general equilibrium in a growing economic system. The actual composition of the capital stock in terms of the various capital resources must be appropriate to the composition of total output demanded. The capital stock must contain no single item which its owner would not wish to replace by a replica, if he suddenly lost it by accident, otherwise the stock cannot be in equilibrium. Such changes in demand for consumer goods as we discussed above must therefore be at once accompanied by a corresponding change in the composition of the capital stock, otherwise this stock cannot retain its equilibrium composition and we confront a new source of disequilibrium. Of course, so long as we regard all capital as homogeneous the problem does not arise. As soon as we face the fact that most durable capital goods, even if not actually specific to the uses for which they were originally designed, have at least a limited range of versatility, the continuous maintenance of the equilibrium composition of the capital stock in a world in which relative demand and technology are bound to change in quite unpredictable fashion, emerges as a serious problem.

It is instructive to look at the whole problem from the point of view of the convergence of expectations. A society in which economic progress occurs is part of an uncertain world. Nobody knows the future. In a stationary world it is possible to appeal to the constancy of the “data” and the continuous recurrence of events to justify the belief that all members of such a society will sooner or later become familiar with them and their expectations will converge on the recurrent pattern of events. In an uncertain world this is impossible. Experience shows that different people will entertain widely divergent expectations. This will be so not merely because some men are, by temperament, optimists and others pessimists. Differences in knowledge are here often of fundamental importance. The diffusion of new knowledge is not a uniform and not often a continuous process. Some sources of knowledge are only available to some, but not to others, while the ability to make use of new knowledge is most unequally distributed among men.

For all these reasons expectations in an uncertain world are bound to diverge. But divergent expectations cannot all be fulfilled. Some are bound to be disappointed. The plans based upon them will fail. Some plans will be even more successful than their makers had expected. In either case the planners will not be in equilibrium over time. At the end of the period they will wish they had pursued different plans, and this will apply to those whose plans failed as well as to those whose plans succeeded better than expected. They will thus have to revise their plans in the light of an unsatisfactory experience. But continuous equilibrium requires continuous success of plans. We have to conclude therefore that in an uncertain world in which expectations diverge and the plans based upon them cannot be consistent with one another the particular type of dynamic equilibrium known as “growth equilibrium” is impossible.

III.

Mises rejects the notion of equilibrium and proposes to replace it by that of The Market Process. In following him we confront a number of difficulties. Not the least of them stems from a fact of history which none of us can eschew. The ascendancy which the school of Lausanne has gained in this century has created a situation in which for most of us it has become difficult even to conceive of a world without equilibrium. It nowadays requires quite an effort to do so. So much of what we have learnt and thought seems to depend on it that without it we appear to be drifting helplessly on an uncharted sea without a possibility of taking our bearings. But the inadequacy of the Lausanne notion of general equilibrium has been established. We have to tackle the uncomfortable task of substituting for it something else, something at once more akin to reality and more congenial to praxeological thought.

Fortunately we have Mises' work to guide us in this task. In ridding our minds of the domination of the equilibrium notion the market process presents itself as a better alternative. Perhaps such a conception came more naturally to somebody who shaped his fundamental conceptions in the Vienna of the first decade of this century, the decade in which the reputation of the Austrian School was at its peak.[1] No doubt the young Mises, imbibing the “pure atmosphere” of the school of Vienna, not as yet contaminated by alien particles, found himself able to conceptualize, with little effort, the essence of the market economy in the form of the market process. For us, as we explained, an effort is here required. We should make a start by looking at different meanings of the notion of equilibrium.

First of all, we have to note that what has happened to the notion of equilibrium is that the economists of Lausanne and their successors to-day have stretched the meaning of equilibrium to such an extent that a notion, in its original meaning useful and indeed indispensable, has been applied far outside the borders of its natural habitat.

The Austrians were concerned, in the first place, with the individual in household and business. There is no doubt that here equilibrium has a clear meaning and real significance. Men really aim at bringing their various actions into consistency. Here a tendency towards equilibrium is not only a necessary concept of praxeology, but also a fact of experience. It is part of the logic inherent in human action. Interindividual equilibrium, such as that on a simple market, like Böhm-Bawerk's horse market, already raises problems but still makes sense. “Equilibrium of an industry” à la Marshall is already more precarious. “Equilibrium of the economic system as a whole”, as Walras and Pareto conceived of it, is certainly open to Mises' strictures. “Growth Equilibrium”, as we have tried to show, the equilibrium of a system in motion, is simply a mis-conception.

The vice of formalism is precisely this, that various phenomena which have no substance in common are pressed into the same conceptual form and then treated as identical. Because equilibrating forces operate successfully in the individual sphere of action, we must take it for granted, so the formalists tell us, that they will also do so outside it. From Walras to Samuelson we find the same manner of reasoning, the same arbitrary assumptions, the same unwarranted conclusions.

What, then, are we to do? If, with Mises, we adopt the Market Process as our fundamental ORDNUNGSBEGRIFF, how much of equilibrium can we embody in it? We suggest that we envisage a world in which millions of individuals attempt to reach their individual equilibria, but in which a general equilibrium that would embrace all of these is never reached. The Market Process derives its RATIONALE from, and has its place in, a world in which general equilibrium is impossible. But to deny the significance of general equilibrium is not to deny the existence of equilibrating forces. It is merely to demand that we must not lose sight of the forces of disequilibrium and make a comprehensive assessment of all the forces operating in the light of our general knowledge about the formation and dissemination of human knowledge.

If, with Mises, we reject the notion of general equilibrium, but, on the other hand, do not deny the operation of equilibrating forces in markets and between markets, we naturally have to account for those disequilibrating forces which prevent equilibrium from being reached. In other words, to explain the continuous nature of the market process is the same thing as to explain the superior strength of the forces of disequilibrium.

The market process is kept in permanent motion, and equilibrating forces are being checked, by the occurrence of unexpected change and the inconsistency of human plans. Both are necessary, but neither is a sufficient condition. Without the recurrence of the first, i.e. in a stationary world, it is indeed likely that plans would gradually become consistent as men came to learn more and more about their environment including one another's plans. Without the inconsistency of plans prompted by divergent expectations, on the other hand, it is at least possible that all individuals would respond to exogenous change in such a manner that general equilibrium can really be established. A good deal would here, of course, depend on the speed of such adjustments. Where this is high, each adjustment may have been completed before the next unexpected change occurs. What, however, will in reality frustrate the equilibrating forces is the divergence of expectations inevitable in an uncertain world, and its corollary, the inconsistency of plans. Such inconsistency is a permanent characteristic of a world in which unexpected change is expected to recur.

Within the general framework of the market process, prompted by the two permanent forces whose MODUS OPERANDI we have just attempted to describe, equilibrating adjustments in individual markets, both price and quantity adjustments, will, of course, take place. The equilibrating forces will be found to do their work. But we can never be sure that the spill-over effects which an equilibrating adjustment in one market has on other markets will always be in an equilibrating direction. They may well go in the other direction. Equilibrium in one market may be upset when the repercussions of the equilibrating adjustments in other markets reach it. There is therefore no reason why the effects of such intermarket repercussions must always on balance be equilibrating. But our inability to assess the net result of this interplay of equilibrating forces in different markets does not amount to the discovery of another permanent force which keeps the market process in motion. It is a process within the market process.

We have never been able to understand why in the discussion on Keynes' so-called “underemployment equilibrium” some economists, opposed to Keynesian teaching, should have regarded it as either necessary or desirable to argue that in a market economy the market process, if only left unhampered, would “in the end” tend to bring about full employment. In the light of the considerations presented above such a conclusion appears unwarranted. If the outcome of the contest between equilibrating and disequilibrating forces is at best uncertain, why should it be less so in the case of the labour markets, affected as they are by a variety of factors, many of them non-economic? If we have good reason not to believe in the generality of equilibrium, why should we want to assert that in the labour market alone equilibrium will always come about in the end? The cause of the market economy is not served by such assertions which a deeper understanding of the market process and the complex play of forces on which it rests will show to be fallacious. We have to learn to live with unemployment as with other types of disequilibrium.

IV.

It may be useful to elucidate the ideas presented above on market process and equilibrium by restating them in terms of the diffusion of information, somewhat in the manner in which Leijonhufvud has recently interpreted some ideas of Keynes.

We pointed out above that a good deal always depends on the speed of the adjustments following disequilibrium. Where these are made rapidly, equilibrium may be reached before the next unexpected change occurs. Most economists agree that the market is an agent for the diffusion of information, but we may well doubt whether this can be at all regarded as a rapid process. Equilibrium theory, in order to affirm the existence of a strong tendency towards it, has to assume that correct information about equilibrium prices and quantities is readily distilled from market happenings and available to all participants. Otherwise there can be no immediate adjustment. With slow adjustments a good deal may happen in the meantime before equilibrium is reached.

In reality, of course, information will spread slowly because not all participants have the same ability to assess the informative significance of the events they observe. But even apart from this fact, which in any case prevents equal knowledge by all market participants, we have to take note of two further facts which in reality cannot but impede the diffusion of information.

Firstly, nobody can be certain whether an event he has observed constitutes a “real change” or a random fluctuation. He has to wait for confirmation and this takes time. Secondly, nobody knows for how long the information provided by a market event will remain relevant to his plans. In a changing world information which is relevant knowledge to-day may have become obsolete by to-morrow. These two facts, pulling the individual in opposite directions, account for the divergence of expectations.

We thus have to conclude that the diffusion of information does indeed form an indispensable part of the market process and by itself constitutes an equilibrating force. But it is in reality bound to be a rather slow process, likely to be hampered by the divergence of expectations and overtaken by unexpected events.

Mises, as a critic of equilibrium theory and exponent of the Austrian tradition, assumed the rôle of an innovator when he presented his conception of the Market Process as an alternative. It is, however, noteworthy how slowly and gradually the Austrian school evolved these fundamental concepts which serve to unify economic action in society.

In the Walrasian system the notion of equilibrium is employed as a formal device to unify economic action on the three levels of individual, market, and system. This unification is apparently accomplished at one stroke on all three levels. Hence the formal elegance and architectonic unity which have so fascinated many of our contemporaries. But, as we saw, poverty of content is here the price to be paid for elegance of form. While we learn something useful about what governs and unifies individual action, we merely learn a few half-truths about the forces operating in the system as a whole.

The Austrian school presents a very different picture. Here conceptualization and unification are often painfully slow. Even on the level of the individual it took half a century and was not achieved until Schönfeld's WIRTSCHAFTSRECIINUNG of 1924. In the development of Mises' thought as we said above, the idea of the market process was probably conceived 60 years ago, but it was not formulated until the 1930's.

But the slow progress has now brought its reward. We are now able to gain an insight into the complex nature of the forces operating, in particular between markets, which was never dreamt of in the halls of the palace on the shore of the Lake of Geneva.

Mises has provided his disciples with an instrument of thought which promises to be of superb power. In years to come it will be for them to prove their worth by handling it with care and adroitness.

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Values, Prices And Statistics
Bettina Bien

Statistics And The "New Economics"

During the course of his New York University graduate seminar, Mises frequently criticized the propensity of the "new economists" to compile historical data in numerical form. Many of his seminar students, imbued with the thinking of their predominately Keynesian professors, could not understand why Mises persisted in this criticism. When they asked his reasons for opposing statistics, he always denied that he was "against statistics" in any way. But, he added, they should remember that statistics were always history, and only history. Statistics could in no way advance the understanding of economic theory.

Many things can be counted and measured, Mises said, such as miles of railroad tracks, numbers of automobiles, bales of cotton, pounds of tea, pairs of shoes, and so on. Entrepreneurs were well advised to take advantage of any such information available. But Mises always cautioned his questioners to keep in mind that such statistics were historical data, not economic theory. If statistical data are to be useful, they should be recognized for what they are and interpreted in the light of economic understanding. It is the ideas that are the basis for the selection and interpretation of statistics that are important. It is the ideas by which statistics are interpreted that give them whatever significance they have.

One of the major theses of the "Austrian School of Economics," of which Mises is the most eminent spokesman, is that economic institutions are developed from personal ideas and market prices are derived from subjective values. It is Mises steadfast defense of this position which has made him such a vigorous and persistent critic of the "new economics" and its use of statistical data.

Mises' Interest In Economics

It was not family background or environment that led young Mises to the study of economics. His father was a professional engineer for the nationalized Austro-Hungarian railroad system. Few of Mises' teachers were much concerned with philosophical or ideological matters and the majority of them were socialistically inclined. Yet Mises had an inquiring mind. His interest and understanding of theory was primarily an intellectual achievement, developed largely through his wide reading. Thus, his real economic education came from books. As a result, he has great respect for the benefits to be derived from reading and frequently remarks that "books are the best university."

As a young man, Mises was impressed with Carl Menger's Grundsätze der Volkswirtschaftslehre? (1871). Menger, a former University of Vienna Professor, whom Mises later came to know personally, was then no longer actively teaching. In

Menger's book, economics was described as a science based on the ideas, values and actions of individuals. Menger's presentation of economics and his explanation of the marginal utility subjective theory of value was undoubtedly instrumental in channelling young Mises' interests into theory. By the time Mises received his doctorate in 1906, his driving interest had become the study of human action as the explanation of economic institutions and an aid to individuals in planning their future actions.

Mises' first serious work as a mature person was in the field of human action—THEORIE DES GELDES UND DER UMLAUFSMITTEL (1912), the second edition of which appeared in 1924 and was translated into English as THE THEORY OF MONEY AND CREDIT. In this first of his major books, Mises explained the institutions of money and credit as developments emerging from the separate actions of many individuals, acting in the light of their respective ideas and subjective values.

Subjective Values

The thesis that economic institutions develop from ideas, subjective values and the actions of countless individuals, performing independently or in cooperation with others, to attain their various ends, is basic in all the teachings of Mises. Once it is recognized that all market institutions, such as prices, money, credit, and the like, are outcomes of conscious human actions, it is obvious that economic theory differs sharply from the physical sciences. This recognition also makes it clear that economics is not simply a study of physical quantities of raw materials and goods produced. Economics is a qualitative science, pertaining to purposive choices and actions, for which there is no standard of measurement.

The “new economists” try to express economic doctrines in statistical averages and aggregates based on monetary figures. In doing this, they assume that human ideas, values and actions can be measured by a common standard. With adding machines and computers they juggle figures based on the reports of many individuals, as to their monetary receipts and expenditures. The “new economists” construct averages, aggregates and complex indices of prices, assuming that these statistics describe and explain complicated economic phenomena. In making this assumption, the “new economists” forget, if they do not completely ignore, the axiomatic truth of economics, the fact that the human actions from which their data stem, develop out of personal, subjective ideas and values, for which there is not, and cannot be, any standard of measurement.

All attempts to explain economic theory with the help of mathematics rest on extremely muddled thinking. To eliminate the confusion, it is necessary to analyze the various economic institutions and demonstrate how they arise from the ideas of individuals, each acting on the basis of ideas and subjective values. This calls for re-emphasizing the subjectivity of the values which precede and are responsible for the purposive actions which follow. It also calls for understanding clearly what “subjective” really means.

"Subjective" contrasts with "objective" as the impressions an object makes on a person's senses and thoughts contrast with the object's physical properties which may be measured and stated in numbers. Subjective analyses rest on interpretations, ideas and the values of the subject making the analysis. Objective characteristics are intrinsic to the object being described. Objectively described, a crowbar is "a bar of iron or steel, usually wedge-shaped at the point or working end and more or less bent." Subjectively described, a crowbar may be "valuable" as a tool for lifting heavy loads or as an instrument for murder. Subjective values are always the same. Subjective values cannot be meaningfully counted, added or measured. Subjective values, like love, can only be compared by the person doing the valuing and arranged by him according to his own personal scale of values.

The Market

Consciously or unconsciously, everyone arranges all the various things he wants—material goods, services and immaterial or spiritual values—according to his personal, subjective, scale of values at the time. He is always most eager to acquire or to hold the things he values highest. He will strive more energetically and offer more for them, than he will for things he values less. At any moment, he is always aiming at the goals he considers most important. It is his actions, with the actions of others, that create the market processes.

Individuals do not act in a vacuum, and they seldom act alone. They take into consideration not only the physical world of reality but also the society in which they live. Their decisions, choices and actions are always made in the light of physical conditions. Their decisions, choices and actions are also always made in the light of the decisions, choices and actions being taken by other persons.

The world in which men are acting is a world in constant flux. Changes are continually going on in the physical world. Stocks of existing goods are being used, new raw materials are being unearthed and physical changes are altering material conditions. Other changes are also always being wrought by the purposive actions of individuals in response to their ideas and their changing environment. Persons are continually acquiring new ideas, reassessing old ones, and shifting their values according to their relative subjective importance under new conditions. Persons must make decisions and plan actions to be taken over varying periods of time, in anticipation of uncertain changes in the future. Ideas influence values; values determine actions; actions lead to changes; and changes in turn affect ideas, subjective values and, thus, the future actions of individuals. In this way, step by step over centuries, the market economy we know today evolved from the billions and billions of actions of countless persons.

Individuals cooperate, divide the labor, compete and trade with one another—each in the attempt to attain his most important realistically attainable subjective values. The specialization of individuals results in exchange. Their specialization and exchanges lead to increased production, savings, investments and further changes on the market. Eventually, over time, a fantastically complex network of interlocking, interpersonal exchanges evolves. This network of transactions is the market. Economic theory explains this complicated network very simply—as the outcome of purposive actions of countless individuals, on the basis of their ideas and subjective values.

Prices

The statistics Mises censures so severely are not those composed of countable and measurable physical goods. Mises' criticism is directed at attempts to use “prices” as if they represented quantitative measurements of something. This misunderstanding is compounded when prices are made the basis for complex statistical averages and aggregates such as price “levels,” price index numbers, price “deflators,” the so-called “standard dollar,” “national income” estimates, “gross national product” figures, and the like. To explain the fallacy on which these statistical concepts rest, Mises applies the analysis of the marginal utility subjective value theory of the “Austrian School.”

The urgency of a person's subjective values becomes apparent through his actions. The more eager he is, the greater effort he will put forth and the more he will be willing to offer in the hope of attaining what he wants. As he acts through the market, his subjective values come into contact with the subjective values of many other persons as they too express their personal values through their respective actions. In this way, the values and the actions of everyone have an impact on the actions of everyone else.

Everyone always does the best he can, in the light of his limited personal knowledge, abilities, understanding and circumstances, to attain the various subjective ends he values. Every person's eagerness to attain his goals is an open invitation to others, who are seeking to accomplish their own ends by trying to supply, through the market, what others are demanding. Thus, the market processes tend to draw together persons who have some prospect of helping one another.

When two persons trade, the ratio at which that exchange takes place, at that particular time and place, depends on comparisons of their respective subjective values. Each particular transaction takes place at a definite ratio or “price.” At the instant the trade is made, a specific quantity of a good or service is exchanged for a definite quantity of a specific monetary unit. This ratio emerges out of the relative subjective values of all interested parties for the specific items being traded, as compared with their evaluations of all available alternatives known. A price always refers to a specific transaction. Prices are merely representations of fleeting ratios expressed in monetary terms.

In logic it is said—and certainly nobody denies it—that two things equal to the same thing are equal to each other. The fact that prices are stated in numbers may make it appear that two items which were exchanged for the same quantity of money at different times and places must have some fixed relationship to one another. However, prices are the outcomes of conscious human actions. In the field of human action, two things which exist at different times and places, although they may otherwise appear to be the same, are never equal to the same thing, nor equal to each other.

In the first place, they are distinguished from one another by their different geographical and historical settings. These two features alone affect the values they have for acting human beings. But more than that, objects are always being valued—in the light of historical events, changing physical conditions, altered supplies and demands and new social and economic situations—by persons whose ideas, values, ends, and needs are also always changing. As their ends change, so do the means they consider appropriate and the values they attribute to various means. As a consequence of all these changes, prices represent transitory exchange ratios only, at specific times and places. Prices are crystallized representations of relative subjective values at specific historical instants when definite trades were concluded.

Figures indicating sums of money may be added, subtracted, multiplied and divided. But the traders' subjective evaluations of the two sums of money cannot be measured or expressed in numbers. If two prices, arising at two different times or places, are used for mathematical computations as if they were two physical quantities of the monetary unit, their true significance is lost. Combining the two monetary figures yields a third figure. But this new figure bears no meaningful relationship to either of the two market prices. Nor is it related in any way to the subjective values on which the two market prices were based.

Money

Money was not created by the wave of a magic wand, royal decree, government fiat, or any act of a parliamentary body. Money was a product of the market, a medium of exchange that came into use because men found it made transactions easier and enabled them to satisfy their various subjective values better. Money is perhaps the most important of all the market institutions which have emerged from the conscious actions of men.

Because men have subjective values and goals, they value any means which they expect will facilitate the pursuit of their goals. Goods and services expected to be useful acquire value through the market as many acting individuals compete for them. In the course of historical evolution some commodities came to be more highly valued and more widely desired than most others. Sooner or later, in some community—no one knows just where or when—some such commodity, high on the subjective value scales of many persons, was introduced into trade to facilitate exchanges. In this way, indirect exchange was born.

As men specialized more, traded more frequently over greater distances, arranging transactions that involved longer periods of time, direct exchange (barter) grew increasingly cumbersome. The first person to recognize the advantages of indirect exchange could have been a hunter, seeking to exchange hides for a new bow and arrow. If he had failed to persuade an owner of bows and arrows to take his hides in trade, he may have pulled a gold bracelet from his arm, arguing that many persons liked gold. If the bow and arrow owner would take the hunter's bracelet now in trade for a bow and arrows, he would have gold—something others valued. The bracelet of gold could then be used at a later time to trade for whatever might be wanted.

We cannot know precisely how the first cow, strip of wampum, piece of silver or gold nugget came to be used as a medium of exchange, but at that instant indirect exchange was introduced. When traders were ready to accept an intermediate commodity as a temporary expedient, pending an opportunity to obtain what they really wanted, it became easier to arrange transactions. The use of a medium of exchange permitted greater specialization and enabled everyone to use the market to better advantage to satisfy their various subjective values.

The market value of any particular commodity is always shifting in response to the changing subjective values of the individuals living and trading at particular times and places. Similarly, the market value of the commodity used as money shifts in response to the changing subjective values of the participants in that market.

The convenience of using a medium of exchange, instead of having to rely entirely on barter, enhances the desirability of the commodity used for this purpose. Once its greater marketability becomes widely recognized, so that it comes into general use as money, its acceptability in exchange increases still more. Thus, its market value rises on that account also. As a result, this commodity will command more highly valued goods and services on the market in its role as a medium of exchange than it can simply as another useful commodity. Still it is possible to trace this higher exchange ratio for this commodity in its role as money to the varying unequal subjective values of acting individuals and their ensuing purposive actions.

Money is a commodity, the most marketable commodity in the community which it serves as the medium of exchange. Like other commodities, the value of the monetary unit on the market, the ratio at which it is traded for other goods and services, its purchasing power, emerges from the ever-changing subjective values of acting individuals. Understanding of this subjective origin of money explains why monetary prices are not objective measurements.

The Role Of The Entrepreneur

The successful entrepreneur is the true “creator” of market values, values which are derived through the market from the interplay of subjective evaluations. The entrepreneur looks for opportunities to buy, transport, combine, and/or process various factors of production in the expectation of increasing consumer satisfactions. He tries to convert factors of production to purposes of greater value, in the subjective judgments of other individuals, than they would have had in other uses. If the entrepreneur succeeds in his anticipations, he will have transformed factors of production into new forms, combinations or locations that yield greater consumer satisfactions than they would have otherwise.

A simple example of entrepreneurial activity which increases the satisfaction of consumers is a “white elephant” sale. The person who arranges to offer for sale one family's attic “junk” and finds buyers who place higher subjective values on such “junk” converts “white elephants” into “treasures.” By arranging the transaction, he increases satisfactions all around.

Similarly entrepreneurs on the market are continually looking for opportunities to move, combine or process economic “white elephants,” so to speak, in the hope of transforming them into something consumers value more. Entrepreneurs may purchase raw materials (iron, wood pulp, chemicals, etc.), tools and machinery, the services of workers (labor), and so on, anything they believe will serve their purpose. If the entrepreneurs succeed in selling the processed factors of production to consumers who consider them more valuable in their new forms than in other arrangements, they can earn profits.

Entrepreneurs always act as middlemen, transferring and/or transforming factors of production with relatively low values into finished goods or services they hope will have higher values. When this job is done, they usually ask prices—they can never set or “administer” prices—which will more than cover their costs. Whether or not an entrepreneur receives the sum he asks for will always depend on the relative subjective values of consumers. The entrepreneur's profit or loss, as the case may be, will be determined in every instance by the exchange ratios at which his products are finally traded when they reach the market.

Price Statistics And Economic Reality

Mises' criticism of the statistics used in the “new economics” rests on an understanding of the real world of human action. The market economy is the product of personal, ever-changing, subjective ideas and values which result in billions and billions of actions. As all economic institutions are interrelated through the market, a shift in the subjective value judgments of one individual alters the interrelationships of all market data. Thus, all market phenomena are in a constant state of flux.

With irrefutable logic, Mises has demonstrated how the ideas and values of countless individuals have contributed, step by step over millenia, to the development of today's complex economic institutions. The subjective values attributed by individuals at any instant to their available quantities of money, relative to the values they attach to the various goods and services available on the market, lead them to take specific actions. These countless individual actions, in turn, are always effecting changes and influencing the ideas and values of other acting men.

When men discovered that it was easier to gain their subjective values through the division of labor and trade, their actions gave rise to the market economy. As trade increased and barter proved clumsy, the conscious choices of countless persons, each seeking his own subjective values, led in time to indirect exchange and the use of a commodity as money. Through their contacts with one another on the market, exchange ratios among the relative subjective values of individuals developed and gained expression in the form of prices. At any instant, the exchange ratio between a quantity of money and the other goods and services being traded reflects the relative subjective values of all the participants on that market. The value of the money side of the exchange ratio fluctuates constantly as does the value of the goods or services side of the ratio. Such transient ratios emerging from countless ever-changing values cannot be measured. Nor can they be used with meaning as the basis for mathematical computations.

The understanding derived from the doctrines of the "Austrian School of Economics" enables us to retrace the complex interrelationships of today's market economy back to their origins. We find that the entire world of economic reality and all market institutions rest on the ideas of individuals, individuals who are continually ranking their subjective values at any moment, in the order of their relative importance to them—always preferring, choosing, deciding and acting in accordance with their respective ideas, abilities, interests and circumstances.

Every development in this entire sequence of events in the development of market institutions is relative to everything else in the economy. Every ratio among the various phenomena is interrelated and subject to constant shifting whenever any actor alters one component factor for any reason. Yet, in the last analysis, every step is logically explainable as the outcome of the ever-changing subjective value judgments of acting individuals, comparing available assets with available opportunities for action at every instant.

The true significance of prices stems from their role as fleeting exchange ratios of specific transactions, ratios which arise from the interplay through market processes of relative subjective values of acting individuals. As such, prices furnish some of the keys to understanding the world of economic reality. Prices can help entrepreneurs to plan for future production, so as to convert factors of production more effectively into more valuable uses. Treating historical prices as if they were quantitative measurements of something stable, expressed in a monetary unit assumed to be a constant standard, is to consider them as something they are not.

Market values and market conditions are always fluctuating. Statistics which purport to portray such market phenomena misrepresent, misinterpret and mislead. They tend to deny the significance of the connection between particular prices and specific historical situations. They also tend to ignore the interconnexity of all prices. But more than this, statistics based on prices assume a stability of money as the standard of measure and an objectivity which is foreign to the market economy, where everything is forever changing on the basis of ever-shifting subjective values. Thus, market phenomena lack the two qualifications required for statistical analyses to have meaning—a constant standard for measuring and characteristics which may be objectively described and measured.

Subjectivity remains at the root of every human action. As a result, subjectivity is also the basis of all our market institutions. It was recognition of the subjective nature of the values on which all economic activities are based that enabled the "Austrians" to solve the paradox of value which had stumped earlier "Classical" economists. This subjectivity is the clue that makes intelligible the very complex interlocking economic relationships that have developed throughout the years. Thus, Mises maintains that it is extremely important to point out that the statistics of the "new economics," which are based on averages and aggregates of monetary prices, have no meaning for economic theory.

As Mises explained to his seminar students, the statistics of the "new economics" fail to contribute to an understanding of economic reality. The real world of economic action is a world of subjective values and resulting human actions. This is a world that is in a constant state of flux.

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The Tax System And A Free Society
Oswald Brownlee

Most of the modern treatises on taxation deal with the characteristics of a tax system that are of greatest advantage to the state. The canons of taxation enumerated by Adam Smith in The Wealth of Nations - certainty, convenience and economy - were defined from the standpoint of the taxpayer. But, even these terms have been redefined to refer to the certainty of the tax yield to the state treasury and the convenience and ease of collection from the point of view of the tax collector. In this short paper I want to deal with the tax system as it impinges on the taxpayer and to try to set forth some taxing practices that seem to me to impinge on the vitality of a free society.

I hope that there are many tax systems compatible with a free market economy - if we mean by a free market economy one in which there are no artificial barriers to entry into economic activity, the terms under which choices can be made are the same to all participants and are essentially unaffected by the level of activity of any one private economic unit, government does not coerce individuals with respect to their choices and the role of government as a producer is confined to the provision of goods and service which it can produce more efficiently than can private producers. Funds for the operation of government could be secured in many different ways with no important differences in the ability of a free market economy to survive.

If a free market economy could exist in only a few restricted tax environments, prospects for its survival might be dim indeed. Different tax structures will result in different production patterns and different rates of saving and may result in different degrees of income fluctuations for given autonomous disturbances. These differences are important, but they impinge on differences in the vitality of a free market economy in the same way as they would on a socialist one. Perhaps it is in the interest of supporters of the free market system to advocate a tax system which has associated with it a near minimum welfare loss, if the free market is to gain maximum support. However, even this contention would be extremely difficult to prove.

Although I will discuss some aspects of these welfare costs, let me first discuss some aspects of coercion and some tax tendencies that are inconsistent with a free market economy.

II

The validity of my contention regarding the vitality of a free market economy in many different tax environments obviously is dependent on how one defines coercion. Is not the taxation of a particular commodity coercive in that the relative price of that commodity is increased and consumers are thereby induced to consume less of it?

If this is coercion, no tax system will be without it, for only a head tax does not affect economic opportunities—and, even it can be avoided by dying. I believe that the important aspect of coercion in a tax system is not what it does to relative prices but whether there are clearly defined rules that establish one's tax liability without the necessity for consulting taxing authorities. Without such rules the government can use arbitrarily the tax system to penalize or reward particular economic units and in effect interfere whimsically with the market mechanism. Some rules may be bad ones, but one will know what they are and can work for modifying them.

III

Survival of a free market economy requires that the government at least establish conditions such that monopoly is not encouraged, even if no active measures are taken to foster competition. Several features of contemporary tax systems violate this condition. Of particular importance are:

1) the taxation of imports
2) differential tax treatment of income and capital gains
3) gross receipts or “turnover” taxation

Few countries employ customs duties as a major revenue source. The objective of such taxation usually is protection for domestic economic activity rather than governmental revenue. The result usually is to cut real national income. However, in addition to the welfare losses associated with such levies, the taxation of imports leads to the growth of monopoly, particularly in countries where the size of the market is small. There probably are not many instances where import duties now encourage monopoly in the United States, but such instances are numerous among less developed nations.

If a national market is large enough so that the output of an economically efficient firm is a relatively small fraction of total sales, monopoly is impossible—without collusion among the firms. Many national markets are so small that the total quantity traded per unit of time is less than the amount that would be produced by a firm of the most economic size. Obviously, such a commodity would not be produced nationally—if it were not for protection. It will be economic for a country to produce a commodity if the size of the market is at least equal to the size of the efficient firm, and that firm can exert no monopoly power. This latter condition can be fulfilled if there are potential foreign producers who can supply the product at the firm's minimum cost. In the absence of import taxation or other forms of protection the problem of private enterprise monopoly usually is not presented.

In the United States capital gains are taxes at a rate of 25 per cent or at one-half the marginal personal income tax rate applicable to the taxpayer, whichever is the smaller. In the U.S. and in other countries where income and capital gains are taxed at different rates, we have had an opportunity to observe the great amount of activity devoted to converting income into capital gains. Although such activity yields a private gain, it is not only an obvious social waste but also gives a lift to monopoly in that it encourages retention of corporate earnings. Rather than receive his dividends and make his own choice as to whether to reinvest them in the same enterprise or some other line of activity, the stockholder leaves them with the corporation where he may gain through capital appreciation even though the capital may earn less before personal taxes than in some other uses.

I believe that this has been an important factor in the recent growth of established large corporations in the U.S. It gives established enterprises a distinct advantage in acquiring funds and thus is a man-made impediment to entry. It encourages firms to engage in activities in which they have no comparative advantage. One can cite such combinations as baseball teams and television, tobacco products and cosmetics and flour milling and boat construction as evidence.

There are several cures for this ailment, the most obvious one being to tax capital gains as income. However, in a system with progressive income tax rates, this cure also taxes persons receiving fluctuating capital gains at higher rates than persons with stable incomes - unless provisions are made for averaging income for tax purposes over a relatively long period of time. This may also have disadvantages in terms of its impact upon the inherent stability of the economy in that it probably reduces the correlation between current tax payments and current spending. There would be no problem if an expenditures tax were to replace an income tax, since when income is received or from where it came is of no significance for tax purposes. Also, a strictly proportional income tax or one with a constant marginal rate in which capital gains are taxed as income would involve no discrimination. I will discuss these possibilities later.

Turnover taxes have been levied at very low rates by a few of the states in the U.S. and are not significant in the tax structure. However, turnover taxation is attractive to under-developed countries because of its supposed low collection costs. A turnover tax induces vertical integration and hence larger enterprises than would exist in its absence. Like the differential tax rates on income and capital gains, it is an encouragement to monopoly and a threat to a free market economy. Small enterprises that might introduce more efficient techniques have less opportunity to enter.

IV

Certain features of the tax structure are inconsistent not only with a free market economy but with a free society because they are coercive, i.e. they permit the government to make arbitrary decisions with respect to the tax base or require the taxpayer to negotiate with the tax authorities in determining his tax liability. The ease with which additional tax revenue is made available as income grows without increasing tax rates also is of importance in determining the extent to which government undertakes activities that would not be sanctioned if put to a popular vote.

An amount of tax paid by some taxpayers that is the result of direct negotiations between them and the taxing authorities is characteristic of the taxes levied by local governments in some states in the U. S. on real estate and other property. Property assessment for purposes of determining the tax base usually is performed by low paid and incompetent civil servants, and there are wide variations in the amounts of taxes paid on properties of identical value in a given taxing jurisdiction. Taxpayers have the right to appeal to the courts if they believe their assessment are too high. However, the cost involved is large, and - of greater importance - an appeal is very likely to lead to an increase in the amount of tax paid because all properties are underassessed.

The situation could be substantially improved by such things as permitting the taxpayer to assign a value to the property and giving the taxing authority the right to purchase at the assigned price or paying assessors in accordance with the accuracy of their assessments for properties sold during a particular time period. However, there is much opposition from businesses to improving assessment procedures. A business frequently believes that its negotiator is more clever than that of its competitor and that it has obtained or can gain an advantage through the existing procedure.

I believe that the forces favoring arbitrariness in property taxation are so strong that the tax should be abolished. In its present form it truly gives government opportunities to coerce individuals and is inconsistent with freedom.

To me the most pernicous aspect of income taxation in the U.S. is the exclusion or deductibility of certain items—other than expenses associated in obtaining income—from the tax base (both corporation net income and personal income) for purposes of determining the tax liability. These items include interest paid, selected taxes, medical expenses in excess of a certain fraction of income, interest on state and local government securities, imputed income from owner-occupied housing and contributions to selected “charitable” and “artistic” activities.

If well defined, these deductions and exclusions constitute subsidies to certain activities and, although they may incur substantial welfare losses, are in the same class as taxes on selected commodities. The marginal rate of subsidization, i.e. the ratio of the government contribution to the private contribution, depends upon the marginal rate of taxation. For most corporations, the government (meaning other taxpayers) contributes about equally with the corporations. The contributions of some individuals can be as low as about one-third the amount contributed.

However, in many instances the deductibility of an item is not unambiguously known and is subject to the whim of the tax administrators. Much of New York theater and its cabarets, not to mention its call girls, are dependent upon arbitrary decisions regarding the legitimacy of a claimed business expense. More important, the government may employ its power to classify contributions to encourage the growth of certain organizations and kill others. It was able to obtain ransom for prisoners captured during the Bay of Pigs fiasco by asking businesses to contribute goods, the contributions being deductible at about twice their production cost for tax purposes. The cost to businesses was thus zero, and taxpayers as a whole paid a ransom which they probably would have been unwilling to make had they been asked explicity.

Attempts to alleviate these conditions have been both weak and unsuccessful. Their importance, and hence the pressure to maintain them, is directly related to the tax rates. For this reason, if for no other, the survival of freedom may depend upon lower marginal rates of income taxation than now exist in the United States. A tax structure in which the marginal tax rate increases with money income, as is true of the United States structure, makes the share of income taken by the government increase with the price level, even though real income and the tax laws remain unchanged. In spite of so-called tax cuts, real tax rates increased for some income groups due to the inflation. Clearly the tax structure should be defined in real terms so that the government has less incentive to foster inflation.

The coercive aspects of various social security taxes have been so widely discussed that I need not devote a lengthy discussion to them. That an individual should purchase a minimal annuity or accumulate in some other fashion some minimum amount of assets for his support in old age and that he should also purchase some minimum health insurance has been fairly widely accepted among liberals. However, that he should be forced to make such purchases and that the annuities and insurance be purchases only from the government has not been accepted both because government monopoly is no better than private monopoly and because of the income redistribution which accompanies such taxation. I see no place for such taxes in the tax system of a free economy.

V

There is much interest among true liberals in the consistency of progressive taxation of individual income and a free society. If persons share proportionately to their incomes in the costs of government, I believe that the level of government expenditure is likely to be lower—at any given level of national income—than if most persons give up proportionately little and some give up proportionately much. The present tax structure seems to include a bias for larger than optimal expenditure.

I believe it is more enlightening to discuss whether marginal tax rates should increase with the size of the taxpayer's base, rather than whether the tax system is progressive. I do not believe that progressivity is a threat to a free market economy except for the long-run impacts of its lower economic efficiency on the vitality of the system. Marginal tax rates which increase mildly with the tax base seem to me to be just as compatible with a free economy as constant marginal rates. However, on grounds other than consistency with a free market economy the case for constancy of marginal rates seems to me to be a very strong one. Although marginal rates of taxation on corporate net income are not invariant with income, some excise tax rates vary with the total outlay and there are property tax exemptions so that on some properties the marginal property tax rates is zero; controversy over the nature of the appropriate tax schedule has centered largely on that for personal income.

Let us assume that current personal income including capital gains constitutes the entire tax base. If the marginal tax rate is a constant, the time pattern of the receipt of income plays no role in the total tax paid over a given period of time for a given total income. Individuals with identical lifetime incomes pay identical taxes—assuming no change in the tax structure. Note that an invariant marginal tax rate means that the tax paid will be negative if income is less than a given number—which may be greater than, equal to, or less than zero.

In the taxation of expenditures, the time distribution of expenditure is of importance if the marginal tax rate is not constant. To avoid discrimination among taxpayers with the same totals, but different time distributions, of expenditure, a constant marginal rate is desirable. The tax can be made progressive by introducing an exemption, and there could be negative tax payments for taxpayers spending less than the amount of this exemption.

VI

As I stated at the beginning of this paper, many tax systems are consistent with a free economy. Elimination of property taxes, import duties and turnover taxes; inclusion of capital gains as income, elimination of deductions of expenses that are not associated with earning income and requiring that marginal tax rates be constant still leaves us with an infinite number of combinations of, say, income and expenditure tax rates all of which would yield the same revenue. However, other criteria can and should be introduced to further restrict the possibilities. I shall rely on the welfare cost—i.e. the amount by which national income is made smaller than it could be because one tax rather than another is used.

One difficulty with this criterion is that one must know a great deal about the economy in order to know when the welfare cost is minimized. For example, a system of excise taxes is not optimal—for a given amount of revenue to be raised by excise taxation—when all of the taxes are levied at the same ad valorem rate unless the elasticities of demand for all commodities are identical, all commodities being produced at constant marginal costs. Thus, an expenditures tax probably is not a welfare maximizing collection of exise taxes. Similarly, because an income tax is a subsidy to leisure, it also cannot be welfare maximizing. However, some things about taxes still can be said knowing only some general properties of the economy.

> (1) The tax on corporate income is a tax on capital used in the corporate sector of the economy and leads to too much labor and too little capital being used in that sector. It should be eliminated unless labor use is to be taxed similarly to capital in the corporate sector but not in the non-corporate part. Although most countries tax labor use through so-called social security taxes, the tax rate usually is the same in all uses—except leisure—so that one should eliminate the corporation income tax even though social security taxes were retained.
> (2) An expenditure tax does not tax leisure whereas an income tax subsidizes this activity. Hence, a combination of an income tax and an expenditure tax could be less efficient than either used alone. However, the price elasticity of demand for leisure is not very large and equal rates of excise taxation on all commodities except leisure (which is the outcome of the expenditure tax) also is not optimal. Consequently, I would guess that some combination of an income tax in which saving is exempted and an expenditure tax would be nearly as good as is achievable.
> (3) Some taxes other than the income and expenditure tax and yielding minor amounts of revenue should remain in the tax system as approximations of charges for services distributed in accordance with the amount of taxes paid.

> Motor fuels taxes and license fees to pay for highway services and per capita taxes to pay for police and fire protection fall in this category.

VII

Economists usually discuss the expenditure and tax decisions of governments as if they were (1) a selection of how much to spend based on a comparison of the marginal values of government proposals and the product that would be yielded if the resources were used in the private sector of the economy and then (2) a decision as to how best to finance these projects. Obviously, an expenditure should not be made if its marginal value is less than that in the private sector.

In practice, this procedure is not that which is followed. A better simple model might be that governments estimate how much they can extract from their constituents and then determine how to spend what they can get. Actually, spending often exceeds what the government believes it can extract by means other than inflation, budget deficits having been responsible for inflations in many countries. In the United States, there sometimes have been reductions in Federal tax rates, but combined state and local rates have almost invariably been marching upward during the past 3 decades. Although local rates have sometimes been cut, such decreases have taken place only when revenues from state or Federal sources replaced them.

In view of current practice, it has been suggested that a ceiling be placed on the share of a country's income that can be used by government. Usually this is expressed as a ratio of government expenditure to total income, and numbers such as 0.25 have been suggested. It does not increase the welfare of a nation when it fails to push government activities whose productivities clearly exceed those of activities that might be undertaken in the private sector. However, it is highly unlikely that a restriction of say, 25 per cent on the share of total income that could be used by government would rule out any government projects that yield more than private ones—if government appropriately ordered its activities. There is no assurance that such a ceiling would force government to perform more efficiently at a reduced scale. However, it would induce an ordering of possibilities instead of an attitude that there is no limit to the scope of undertakings available to government.

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How “Should” Common-Access Facilities Be Financed?? James M. Buchanan

Introduction

This paper challenges some of the sacred cows in public finance. I demonstrate that the efficient means of financing certain common-access facilities may involve the imposition of taxes that are inversely related to the income-wealth positions of potential users. The analysis suggests, further, that the adoption of such taxes may be in the interest of those very consumers who are subjected to the relatively high rates. Although its subject matter is limited in scope, the paper adds to the mounting evidence that traditional public-finance precepts are little more than outmoded shibboleths for old-fashioned left-liberal economists who have seldom separated their ethics from their analysis.

Common Access Without User Prices

For many facilities adequate financing from direct user pricing is inefficient in an institutional sense. The costs of excluding users on a unit-of-service basis may be prohibitive. In such cases, usage of the facility may be opened to all. Access to the services of the facility may be made commonly available to all members of the relevant community without payment of a user charge. To finance such a facility requires resort to some means other than direct pricing of services as used. These means may take the form of initiation fees, annual club dues, membership subscriptions, or season tickets in the case of privately-owned facilities (golf and swimming clubs are good examples) or taxes in the case of publicly-owned facilities (examples are municipal swimming pools, and museums). The organizational arrangements, as such, are not directly relevant to the question to be examined here. The discussion is limited to the ordering of such “nondirect” prices among members of a potential user or consumer group. Somewhat paradoxically, the analysis suggests that for some common-access facilities, low-income users “should” be charged higher “nondirect prices” than high-income users.

An Example

Consider a simple example which we place in a collective-choice context. Suppose that there are acknowledged advantages to a small community of nearby residents from the maintenance and upkeep of a beach facility. Furthermore, assume that the charging of direct user prices in the form, say, of daily or hourly fees, involves unduly high collection and enforcement costs. The facility may be maintained at differing levels of quantity, which can be measured continuously in square yards of sand beach. The decision as to the quantity to be maintained is to be collectively made. Income-wealth levels differ as among members of the community of prospective consumers or users, but, for simplicity, we assume that underlying preference functions are identical for all persons.

The question is: How “should” the community of users finance the beach-maintenance charges, and how much maintenance (measured in square yards) “should” be undertaken? Conceptually at least, the second part of this question can be answered without difficulty by anyone familiar with the modern theory of public or collective-consumption goods. A necessary condition for the attainment of an optimal or efficient quantity of the “good,” in our case, the beach facility, is equality between marginal evaluations summed over all potential users and the marginal cost of providing the “good.” In terms of this example, optimality is reached when the value placed on slightly larger beach area, summed over all persons in the community, is equal to the added maintenance cost involved in the slightly larger area. As noted, this is a conceptually satisfactory answer rather than an instrumentally helpful one. The criterion tells us next to nothing about how the marginal evaluations of the members of the community may be determined.

Wicksell's Criterion For Efficiency

Knut Wicksell's approach to the problem of financing publicly-provided facilities provides more instrumental assistance in this respect.[1] The costs of financing differing levels of beach maintenance may be presumed to be known in advance. If we disregard, for now, the costs of organizing for political decisions, we may suppose that some arbitrarily-chosen small initial level of beach maintenance, say for X square yards, is proposed along with a whole array of differing tax-sharing arrangements. Among the community of N persons, total tax payments, T, must be equal to the known costs of financing the initial level of maintenance, X. Individual tax shares may, however, range from zero to T, or, if we designate an individual's share as t_i, the condition to be met is that $0 \leq t_i \geq T$.[2] Any tax-sharing scheme that meets this condition qualifies for inclusion in the array that is matched against the proposed outlay.

In some way, say at a town meeting, the outlay proposed is presented for a vote in the form of a series of motions each one of which embodies simultaneous approval of the outlay and a specific tax-sharing arrangement for financing it. So long as unanimous consent is not secured, no decision is reached. The decision stage stops when some tax plan for financing the outlay secures the agreement among all members. For the small, initially-proposed quantity of maintenance, there may, of course, be many tax schemes that could generate unanimous support. Suppose that one such scheme is adopted. From this point, a second proposal is made which embodies the financing of some increment to X. The same voting procedure is followed, with unanimous approval being the criterion for final decision. In this way, the community proceeds by a series of finite steps to determine the appropriate quantity of beach maintenance to be provided and, simultaneously, the tax sharing of the costs of the facility will be determined.

The Wicksellian collective-decision model conceptually provides us with a meaning of efficiency in financing, a meaning that might be revealed by individual behavior under a set of idealized conditions. Even Wicksell recognized, however, that these conditions could hardly be realized in any real-world decision process. Group decision-making takes time and hence involves costs. Furthermore, the existence of a unanimity rule creates strong incentives for unproductive investment in bargaining strategy on the part of individuals. On balance, the Wicksellian framework provides little more than a benchmark from which departures may be measured. In a larger institutional sense, efficiency in collective-choice making may require violations of the conditions that are required to guarantee efficiency in the narrowly allocative sense.3

Tax Institutions And Collective Decision Rules

To this end, modifications on the Wicksellian scheme have been variously proposed. Relatively little support may be found for application of a unanimity rule, but public-finance scholars have recognized that properly chosen tax-sharing schemes may partially substitute for the inclusiveness of rules. To the extent that tax-sharing institutions can be selected and imposed independently of the collective-decision process, and to the extent that the tax shares embodied in these institutions accurately reflect the strength of individuals' desires for the facility to be financed, the inclusiveness of choice-making rules may be relaxed without generating predicted departures from efficiency in outcomes. As an extreme example to illustrate this relationship between tax shares and decision rules, consider a community of equals in which a tax sharing institution requires equal payments. In this case, if the facility to be financed is of the extreme polar type that benefits all members of the community equally, any decision-making rule will yield the same result as any other, from single-person dictatorship to unanimity.4

The tax institutions that are observed to exist normally relate individual tax shares positively to income-wealth positions of individuals, and ethical norms for tax sharing embody this relationship. To the extent that these institutions are interpreted to embody efficiency at all, the relationship between income-wealth criteria and tax shares is taken to indicate a positive income-wealth elasticity of demand for the services provided by the publicly-provided facility. Since this is characteristic of so-called “normal” goods in the private economy, the extension of this assumption to apply to goods and services that are publicly-provided seems to be fully acceptable. If publicly-provided goods are characterized by a positive income elasticity, certain bounds would be set on the inefficiency of public-goods provision, almost independently of consideration for the actual rules for reaching collective or political decisions or for the practical workings of these rules. That is to say, so long as individual tax shares are positively related to income-wealth positions, and so long as the goods in question satisfy criteria for “publicness,” the inefficiencies generated by less-than-unanimity rules for decision may not be excessive. Something of this sort, at least, may describe what we might call the “conventional wisdom” among modern public-finance specialists.

I shall demonstrate, however, that there is a major error in the line of reasoning traced out briefly above. When this error is corrected, it is relatively easy to show that, for the sort of facilities examined in this note, there need not be a positive relationship between income-wealth level and tax shares for individual members of the community, even if, under some conditions, the services of the facilities should be characterized by a positive income elasticity of demand. Efficiency may require that low income-wealth recipients pay somewhat larger tax shares than their high income-wealth counterparts, and failure to allow this in fiscal institutional structures may, in fact, impose differential harm precisely on the low income-wealth users of the facilities.

Dimensions Of Evaluation

Let us return to the beach maintenance example introduced earlier. If their underlying preferences are essentially identical, how could it be possible that a low-income member of the community might place a higher marginal evaluation on some given extension of the facility size than his high-income neighbor? Once the question is put in terms of this sort of example, the answer seems intuitively plausible. The marginal evaluation that an individual user places on an extension of the facility is the increment to total value that he anticipates to derive from this extension, an increment that is dependent on his anticipated total usage of the facility. If it can be plausibly argued that the low income consumer uses the services of the common-access facility more than the high-income user, it becomes logically possible that the marginal evaluation which he places on the extension of the facility is relatively larger. This will be possible even if, over wide ranges of equal service levels, the evaluation of the high-income user is relatively greater.

For a market-supplied good or service, income elasticity is defined to be the percentage change in quantity demanded divided by the percentage change in income. But this definition obscures the assumption of a fixed price. Implicitly, the adjustment that takes place in consumption consequent on the change in income is in quantity demanded. Hence, individual persons at different income levels are presumed to consume or use differing quantities. For a public good, however, the characteristic feature is precisely the absence of quantity adjustment. That quantity which is available to one user is, by definition, equally available to all users. In our example, the beach, in whatever quantity provided, is equally available to all members of the community. The common measure of income elasticity is scarcely relevant until and unless we specify a price. In this case, however, it is precisely the “price” differentials, in this case tax-share differentials, that we seek to establish. To say that the publicly-provided good exhibits a positive income elasticity of demand is meaningless without some specification of the demand price.

But the commonly available facility may be used variously by different members of the community. Usage of the services of the facility, the beach in our example, depends on the action of the individual in availing himself of the privilege. And it is in this respect that the low-income or low-wealth consumer may be motivated to use the services of the facility to a relatively more intensive level than his high-income counterpart.

It will be helpful to think of a common-access facility, in whatever quantity provided, as being made available to users at a zero direct price, although the analysis would be unchanged if some nominal user fees should be charged. At a zero price, why should we predict that the consumer with relatively low income would utilize the services of the facility more than the user in a more favorable economic position? If usage were genuinely "free," we should predict that, with comparable utility functions, the intensity of usage would be approximately the same for all persons. But, despite a zero money price, the actual usage of a facility cannot be "free" in a utility sense. Consumption takes time, and facilities of the sort discussed here are likely to be relatively time-intensive when compared with other consumption goods and services. As Gary Becker has emphasized, it is necessary to consider "time prices" as well as money prices in any complete theory of individual consumer adjustment.5 The time-price, unlike money price in market transactions, will not be uniform as among separate consumers because of the differing opportunities for using time in other ways, either in the production or in the consumption of income. Almost by definition, these opportunities are relatively greater for the potential user who receives the relatively higher income. The services of the publicly-provided facility, available at zero user prices, are, therefore, "cheaper" for the low-income person than for his high-income cohort because of the differential in time price. From this it follows that there will be a difference in the intensity of usage of the facility as between income levels, and that the relatively low-income user will consume more services of the facility. In our example, the number of trips that the relatively low-income user will make to the beach each year may be predicted to be greater than the number made by his high-income counterpart, assuming similarity in underlying utility functions. The potential user who has a relatively high income can spend his time in alternative ways, either by consuming substitute services (he may go to the mountains), or by earning more income.

The relationship between usage and alternative opportunities can be empirically observed and is, of course, widely recognized. The "beach boys" are those who do not have either income or alternative employment opportunities readily available. The only point that is at all novel in this analysis involves the implications of this for tax-share adjustments and for determining the efficient quantity of facility to be provided. To examine these implications more carefully, let us return to the Wicksellian collective-choice process introduced above. Suppose that the community is currently financing a quantity of beach maintenance, say Y square yards of beach area, and that this is being financed from the levy of equal per head taxes, regardless of the fact that persons with differing incomes are among the group of users. An increment in quantity is now proposed, say a shift from Y to Z in quantity, with the unanimity rule in force. The cost of financing the increment is known, and the proposal to add this quantity is placed before the group, along with a whole array of tax-shares arranged so as to cover the outlay that is required.

Consider the positions of two separate members of the decision-making group, A and B. The first person, A, uses the common-access facility, say, six times per year, and he places an evaluation on the incremental change in quantity based in this anticipated usage. The second person, B, who has fewer opportunities for alternative consumption and for productive employment, uses the beach, say, twelve times per year, and his evaluation on the incremental change in quantity proposed is based in this anticipated usage. It is surely possible, indeed it is plausible to think, that individual B may place a somewhat higher valuation on the incremental change in beach maintenance quantity than individual A. To the extent that he does so, the Wicksellian decision process might attain unanimous agreement on the extension only through B's expressed willingness to pay more than one-half of the tax costs involved in the extension under consideration. If institutional rigidities or incorrectly derived norms for the allocation of tax shares prevent any negative relationship between tax shares and income levels, inefficiency would characterize the final outcome. And the incidence of this inefficiency may well cause more harm to B than to A.

Real World Applications

It seems possible that the factors emphasized here may be a relatively significant source of public-sector inefficiency in the real world, although detailed empirical investigation would be needed to support this as a generalized hypothesis. Municipal governments are alleged to be in financial crises everywhere, but crises are defined with respect to traditional and orthodox sources of tax revenues. Widespread discussion of reform includes the replacement of traditional tax sources by direct user pricing when and where this may be at all applicable. Objections to user pricing can be, and are, made on distributional grounds. Those who are likely to be harmed are low-income beneficiaries of what are now largely “free” services, that is, free of direct user prices. In light of these quite legitimate distributional arguments against direct user pricing, consideration should perhaps be given to the replacement of traditional taxing sources by unorthodox ones. It seems quite possible that the relatively poor members of many communities would secure net benefits from the levy of taxes that are actually related to incomes negatively rather than positively. If such a negative relationship seems bizarre, the limiting case of equal-per-head taxes might be considered. The distinction between equal-per-head taxes and direct user prices should be noted. Direct user prices are uniform for all persons, per unit of service demanded. Equal-per-head taxes are uniform for all persons, but services of the facility consumed may vary as among these persons. Hence, to the extent that low-income persons utilize the services of a common-access facility more intensively, the final money “price” per unit of service remains lower for them than for their high-income cohorts.

Unless some such fiscal devices are introduced, common-access facilities in existence may be allowed to deteriorate rapidly as their usage by high and median income residents of municipalities continues to fall. Low income central city residents can secure genuine advantages from municipal provision of additional common-access facilities. But higher income residents who have privately available substitutes may be unwilling to finance added municipal facilities through orthodox taxing formulae. If they are forced to do so, they may continue to migrate to independent suburbs in increasing numbers.[6] The introduction of imaginative tax devices that are designed to reflect the realities of common-facility usage and evaluation rather than outmoded norms of traditional public finance may allow additional common-access facilities to be financed which would otherwise be impossible.[7] Rather than opting out through migration, relatively high-income members might be willing to contribute to the fiscal surplus potentially available to all members of the community, even if this surplus should be differentially enjoyed by low-income members. Even the resident who has his own private swimming pool may be willing to pay some tax share in the financing of a municipal common-access pool. He may, however, be unwilling to pay a tax-share that is dictated by the orthodox tax institutions which relate payments not to relative evaluations, but to an income-asset base.

Generalizations

The argument of this paper should not be interpreted as a general attack on particular tax institutions. The analysis has been limited to common-access facilities that are publicly-provided. The argument does lend support for multi-sector budgets which would allow differing components of a public-goods mix to be subjected to differing fiscal choices. Tax institutions that may provide some approximation to efficiency in the array of tax shares for certain categories of publicly-provided goods and services may be quite inappropriate for other categories. Methodologically, the argument re-emphasizes the importance of separating efficiency and distributional norms in the analyses of fiscal institutions. In the attempts to make all fiscal institutions incorporate distributional objectives, important potential efficiency gains may be neglected, which, themselves, might have desirable distributional by-products.

Privately-Owned Facilities

As suggested at the outset, much of the analysis applies to privately-owned and organized facilities as well as to publicly-organized, governmental facilities. Only the latter have been discussed in detail here. Consider a privately-organized, cooperative swimming club, which is confronted with a decision concerning whether or not to construct an addition to the facility. There seems to be no apparent reason why the incremental subscriptions required from members need be uniform, and, indeed, it seems likely that for many situations nonuniform subscriptions would secure approval more quickly. Members or potential members who are anticipated to use the services of the common facility more intensively may place differentially higher evaluations on the proposed extension in size. And these members may, on balance, be classified below other members on income-wealth criteria. To restrict subscriptions to uniform levels per member may inhibit construction of the proposed extension, with the resultant concentration of opportunity loss on those who stand to benefit most from the incremental addition.

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Pitfalls In Planning: Veterans' Housing After World War II Marshall R. Colberg

Von Mises called it a "paradox of planning" that socialist economic calculation could to some extent rely on prices established under a previous regime of capitalism but that as conditions changed the planners would more and more grope in the dark.[1] Similarly, he pointed out that an individual socialist country can utilize market prices established concurrently in capitalist economies but that without such assistance would flounder.[2] As a consequence the attempt to "reform" the world socialistically would never be successful. The necessary guideposts would be destroyed.

What about centralized planning of key production in a capitalistic country where, presumably, enough markets would remain free to furnish the guideposts which Von Mises so strongly emphasizes? United States experience with the Veterans' Emergency Housing Program in 1946 and 1947 provides our principal evidence regarding the problems and pitfalls which are inherent in such an endeavor. A somewhat similar effort is involved in such areas as the Interstate Highway Program, but the Veterans' Emergency Housing Program was unique, to date, in that central planning was utilized for a commodity where consumer sovereignty is normally relied upon as a guide to production. The present writer's firsthand experience with that program will be drawn upon to illustrate the problems that were encountered. Any future government programs of this general type would encounter the same difficulties in aggravated form, since the termination of World War II at least found the United States with a Washington bureaucracy accustomed to administering controls and with businessmen accustomed to some degree of compliance.[3]

Production Goals And Schedules

Administrators of the Veterans' Emergency Housing Program took a cue from President Roosevelt's wartime proclamation of goals for military airplane production. With great accompanying publicity, Franklin Roosevelt called for the production to 60,000 airplanes in 1942 and 125,000 in 1943. No serious attempt was made by the procuring agencies to meet these goals; in fact, the 1943 goal exceeded military requirements by far. (Actual 1942 production totaled 47,836 planes while 1943 output was 85,898.)[4] In many ways the publicized goals were harmful because a multiplicity of useless production schedules resulted from the effort to make totals equal exactly 60,000 and 125,000. Single engine, civilian type airplanes, pilotless target craft, and even "equivalents" of spare parts were included in efforts to make schedules equal the goals. For a long time Washington officials were afraid to tell President Roosevelt that his goals were not being met. Actually the production achievement was excellent: the goals were at fault.

Much publicity also attended the goals set under the Veterans' Emergency Housing Act, which was signed by the President on May 22, 1946. A total of 1. 2 million housing units were to be provided in 1946 and 1. 5 million units in 1947. This two year plan was translated into a schedule of starts as shown in Table 1.

Table I Original Starts Schedules for Housing As of February 1946 (Thous. Dwelling Units)

1946	Conventional	Prefab.	Conversions	Re-Use	Trailers	Totals
1st Q.	107	5	13	22	4	151
2nd Q.	153	25	12	88	9	287
3rd Q.	195	90	13	90	17	405
4th Q.	195	130	12	0	20	357
Total	650	250	50	200	50	1,200
1947						
1st Q.	200	140	13	0	0	353
2nd Q.	235	170	12	0	0	417
3rd Q.	215	152	13	0	0	380
4th Q.	200	138	12	0	0	350
Total	850	600	50	0	0	1,500

The composition of the 1946 housing schedule reveals the almost inevitable tendency of planners to include dubious items in order to make the program appear better. It can be seen that one fourth of the 1946 schedule consisted of temporary re-use of wartime barracks and dormitories, trailers, and conversions of existing residences into a larger number of dwelling units. In addition, the "window-dressing" was augmented by expressing all output in terms of starts rather than completions. The comparable "numbers racket" in World War II aircraft production was, as already mentioned, inclusion of things that were not actually military airplanes and counting as "completed" many units that still required extensive modification outside the assembly plants.

As production ensues, a planner is most reluctant to give full recognition in his scheduling to the extent of failure of an unsuccessful portion of his program, or to failure of the program as a whole. The tendency to overschedule in a weak segment is illustrated by data in Table 2 for prefabricated houses, which fell very seriously below the original plan. The 1946 total for this category was revised downward from 250 thousand in February to 100 thousand in July and to 40 thousand in November: the actual total built was 37 thousand. To the extent that other administrative actions such as priority ratings, labor referrals, material allocations, and subsidy payments are based on such seriously infeasible schedules, resources are misallocated, and the misleading schedule is much worse than none at all.

Table 2 Starts Schedules for Prefabricated Houses (Thous. Units)

Schedule as of:	1st. Qtr.	2nd. Qtr.	3rd. Qtr.	4th. Qtr.	Year 1946
Feb. 1946	5	25	90	130	250
July	4[?]	7[?]	31	58	100
Nov.	5[?]	9[?]	11[?]	15	40
Actual	5	9.1	11.8	11.3	37

[?] Preliminary estimates of actual shipments.

The poor showing in the prefabricated housing sector, along with the highly publicized total housing goal, put pressure on the Housing Expediter to exaggerate schedules in other sectors. For example, starts as scheduled in July 1946 for the last half of the year for conventional and conversion units together were about 35 per cent above the number realized—a sufficient discrepancy to cause serious administrative errors to the extent the schedules were taken seriously. There is a strong likelihood that an unrealistically high production schedule will be heavily, but not uniformly, discounted by those who influence the allocation of resources. This includes not only government officials but also businessmen who supply materials and components of the end items. A multiplicity of schedules resulted from lack of confidence in the central agency's schedule both during World War II munitions programs and the Veterans' Emergency Housing Program. Often the "plan" is disregarded by those at the working levels and remains largely a public relations and propaganda device.[5] Since most elements of the price system and individual incentives to maximize income still remained in effect, especially after World War II was terminated, these were more influential than the central plan in guiding production. However, much confusion and inefficiency resulted from the partial adherence to, and partial disregard of, Washington plans.

Materials "Requirements"

The ambitious plans of the federal government for prefabricated housing production stimulated much related administrative activity. As of April 1, 1946 each softwood plywood manufacturer was required by the Civilian Production Administration in a "production directive" to turn out at least 45 per cent of his monthly output in the form of construction plywood, of which no more than 20 per cent might be in exterior type. At least 5 per cent had to be in the form of door plywood.

In addition, a "premium payment" (subsidy) plan was put into effect for plywood. Plywood manufacturers were authorized to pay suppliers of Douglas fir peeler logs a premium of $7.50 per thousand feet above OPA ceiling prices. A manufacturer was reimbursed in full for this added cost if his plant turned out plywood at a rate at least 25 per cent above his quarterly quota, which was based mainly on past performance. The plywood plan was originally intended to run from June 1, 1946 through March 31, 1947, but was terminated November 30, 1946. The plywood subsidy cost $2,354,650 in payments. Actually, it was not necessary for the government to take any special action with respect to plywood because other factors caused the production plan for prefabricated housing to be completely unrealistic. Among these was a lack of consumer acceptance, since the program relied on private purchase of housing. (This caused a change of designation from “prefabricated houses” to “factory built houses.”)

Even where schedules were less disastrously in error than was the prefabricated housing schedule, computation of supporting “requirements” was often only a guess. Yet these very rough estimates formed the basis for subsidy payments, export restrictions, limitation of non-preferred construction, production directives, inventory limitations, priorities, and price ceiling adjustments.

An example of the difficulty of computing supporting requirements was found in the case of finishing lime (plaster). First there was the hard question as to how many walls would be plastered and how many would use wallboard. Even more damaging was the question of average thickness of a coat of plaster. If one-sixteenth of an inch were used as a factor, no shortage of finishing lime could be foreseen. But if the average coat of plaster is one eighth of an inch in thickness, a serious shortage loomed. The problem was never solved, but was probably unimportant anyway. Planners inevitably rely on fixed bills of materials, being unable to estimate possibilities of substitution. An actual shortage of plaster would probably cause the coats to be thinner, and more wallboard, paneling, and other substitute materials to be utilized.

The utter confusion which can attend the work of a government committee responsible for making materials allocations is indicated by the following quotation from the minutes of the Fourth Quarter Steel and Iron Castings Meeting held in Washington, D.C., August 21, 1946.

Mr. A.: “I take it then that the figures just read for sheet and strip in the breakdown are subject to correction.”

Mr. B.: “That is right.”

Mr. A.: “Right, Mr. C., will you give us the estimated unit equivalents for the total tonnage?”

Mr. C.: “883, 343 units.”

Mr. D.: “883, 343. In one quarter?”

Mr. A.: “That would be about the annual capacity, I think, but let's come back to that.”

Mr. B.: “Yes, this one is going to be subject to revision.”

Mr. D.: “Well, I thought this one was screened.”

Mr. B.: “Screened under the criteria that we have to go by. You can fix the percentage on that screened criteria.”

Mr. E.: “That is merely screened down to what they think the industry can use.”

Mr. B.: “No, screened on the criteria called for.”

Mr. A.: “Gentlemen, since we decided to go through and get all of the figures set down without the comments, let's proceed that way and come back.”

Mr. C.: “I don't even dare get into furnace pipe, fittings, and duct work. I am going into that last.”

Subsidies For Building Material Producers

A central, and most revealing, aspect of the federal government's attempt to speed postwar housing construction was the “premium payments” scheme for building materials. The Housing Expediter asked Congress for authority to pay up to $600 million in such subsidies. Congress approved a limit of $400 million. Actual payments made were $27.8 million. Almost half of this amount was paid to producers of merchant pig iron, not a building material. Only about one third of merchant pig iron ultimately went into building materials, but the intent of Congress was interpreted broadly.

Table 3 Subsidies Paid

Material	Premium Payments
Structural Clay Products	$ 3,726,073
Softwood Plywood	2,354,650
Merchant gypsum paper liner	761,200
State-owned timber	35,545
Convector radiation	446,688
Hardwood Flooring-Southern	1,769,423
Hardwood Flooring-Northern	60,726
Cast iron soil pipe and fittings	3,988,034
Merchant pig iron	12,406,100
Sand-lime brick	5,490
Housing nails	2,201,878
Total	$ 27,755,807

The eleven subsidy plans issued were small in number compared with the total considered seriously. The abortive plans reached all stages of readiness from premature annoucement in the public press of plans that were actually withdrawn to preliminary drafts prepared by committees or individuals. Materials which received consideration but for which plans were not issued included: clay sewer pipe; concrete block and brick; lath; finishing lime; cast iron pressure pipe; galvanized and carbon steel sheet; low-cost water heaters; ranges; steel windows, outside house paint; and imported linseed oil.6

The subsidy plans which were activated usually were based more on the availability of relatively full information regarding an industry than on relative need for the material. Also, the problem of "selling" many industries on the desirability of subsidies was much greater than anticipated. A main reason was the emphasis by the Housing Expediter on the economy of premium payments compared with increases in ceiling prices. Since subsidy payments were to be made only on increments of output above quotas, and since they would be paid out of tax receipts rather than by house buyers, they were considered better by the administrators. The materials producers looked at it differently. They often felt that the Office of Price Administration would be less likely to grant ceiling price increases if the industry accepted a subsidy. The degree of competition and extent of unionization of workers was also of consequence. The brick and structural tile industry, consisting of widely scattered, highly competitive firms, welcomed a premium payments plan. The clay sewer pipe industry, which was smaller and located mainly in Ohio, unanimously rejected a plan which was very similar in nature. Where labor was organized and contracts were due to be negotiated in the near future, management feared that the workers would be able largely to take over any premiums received by the companies. After termination of the subsidy, the higher wage rates would still be in force. In some industries there was also apprehension that subsidy payments would be used to expand capacity, hurting long-run prospects by increasing competition.

Where subsidy plans were actually formulated, the problem of determining production quotas (above which payments would be made) illustrated another common type of problem inherent in central planning. Industry representatives wanted low quotas—preferably low enough so they would collect payments for production that would have been turned out without subsidies. Government representatives wanted to keep quotas high enough to bring out some special effort but not so high as to make premiums really hard to earn so as to endanger acceptance of the payment plans. Representatives of firms already operating at high output rates claimed that premium payments would mainly benefit inefficient entrepreneurs whose plants were still closed down and who would therefore get low quotas. Formulas under which subsidies were paid represented uneasy compromises among the various forces and desires involved.

Limitations Of Other Construction

In addition to positive steps to stimulate housing construction, the federal government tried to give an indirect stimulus by limiting competing construction, especially of commercial and industrial buildings. National and regional construction quotas were set in dollar terms. It was clear that many projects including racetracks, were started just before the deadline, probably with inside information from government employees as to the effective date of the limitation order. Some buildings that would otherwise not have been built in 1946 were started quickly because of the profitable situation that would arise when non-residential construction in general was reduced in volume.

The imposition of regional controls brought about a discriminatory situation in which the same type of structure approved in one city was turned down in another. The probability of graft and favoritism is obvious as it is whenever valuable economic privileges are handed out by public authorities.

At best, the device of limiting some varieties of construction in order to aid other types is a clumsy one. It was not possible in 1946 to make satisfactory measurements of how much restriction of non-residential construction was actually necessary in order to conserve enough materials, labor, and equipment for veterans' housing. To a considerable extent the activities are not competitive, especially with respect to land use where zoning is effective. Even labor was partially specialized to either residential or business building so that unemployment of heavy construction workers was often reported as the federal limitations took effect.

A tabulation maintained by Civilian Production Administration field offices during 1946 showed that almost 1,500,000 inquiries were made by persons interested in starting non-residential construction projects. About 141,000 projects were formally submitted for consideration and about half, in value terms, were approved. The denial of a project, such as construction of a building for a newly-authorized automobile dealer, involved a heavy financial impact on the individual concerned and bitter protests were common. A considerable number of persons disregarded government stop-orders and went ahead with construction plans, preferring to risk large fines rather than to forego business opportunities. This is a type of "black market" activity inherent in this type of authoritative control. Other persons initiated construction projects without seeking government clearance. During 1946 over 75,000 cases were investigated by compliance officers, and construction was stopped on almost 15,000 projects. One cannot but wonder how many projects were permitted because of pecuniary or non-pecuniary gains by compliance investigators or denied because of insufficient sub-rosa offers. As a generalization (not always valid, of course) one can say that lawyers offer a threat to a market economy because of their personal stake in the regulation of markets.

Priorities

During the postwar reconversion period the distribution of most goods was left under the control of sellers. However, the federal government exercised its still-available wartime powers to influence the distribution of some items deemed to be important to reconversion, particularly those that were related directly or indirectly to the veterans' housing program. A system of priority ratings was one of the devices employed. These were, in effect, ration tickets needed in addition to money to purchase specified items when available supplies (at controlled prices) were not sufficient to meet all demands. Industries favored as purchasers during 1946 included many which turned out building materials, builders of veterans' housing, and producers of coal, sheet steel, gray iron castings, rubber, and fractional horsepower motors.

Holders of priority ratings frequently complained that they were only a "hunting license." More teeth were put into the ratings in September 1946 when high physical "set asides" (75 to 100 per cent) were established for many materials. These materials could not legally be sold on unrated orders without specific release by the Housing Expediter. An obvious danger in this type of regulation is that priority-rated demand will at times be less than the set aside. This will tend to discourage production as well as cause unnecessary inventory accumulations.

One of the difficult questions related to priority ratings was whether they should be “extendible,” i.e., whether a firm to which such an order was first applied should be permitted in turn to place a priority order for a similar amount with his supplier. Industry representatives were invariably opposed to extendibility since it would have been highly upsetting to established producer-dealer relationships. In addition, there was danger of abuse of extendible priority ratings by dealers. For example, a dealer receiving such ratings might serve them on a manufacturer with whom he did not ordinarily deal and receive delivery of the items called for. At the same time he might be able to acquire deliveries through regular channels without rated orders.

The very limited use made of extendibility in spite of its apparent usefulness as a central administrative tool, was one of the more striking examples of the difficulty of allocating resources authoritatively. The complexity of the great web of buyer-seller relationships existing in the nation becomes obvious when government officials attempt to redirect even a few of the flows of materials and components.

Concluding Observations

The Veterans' Emergency Housing Program was pursued vigorously only in 1946. Interagency disagreements occurred almost constantly, causing resignation of the Housing Expediter in December 1946. Most of the opposition encountered by the Office of the Housing Expediter came from government officials who were not opposed to the program but who could not see that any actual gain in residential construction was likely to ensue from many of the proposed actions.

It is not possible to say with certainty whether residential construction was increased by the program in 1946 and 1947. There was probably some increase, but it is not obvious that any gain made was preferable to the disruption of non-residential construction that occurred. Also, consumer sovereignty was replaced by authoritative decisions as to the kinds of housing needed by returning veterans. In the absence of planning a higher proportion of apartment buildings would have been erected, and these would probably have been preferred by veterans in view of their unsettled lives after release by the armed forces. The pre-fabricated housing sector was a clear failure that probably caused a serious misdirection of scarce resources.

Most analysts connected with the postwar housing program came away with renewed respect for the enormity of the job which is normally performed by the price system, operating through millions of individuals who are experts in their own fields of interest. Although only a small part of the economy was subjected to special controls, the administrative task was virtually impossible. It was probably fortunate that a great many regulations were partially or wholly ignored because non-compliers close to the scene often directed resources more rationally than the centrally formulated regulations would have done.

It is remarkable that some persons who were in a position to observe the extreme difficulty of exercising price and production controls during and just after World War II are quick to recommend their reimposition. Such persons must indeed have a great longing for personal authority over the economy!

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Presents For The Poor
R. L. Cunningham

1. Introduction

Suppose a rich man wants to help a poor man. The obvious way to help, it would appear, is to give the poor man some money; for what makes a man poorer than another is that he has less money. But is it always best to give money? Perhaps it would sometimes be better to give some good or service—food or health care, for example? Cash or food—when should one be given, and when another?

I intend in this paper to lay the groundwork for answering this question by identifying as clearly as I can the pros and cons of giving money as against giving goods. I shall proceed by pointing to several quite ordinary examples of giving—giving a man a tie or a boy a dog for Christmas—to see what light is shed on our problem of giving help to the poor. The upshot of my analysis will be to lend support to the dictum: a fool can put on his clothes better than a wise man can do it for him.

2. Jones' Tie

Jones receives a tie from his daughter for Christmas. Now if his daughter's taste in ties is like most daughters' taste in ties—not impeccable—one might ask why Jones is so grateful for the tie, and whether it might not have been better for his daughter to give him cash and let him choose his own present. Our ordinary experience gives us the answer. "It's the thought that counts." Jones was grateful because what he received was not only (a) some tie or other but also (b) an expression of the time, concern and loving care involved in choosing the tie. He can wear it proudly: "My daughter chose this tie for me." Cash, by contrast, has very little display value.

It might be, to change the example slightly, that Jones believes his daughter's taste in ties is superior to his own. If so, there would be another valued dimension to the gift of the lovingly chosen tie: (c) the fact that it was expertly chosen and better even as a tie than one Jones might have chosen for himself.

There might be still another dimension of the gift. Suppose that the tie is a gift from a friend and that it is an exceptionally elegant tie, one Jones would have been too modest to choose for himself. We might speak of this as (d) the luxurious dimension of the gift.

And finally, every gift may be looked at from another's point of view, (e) that of the giver, who may prefer one gift to another because he believes it more appropriate or better in some sense, or because he personally gets more satisfaction from giving one gift than from giving another.

3. Willy's Dog

Willy's father decided to give Willy a dog for Christmas. He knew that Willy had expressed a preference for a chemistry set. But his father believed that he knew better what would "be good for" Willy in the long run, and so bought the dog.

Let us look at the economics of the gift. The dog cost twenty-five dollars. Willy had always been vaguely interested in having a dog, but had he bought a dog out of savings, would have bought a ten dollar dog. Of course a twenty-five dollar dog is better than a ten dollar dog and Willy would have been willing to pay something more for it, but not as much as it actually cost. Willy valued the twenty-five dollar dog as worth only fifteen dollars to him. Since for Willy the dog he got as a present was not "worth" twenty-five dollars, but only fifteen, ten of the dollars spent were "wasted" or somehow "lost" so far as Willy himself was concerned. For Willy's father, on the other hand, the ten dollars are not necessarily wasted, for if he is right Willy will sooner or later come to see the dog as worth the full twenty-five.

Note that since Willy values the dog at only fifteen dollars, he will give it less care and attention than that due a twenty-five dollar dog. Willy's father must take this into account, and will need to persuade or coerce Willy to give the care and attention due a twenty-five dollar dog if he is not to lose part of his investment.

Why had not Willy's father simply given him twenty-five dollars in cash? Willy would then, let us suppose, have bought a ten dollar dog and a fifteen dollar chemistry set. Is this not preferable to a twenty-five dollar dog valued by Willy at fifteen? Well, if the father chooses the more expensive dog, he must be supposing that in the long run that dog will somehow "be better for" Willy than the other alternative, and willing to risk ten dollars to prove it.

4. Public Housing

Our final example will be one taken to be paradigmatic of programs to help the poor by giving goods or services rather than giving the equivalent in cash—public housing. The analysis is only slightly more complicated than that of Willy's dog.

Suppose Smith, a poor man, lives in a hundred dollar a month apartment. The rich, perhaps via government, wish to help him, and make the judgment that the best way to help is to provide a better apartment. They build him an apartment that would rent for two hundred a month, but charge him only one hundred. Smith is now better off because he has a better apartment at no extra cost to him. How much better an apartment? Smith values the better apartment at its market price, as worth only one hundred and fifty to him; that is, he would have been willing to pay one hundred and fifty for that two-hundred dollar apartment had someone offered it to him at that price (just as Willy would have been willing to pay fifteen dollars for the twenty-five dollar dog). So Smith considers himself better off than before to the tune of fifty dollars worth of housing. But what Smith sees as a gift of fifty dollars of housing cost an extra hundred to build, so from his point of view, fifty has been "wasted" or "lost".

Had Smith been given a hundred dollars cash, he might have spent part of it on improved housing, but, on the assumption the donor makes, less than he would if he knew what was good for him. An anecdote illustrates the point. Poor Man: “Please, Doctor, give me this hundred dollar operation for ten dollars—that's all I have!” Doctor: “Alright, here's ninety dollars. Now you can pay my price—do you still want the operation?”

Is it sensible for the donor to spend one hundred dollars to provide housing Smith values at only fifty dollars? Only if, like Willy's father, the giver is sure that the fifty dollars is not really “wasted” and that Smith will really benefit a hundred dollars worth. And the donor, like Willy's father, must take into account the fact that Smith, in the absence of “persuasion” or coercion, will not give it the care appropriate for a two hundred dollar apartment, but that appropriate for an apartment costing fifty dollars less.

Why is it precisely that Smith would not give the apartment the care appropriate to a two hundred dollar apartment? After all, if someone were given a thousand dollar mink coat, but valued it personally at only one hundred dollars, it would hardly be reasonable of him to treat it like a cheap cloth coat. This is so. But it does not follow that it is necessarily “reasonable” of Smith to give high-grade care to an apartment he doesn't regard as worth it to him. The reason for the difference is that Smith does not have full property rights in his apartment—he lacks the power to alienate—for he has no power to sell, mortgage, or sublease the apartment and so capture its market price. But the owner of the mink coat can dispose of it by sale, gift, etc., and so would be unwilling to lose part of its value to others, value he can capture, by care appropriate to a cheaper coat. Smith cannot, to be sure, be given the power to alienate “his” apartment, for he would then turn it into cash and use the cash according to his own judgment. (When land is “redistributed” to poor peasants in “under-developed” countries, the power to alienate the land is not granted; for if it were, some peasants would sell “their” land to another for whom its value as a productive resource was higher than it was for the peasant; the peasant would leave the land, where, it appears, he ought to remain for his own good.)

How reasonable is it of the rich giver to bet that Smith is wrong about the value of housing? The answer appears to be that Smith must be taken to be either ignorant of what is good for him, or too weak to choose what he knows is good for him. But even this is not enough. In addition, the donor must suppose that he both does know what is best for Smith and also that he is strong enough, virtuous enough, to choose the right thing for Smith. It is normal to suppose that a child is often ignorant and the parent often knowledgeable of what is to the child's own best interests; and it is normal to suppose love and concern on the part of the parent. It is not so easy to see that a poor man, just because he is poor, is ignorant of his own best interests or too weak to pursue them—after all no one has more incentive to find out and pursue his interests; or that the rich man, just because he is rich, knows what is good for the poor man and is strong enough to seek it. Do poor people have less incentive to come to know and act for their own best interests than the rich do? Are the poor more like the immature children of the rich than they are like adults? I know of no evidence to support a confident answer of “yes”.

Even apart from the fact that Smith's interest in spending his money to promote his welfare is almost surely higher than that of the rich giver, it is surely true that his knowledge of his own particular circumstances and “needs” is likely to be greater than that of the rich man. If Smith is given cash instead of an apartment, his spending of a portion of it on furniture, a portion on clothing, a portion on recreation, a portion on insurance, etc. might not be as wise an allocation as the rich man's would be in his place, but it does not have to be justified—it need only be wiser than the rich man's choice for him in the rich man's place, with the rich man's limited interest and knowledge. In order for me to trust you to choose for me, it is not enough that I know that if you were in my place you would choose more wisely than I; I must know that you, while in your place, will choose more wisely for me than I while in my place. In order to be willing to have another choose for me, I not only have to distrust myself, I have to trust the other to be able and willing to make superior choices for me (as I do, for example, when I trust a wine steward to advise me on a choice of wine from a cellar with which I am unfamiliar—and here it is to his self-interest to give me good advice.)

It would appear, further, that if the rich believe they know better than Smith what is good for him as regards economic goods (where he starts with the advantage of superior circumstantial knowledge and concern with his own welfare), this elitist attitude would a fortiori obtain in other spheres, the political, for example. It would of course be possible to maintain that the poor are too ignorant or weak to buy what is “best”, but wise and virtuous enough to vote for the best man; but defense of such a position would not be easy.

5. Conclusion

I have tried to make clear what is involved in making a reasonable choice between giving cash, and giving goods or services to the poor.

It appears obvious that “giving a present” is not an appropriate model for giving welfare. It may well be that “It's the thought that counts” or the fact of its being a luxury which adds to the value of the gift tie, but neither has any place in welfare giving. The tie may be valued because it was chosen by an expert, a giver with better taste than the recipient; but that the rich are expert choice-makers for the poor, that they both know and choose what is best not only for themselves, but for the poor, is an assumption that deserves scrutiny.

It receives that scrutiny in our analysis of a parent's gift of a dog to his son, and in the analysis of public housing. In the former case, in sum, there is reason to believe that requisite superior knowledge and good will are present in the parent to a degree sufficient to make up for what appears to the recipient as a “loss” or “waste”, and to balance the relatively poor care the recipient gives his gift. But as regards public housing (taken as a paradigm of the goods and services given the poor instead of cash), doubt is cast on the likelihood of the donor's having, as compared to the recipient, superior knowledge and power to achieve welfare goals for the recipient; and the welfare “loss” or “waste” is attributed to the fact that property rights adequate to avoid this loss are not invested in the recipient—and cannot be so invested without being equivalent to cash.

The overall upshot of this analysis is to suggest that unless the rich are to the poor what the father is to his minor son, there are no good grounds for trusting the rich to benefit the poor more effectively by giving goods rather than by giving cash.

Nothing I have said tells us when and to whom help ought to be given by one to another, or how much, or by whom. I have argued only that once the decision to help is made, help ought to be given in a form which relies on the sources of knowledge and good will most surely available, those sources present in the recipient—not a "present" of concrete goods or services, but cash.

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Restrictions On International Trade: Why Do They Persist? W. Marshall Curtiss

"A business man is always under the necessity of adjusting the conduct of his business to the institutional conditions of his country. In the long run he is, in his capacity as entrepreneur and capitalist, neither favored nor injured by tariffs or the absence of tariffs."

HUMAN ACTION, Page 81

If there is one point of fairly general agreement among economists throughout the world and throughout time, it is that trade should remain free from all sorts of governmental restrictions and interventions. It would seem unnecessary to repeat over and over why the material welfare of individuals is enhanced through the division of labor and freedom to trade; unnecessary especially among those familiar with the works of Dr. von Mises. His writings constantly emphasize this truth. Most of his friends who honor him on his 90th birthday accept the case for free-trade as self-evident.

But restrictions still exist! Tariffs and other barriers to trade seem to move through cycles, relaxed at times, and then reapplied. Why, in the face of reasoned arguments by leading intellectuals, do restrictions to trade have such an appeal to lawmakers? In other words, who is it and what is it that moves the lawmakers to take such action?

Who Expect To Benefit From Protection?

The cry for protection comes in many voices. A glove manufacturer resents finding imported gloves in the market. It is natural for any firm to take any legal steps available to sustain profits and remain in business. If a way can be found to eliminate this foreign competition, perhaps convince the government to raise some sort of barrier to the foreign gloves—a tariff, or a quota, or an embargo—then the glove maker might be able to continue in business, competing with domestic firms as always, but avoiding the foreign competitor.

The glove industry may maintain a lobby in Washington to try to convince the lawmakers that unless protection is provided, thousands of jobs will be lost, unemployment will rise, and companies will go bankrupt. And it may all be true! At least it often is convincing enough to the lawmakers.

What happened to the logical argument of the economists who said protection hurts the consumer? Well, the argument stands, but the consumer's voice is faint. What if it does cost a few pennies more to buy a pair of gloves? Compared with the loss of a job or a failing company, this is nothing! Or so it seems to those seeking protection.

Now, suppose a domestic firm is in financial trouble, in no way caused by imports. Does it send a lobby to Washington and ask for help? Not ordinarily. In domestic trade, we accept the idea that a firm must compete without special favors. True enough, companies do fail; men do lose their jobs; but the consumer is not penalized by interventions that reduce production and make things cost more.

If the failure of the Edsel automobile had been because of foreign competition, it might have been argued that a tariff on imports would have saved the car and preserved thousands of jobs. Had the maker been a one-product firm, it might have been saved from bankruptcy. But, no; it was a domestic firm that misjudged consumer acceptance of a product; and that was that! The Edsel is reported to have cost the Ford Motor Company $250 million.

A more recent example is that of Corfam which the du Pont Company developed to compete with natural leather for footwear. After seven years and a reported $100 million, du Pont discontinued production of Corfam.

Only the size of these write-offs makes these two items newsworthy. Thousands of new products are tried each year, and there are many failures. Unless a company has other profitable items which will carry such losses, the company may fail, as many do.

The testing of consumer preferences goes on constantly. Ordinarily, we wouldn't think of asking the government to prevent the failure of a given product. We accept such failure as one of the regulatory aspects of competition and the market. But let the competition be from a foreign country, even though it benefit consumers the same as domestic competition, and there arises a clamor to erect some sort of barrier to save jobs, or to save firms, or to build a fence around our high standard of living, or whatever.

The justifications for tariffs and other forms of protection include the arguments that they keep our wages high, prevent unemployment, protect infant industries, help with national defense, prohibit trade with the enemy, discourage dumping, and so on.

Trade barriers or threats of trade barriers are often used in the formulation of foreign policy. “We will reduce our restrictions if you will do likewise” Or: “Let us reduce our restrictions against underdeveloped countries so that they can benefit from sales to us” Or: “Let us stop buying chrome from an African nation whose internal policies we do not approve.” Among the reasons for trade restrictions, must be included foreign policy. Or, as one author recently stated: “... trade policy in the United States is a political matter.”

But of all the pressures upon the members of Congress and the Executive to enact trade restrictions, few are greater than those exerted by business firms or associations representing business firms. Individual consumers who have the most to gain through the reduction or elimination of trade barriers, and who have voting power enough to elect or defeat any candidate for office, are practically powerless in comparison with business lobbies.

As an illustration, note the results of recent attempts to cut back certain phases of defense spending. Now, the production of something to be destroyed in combat obviously is worthless so far as contributing to the level of living of a people is concerned. If those workers and resources were used to produce housing, build highways, provide medical care, teaching, plumbing, auto repairs and the like, then consumers would be that much better off.

But let it be suggested that we shut down our war machine and the protests are deafening. Workers will lose their jobs; companies will fail; the entire economy will suffer.

Granted, there are difficult adjustments to be made. But the fact that a worker is not needed in an airplane factory shouldn't preclude his finding a productive job elsewhere. One sympathizes with a worker in an industry that is being “wound down” especially in a one-industry community. In the recent discussion of continuing research and development of the SST, many in Congress, and many members of the press based their argument chiefly on the fact that thousands of workers would be disemployed and business firms would fail. The same arguments have been used in trying to maintain our outer space program. Such arguments have a strong emotional appeal and carry considerable persuasive force.

Many of the same arguments are used to establish trade restrictions, and with equally disastrous economic consequences.

In discussing foreign trade, it is well to keep in mind certain basic principles:

(1) Trade between two individuals, entered into freely, always results in benefits to both parties. Otherwise, why would they trade? What anyone else may think of their judgment is beside the point.

(2) Production costs in one nation may be lower than in another nation for every item produced in either nation. But the people of these respective nations may still find it profitable to trade with one another. There always is a comparative advantage in producing some products and importing others.

It is often thought that only nations like Great Britain or other maritime nations benefit by trade, simply because there are so many things they do not produce domestically. True, the United States could close its borders to all imports and exports and still there might be a relatively high level of living for its citizens; but not as high as would be possible through trade with foreigners.

(3) Consumption is the sole purpose of production. Adam Smith explained this nearly 200 years ago. Production is to supply consumers' wants. It is not to make jobs, or to keep a business solvent, or to make one nation dependent on another. Naturally, some of these things happen as a byproduct of production and trade, but that should not be the objective.

(4) Trade ordinarily will be most satisfactory to all concerned when individuals or their agents who have something to trade deal with other individuals or their agents

who want the other side of that trade. Governments should be involved as little as possible; first, because they are not concerned; and secondly, because there is always the temptation to use the trade for purposes other than satisfying consumers.

If an individual in this country wanted to trade some of his own property for something offered by a Russian citizen, we would think little about it, knowing that each party to the trade considered he was better off than before. But if government enters one or both sides of such a trade, there is often the suspicion, sometimes justified, that one party is seeking a military or political advantage.

(5) Imports require exports. Foreign trade appears complicated because it often takes an indirect or roundabout route through several nations. In addition, moneys of several nations with complex exchange rates are usually involved. But it finally boils down to the fact that a nation which imports must export something in exchange.

Many people appear to believe that we might eventually be inundated with imports to the extent that practically all production in this country, all jobs, all business firms, might be wiped out. They fail to see that foreign goods cannot continue to come into this country unless something goes out to pay for them.

(6) A popular argument in support of tariffs is that we will reduce our obstacles to trade if other nations will reduce theirs. In other words, we must do it together.

The lack of understanding of international trade and the effect of restrictions is reflected in this press release in The New York Times for March 31, 1971. “The European Economic Community decided today to give generalized trade preferences to developing countries beginning July 1.” The implication is: “If you are poor, we will let you sell to us.” The truth, of course, is that voluntary exchange, whether the participants be rich or poor, benefits the buyer as well as the seller. Had the “developing country” previously been subject to trade restrictions then, of course, it would gain from the relaxation of those restrictions. But the increased trade also would be of benefit to the “affluent” buying nation.

When diplomats from different countries discuss the reduction of trade barriers, it almost always has the appearance of a high-level bargaining session. How little can we give up in reducing our restrictions on imports in order to gain some reduction in their restrictions against our exports? It never seems to occur to them that we stand to gain by opening our gates entirely, whatever the other nation does. Certainly our consumers would stand to benefit. But, always of diplomatic concern is the effect on firms and on jobs.

A great deal of consideration is given to “most favored nation” reductions. If we give one nation the “benefit” of our reduction, then all nations are entitled to this great benefaction. Actually, unilateral action in reducing our restrictions against imports would benefit our consumers, and might end most of the seemingly endless bargaining over reduction by other countries in return.

Who knows? It might soon be discovered that trade policy should not be a political issue but that free trade between citizens of all nations, rich and poor alike, benefits all consumers.

How Can Free Trade Be Achieved?

Politicians, in the legislative as well as the executive branches of government, respond to pressures of various kinds from their constituents. So long as the pressure for trade restrictions exceeds that for free trade, we can expect restrictions to continue.

Considerable attention just now is directed at textiles, especially the textile trade with Japan. Had such trade been strictly between individuals without the intrusion of governments, many of our present problems would have been avoided. Following World War II, our government made concessions to help rebuild the Japanese economy. It delivered cotton for less than our own textile manufacturers had to pay for it; it practically gave new textile mills to the Japanese. Little wonder that American textile manufacturers resented this unfair competition and sought to restrict imports from Japan. Now, a quarter of a century after the war, while the effects of that kind of “foreign policy” may have worn off, the arguments against Japanese textiles persist and carry weight with legislators.

Over the years, many economic injustices, including misuse of capital and labor, have resulted from trade restrictions. To remove them all at once and go back to free trade is bound to require difficult adjustments on the part of business firms. No wonder they try, in any legal way they can, to protect any remaining shelters or even increase their protection.

From the standpoint of a manufacturer, the so-called benefits of protection and disadvantages of free-trade are short-run and disappear once adjustments to the changed situation are made. The firm still must compete with other domestic firms as well as with imports, even if over a tariff wall. But it is these short-run adjustments that the legislators hear about—the layoff of workers, the reduced profits and even business failures. The longer-run genuine benefits of free trade to consumers arouse little excitement. This is especially true in a country like the United States where imports are a relatively small part of all trade. Who is there to speak for the consumers? The professional protectors seem so interested in auto seat belts, unit pricing, packaging, advertising, truth-in-lending and ecology that they aren't likely to get to the matter of free trade for some time.

Most families present a combination of consumer and producer interests, interests which may seem to be in conflict with regard to trade restrictions. For example, suppose two members of the family work in the local textile mill. The most important day-to-day problem to the family is making certain that these two mill workers are employed and bring home their weekly pay checks. So, if they are convinced that imported textiles may eliminate their jobs, then they are apt to be protectionists. Attesting to this is a story in a recent Sunday supplement headlined “Twilight of a Textile Town”. In this article, it was reported that a mill which had been the town's leading industry for 70 years, went bankrupt and put 844 textile workers out of work.

Furthermore, “50 textile plants in the South have shut down since 1969. The Department of Labor has estimated that 27,200 Southern textile workers lost their jobs in 1970 alone.”

This is a serious situation, apparently calling for a political solution. What is not so obvious is that even if all imports of textiles were stopped, after a short period of adjustment, domestic firms would find strong competition with each other and marginal firms would continue to face failure.

An illustration of how adjustments can be made to a declining industry is related in the New England Letter for April, 1971, published by The First National Bank of Boston. The study shows how, in the early 1950's, many textile mills were liquidated and a basic weakness was shown in the leather and shoe industries. Some of the textile mills are now among those in trouble in the South. Had the problem been handled with political solutions, no doubt New England textiles could have been “protected” in a way that would have kept the mills going with employment and jobs as usual.

But, instead, New England industry changed, in part, to the manufacture of transportation equipment, electrical equipment, and instruments, to name only three. This new type of manufacturing is more export-oriented and enjoys a better international competitive position. It has the greater “comparative advantage” that economists have been talking about. It uses higher skills from its workers, and the “value added in manufacturing” is relatively high. Thus, in the long-run, the return to labor stands to exceed what it was and what it might have been in the production of textiles, shoes, and leather goods. True, some of the newer types of industry have been closely tied to government defense contracts, and with a recent cutback, unemployment increased. However, a basis for export and for increased production for consumers is there.

Adjustments to changes like these are often difficult and must not be passed off lightly. But such changes in an expanding and progressive economy are always going on. Attempts to stop them with artificial restraints are certain to be more painful than is the process of adjusting.

The Solution

As observed earlier, most economists agree that protectionism is unsound. The consumer is served best by allowing people to trade freely with each other, not only domestically but world wide. But restrictions continue to persist, placed there for political reasons. The incentive to erect barriers to trade is a political response to pressure from individuals, groups of workers, industrial groups, and others who think they will gain from protective measures such as tariffs, quotas, and the like.

Because the consumer is the disadvantaged party, it may be argued that the solution lies in his education. But as previously shown, the consumer's stake as consumer of a protected product often is much less important to him than his job as a producer of a potentially protected product. Therefore, it seems doubtful that consumers, as a group, can be effective in bringing political pressure on lawmakers to offset the pressure for protection exerted by other groups.

After two centuries and more of expounding the advantages of free trade, it must seem trite to say that education must be relied upon to bring about a correction of the wrongs caused by protectionism. Nevertheless, there seems to be no short cut. While the consumer, qua consumer, must be included among those educated, it would seem that emphasis should be placed on convincing lawmakers of the advantages of free trade so that they can better withstand the pressures put upon them by their constituents who think they need and deserve protection from competitors.

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"Human Action"
E. W. Dykes

Human Action has often been called a "monumental work". In truth there are not adjectives sufficiently descriptive to do it justice. The title, HUMAN ACTION, is particularly apt for economic laws actually are laws of human action. It is my hope in this tribute to Ludwig von Mises to suggest another line of research of human action.

My first and unforgettable meeting with Dr. Ludwig von Mises occurred at a cook-out at Leonard Read's Bronxville home. I was perhaps thirty-three at the time and a mere neophyte in libertarian matters. After supper, the group of a dozen or so casually divided itself into two smaller groups, the better to carry on the interesting discussions. I was in the opposite group from Dr. Mises. I had been pushing some point fairly successfully in my group when somehow there was a pause and suddenly I was projected into that pause where it became Dr. Mises versus Dykes. Practically paralyzed, I weakly defended my point. Dr. Mises said in clinching his argument, "It is right because it works". That appeared to be as good a place as any to get out and that part of the discussion ended as suddenly as it began.

But I was happy only in the thought that I could tell my grandchildren I had once debated Dr. Ludwig von Mises. Had I not been so tongue-tied quite possibly we might have pursued the "why" of its working. I might have saved endless hours in pursuit of this question myself. On the other hand, certain things which appear clear now might not have unfolded to me, things which are part of an interesting theory.

In the physical world action and reaction are known to be governed by the laws we acknowledge to be a part of the natural order. Many of us are equally convinced that human action works within a law or set of laws as rigid, or more-so, than those that govern the planets in their movements. Quite possibly these two, the movement of planets and human action, apparently disparate things, may be responsive to the same law. A hint of this is found in the Meditations of Marcus Aurelius in which he wrote, "He who lives in harmony with his own self lives in harmony with the universe; for both the universal order and the personal order are nothing but different expressions and manifestations of a common underlying principle".

The man able to live in harmony with himself lives also in harmony with his neighbors. Psychology likely would agree with that. Most persons would agree that coercion could hardly be called a part of harmonious action. What is less generally recognized is that coercion carries with it the seeds of destruction and the fruits of such seeds are not necessarily found in a close relationship in time or in space with their sowing. That is to say, the eventual destructive results may turn up years later and in events not easily related to the original ones. An understanding of this viewpoint is best made possible through the acceptance of the "common underlying principle" suggested by Marcus Aurelius.

In pursuit of the goal of identifying the underlying principle, I found support for a theory held by numerous libertarians to the effect that coercion is never suitable for use in creative efforts. My contribution is to add one four word phrase to it. ANYTHING THAT IS BROUGHT ABOUT THROUGH THE USE OF COERCION—INITIATED FORCE—HAPPENS BEFORE ITS TIME AND, THEREFORE, WILL INVARIABLY BE ATTENDED BY FAILURES OF EQUAL, IF NOT GREATER, MAGNITUDE. (The new phrase is underlined.) Now these failures may be a part of the particular activity or of an activity seemingly unrelated; they may be sudden or deep in the future but they always occur whether or not we are able in all cases to connect them with the initial action.

If this theory has validity its acceptance at the moment must depend on the preponderance of circumstantial evidence in its favor. Its proof must wait for a later time when science comes to recognize the electrodynamic theory of life. For it is in this force field that the common underlying principle will be found. An act of coercion sets up disharmonious relationships which become manifest in other areas of life. This is the vital point. It is not different in kind with the physical reaction of acid on flesh. Only the time factor may be different. In his “The Symphony of Life”, Donald Hatch Andrews says that when we move our hand it is felt throughout the universe because of the unseen connection between all things. Science has shown that all matter may be reduced to energy. It is not yet ready to say that mind is energy or that life is energy although many scientists hold such a view. A revolution in many lines of research will result when this is accepted, my view being that such acceptance is inevitable.

When coercive means are used in creative areas we see the benefits of the constructive “ends” but fail to see the targets of the destructive means. These latter may be hid in the fog of time or in the hustle and bustle of apparently non-related activity. All are the result of destructive “human action” the intended good ends notwithstanding.

Some of the examples of the failures of “ends” are simple to show and quite well known:

With minimum wage laws we force the payment of wages in excess of those which would be commanded in a free market. Some lose their jobs and many other “unseen” persons are never hired. They are obscured in the cloud of unemployed.

We build housing through force and, instead of creating a new and inspired people in the recipients (as was envisioned), we create vast slums burdened with all manner of ugly violence.

We force welfare but the rolls increase in length despite the increase in the national product and standards of living going up. We encourage illegitimacy, fatherless homes and all manner of weird family arrangements.

We “aid” the schools and entice otherwise honest people to compromise their principles and seek grants they don't need and to waste money on unrealistic programs in order to participate so their constituents will “get their share”.

After years of restraint by unfair laws and burdened for decades by ill-advised, destructive prejudices of whites, the black man has been “freed” by laws into an even greater polarization which has led to violence and bloodshed with, perhaps, the worst to come.

Inflation, the most pernicious tax, attends the forced “growth” of the economy and who could count all the destruction of that grotesque demon?

We could go on and on listing the failures for they are as long as the list of coercive actions. Viewed altogether we have a combination of results which reveal the utter futility of the use of coercion. Coercion always fails and it must always fail because it is contrary to an orderly universe. But this line of reasoning hits snags when defenders of coercive governmental action point to the “spin-off” and then easily find examples to indicate the remarkable material advances we make which diminish the apparent costs of war or outer space exploration and similar ventures. The “spin-off” unquestionably has contributed to quite remarkable peace-time uses. The use in medical research of atomic particles developed in the former and the circuitry developed in the latter are cases in point. But the things we see do not begin to compare with those we don't. Any gains in material standards will be more than “compensated” for in other areas. For we have noted a number of reactions to force and we posit that they are not just isolated examples but predictable responses to laws of a higher order not yet readily comprehended. Though we may not definitely say that today's rioting and general unrest are the results of the coercion in war work and space exploration, neither can it be proved they are not. From the examples of bad “ends” shown earlier we must credit the possibility.

A WSJ editorial of May 3rd, 1971, includes these comments: “It is a great insight of the past few years that modern changes in the world, and especially advances in technology, have given men powers which tax their humanity. Science in effect has out dated the rules by which we have traditionally conducted our affairs. Leaders who must use the new powers find themselves faced with staggering moral dilemmas no man should have to resolve.” In other words, man's technological achievements have outdistanced his moral growth. We may define wisdom as the assimilation of experience. Some of our “advances” have come too quickly to be assimilated. They have happened before their time.

Suppose that the development of the conscience is a major goal of evolution, a strong case for which can be made. Man's purpose in his present phase of existence may well be to develop moral character. He does so by becoming responsible through the exercise of conscience which requires him to make decisions. Of necessity, he must be free to make them. When prevented from doing so, by being inhibited in wide areas of societal action by governmental intervention or preemption, it is natural and predictable that things will go wrong.

All of our modern day so-called “advances” which are the result of coercion have come before their time and man's purpose—his need to make free will decisions—has been ignored. When purpose is the price of material progress, the price is too high. Ignorance of the law or ignoring of the law–the results are the same. It is a law that man must be free. Only when man is free will “human action” come to full flower.

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The Genius Of Mises' Insights
Lawrence Fertig

Economic historians of the 21st Century will undoubtedly be puzzled by the reception accorded to economic theorists of the 20th Century. They will be particularly puzzled by what occurred in the span of years between World War I and 1970.

On the one hand the record revealed that academic honors, and in many cases substantial monetary rewards were showered on academicians whose contributions were miniscule. Their works were based on abstruse "model-building" to the delight of a coterie of fashionable economists in leading unversities. They employed intricate mathematical formulae which gave the false impression of scientific accuracy–a presumptive accuracy which disappeared on analysis of the precise meaning of the mathematical symbols employed as the basis of their equations.

Moreover, great honors were showered on economists whose major accomplishments had been to promote a major inflation which, by the end of the 20th Century, was acknowledged to be the source of tremendous social unrest and economic crises. These were the fashionable economists who were sponsored by wealthy Foundations and indeed by most of the intellectuals of Academe.

But when economic historians of the future came to evaluate precisely who had made the most significant contributions to economic theory–to those broad and fundamental principles which explain human actions in the practical world people must live in–their puzzlement increased. For they could find only a meager record of academic honors or monetary prizes by leading ivy-league universities accorded to the one economist who had discovered and formulated some of the most brilliant economic theories of that century. His name was Ludwig von Mises.

Of course Mises had a substantial following among so-called conservatives of that era (most of whom were old-fashioned liberals), who practically venerated him for his great works. But the fashionable world of the intellectuals rather paid homage to some of the most inconsequential statisticians and economists of that era.

After having researched the detailed history of economic thought in the 20th Century, historians of the 21st Century paid tribute to Mises as one of the most powerful and perceptive minds of that earlier era. They stressed the depth of his seminal thinking, and they dwelt upon his significant contributions to economic theory.

The above account may sound like a fanciful look into the future, but it could—it should—happen because the logic of Mises' analysis is being confirmed increasingly every decade and every year. The majestic sweep of his ideas, the genius of his insights, and the rigorous formulation of his theories all combine to stamp his work as of the highest order.

When Mises advanced the concept of “human action” (he terms this ‘praxeology’) as the basis of economics, he did as much to create a whole new world as did the explorers of the 15th and 16th centuries who discovered new continents. “Choosing determines all human decisions,” said Mises. “In making his choice, man chooses not only between various material things and services, all human values are offered for option.” His monumental work, HUMAN ACTION, develops this thought in a profound and wide-ranging discussion which reveals the knowledge of a philosopher, sociologist, historian and economist of the first order.

As everyone who has studied Mises knows, he makes no compromise whatever in defending the principles of the free market. Interventionism of any kind and the development of the welfare state are scourged by his searing prose. Naturally welfare statists and interventionists are not sympathetic to Mises. This accounts for the coolness of many Establishment economists towards this great figure. But the truth of his views is being demonstrated every day.

Crisis In The Equalitarian State

As I write these words in the early spring of 1971, there appeared in the press remarkable accounts of the shattering crisis in the leading equalitarian state of the world—the Nirvana of welfare states—Sweden. The nation was torn by strikes of its leading intellectuals and white-collar workers, including teachers and college professors, railway employees, civil servants, white-collar municipal workers and a host of others. Seven hundred thousand students in secondary schools were left without teachers. Tempers flared and anger was displayed in arguments between blue-collar and white-collar workers.

“Equality issue has shattered—perhaps forever—Sweden's world state social and economic climate,” commented a leading newsmagazine.

The head of the 1.6 million member Swedish trade union federation said, “There has been an element of class struggle in this dispute. The people on strike feel that their position has been degraded.”

Mirabile dictu, Gunnar Myrdal, who was the architect of interventionism and did much to promote the welfare state in Sweden, as in other parts of the world, had this to say: “The organized welfare state has gone mad ... It (the strike) has become a class struggle, with judges, academics and civil servants seeing the lower classes creep up on them ... It's an impossible situation.”

There is a measure of poetic justice in the anguish of Gunnar Myrdal and the other academics in Sweden who promoted the equalitarian society, and are now hoist by their own petard.

Mises stated the insoluble dilemma of the welfare state very succinctly. Under the chapter heading “Inequality and Income” in HUMAN ACTION, he says, “No system of the social division of labor can do without a method that makes individuals responsible for their contributions to the joint productive effort. If this responsibility is not brought about by the price structure of the market and the inequality of wealth and income it begets, it must be enforced by the methods of direct compulsion as practiced by the police.”

Since Sweden, with the approval and urging of its intellectuals, adopted strong restrictions on the inequality of wealth and income, it must now suffer from the “direct compulsion” of the state as it seeks to establish equalitarianism.

Mises' Devastating Analysis Of Socialism

The establishment of an equalitarian super-welfare state is a giant step toward socialism. On this subject Mises is the master. His brilliant analysis in his now famous book, SOCIALISM, has had tremendous impact all over the world. In fact, his analysis has been so widely accepted that his ideas are frequently purloined by writers who fail to realize their origin.

Quite often there appears in some article, or in the daily press a statement by someone who suddenly discovers that the economy of totalitarian Soviets and their satellites are in trouble because of the breakdown of their productive process. Great surpluses of unwanted goods appear, and there are shortages of many essential commodities. Some writer then points out that the Soviet commissars of production have no way to decide what to produce and how much of each category. The socialist economy cannot successfully engage in economic calculation, it is stated. Rarely is it pointed out that Mises, in his great book, SOCIALISM, published in 1922, was the first to discover this fact and to formulate his argument with irrefutable logic.

Communist theoreticians, faced with the appalling inefficiencies of production, of shortages, of public complaints, etc. seek to meet their problems by adopting some of the slogans of the capitalist system. They institute “incentive systems” in factories, rewarding those which produced more efficiently, etc. Also, they assert that some major factories are not producing according to government-indicated quotas but rather are responding to “consumer demand.” Practically this is nonsense.

Long before any of these attempts to leech off the ideas of the private enterprise system Mises, in one brief section of his book, SOCIALISM, destroyed their propaganda with these words: “Where there is no market there is no price system, and where there is no price system there can be no economic calculation.”

Another attempt at employing free-market data as a guide to totalitarian managers of industry was reported in newspapers several years ago. It seems that the bureaucracy of the Soviet Union, in order to get some intelligent idea of the relationship of various consumer products to each other actually imported from the United States about one thousand Sears Roebuck catalogues. The prices and product relationships of Sears Roebuck thus were used as guides to educate and inform those who were managing the closed system. Apologists for the socialist system did not see the humor and bathos of such a policy.

Socialists are always trying to achieve "stability," but the modern world is an ever-changing one. Here again Mises makes a most interesting statement. He says, in SOCIALISM: "To use a popular but not altogether satisfactory terminology, we can say that the problem of economic calculation is one of economic dynamics: it is no problem of economic statics."

I have in a previous tribute to Mises, printed in the Mont Pelerin Quarterly of October 1961, related an incident which illustrates the tremendous influence of Mises. It relates to an important Washington personality who was once a communist disciple and who later became a knowledgeable defender of private capitalism after renouncing his socialist past. One day I attended a dinner party at the home of this gentleman, which included Mises. Towards the end of the evening our host described how Mises had changed the course of his life. It seems that, while he was under communist influence, he had by chance come upon a copy of Mises' SOCIALISM in a book store and sat up all night to read it. He related how he was completely shaken by this experience, and from that point on he re-evaluated his socialist concepts, and finally repudiated them in toto. He described in glowing terms the impact of Mises' SOCIALISM upon his mature mind, and he contributed the complete change of his intellectual life to the power and logic of Mises' concepts.

Mises' Dynamic Marginal Analysis

In passing I might mention another instance of Mises' brilliant insight in his contribution to the purely theoretical subject of marginal utility. It illustrates very well the thrust of Mises' ideas in the direction of a changing, dynamic world.

The Mises view is that the consumer's evaluation of marginal utility changes as his mind changes—every week, every day. His preferences of yesterday are not necessarily his preferences of today. The consumer's evaluation of any item changes not only with the introduction of new products, but also with the consumer's idea of the relative merit of these products and services—whether it be that of an automobile, a suit of clothes, or the private education for his child. Thus not only are products and services always in a state of flux, but the consumer's own conditions and ideas are in a state of flux.

Obviously this theory fits a modern, changing, dynamic world. It is interesting to contrast Mises' view with that of a modern economist who has received much publicity and many honors, Paul Samuelson. Samuelson's view is that the concept of marginal utility is useless because it does not provide any basis for making hard and fast empirical judgments. So Samuelson developed a theory based on the actual choice which consumers have made, and he calls this "revealed preference." This is a typical approach of one who is statistically-minded. "Revealed preference" is history, and history becomes out-moded very soon. Revealed preference of yesterday may be no guide to the consumer's preference today, and certainly not tomorrow.

In a dynamic, changing world, it is the Mises formulation which is the only true guide to a solid economic theory.

“Connexity” Of Mises' World

I would like to select just one more instance—out of literally dozens that could be quoted—of the power of Mises' analysis and its practical application in the world today. As every student of Mises knows, he greatly stresses the inter-relationship of all economic phenomena. At one point he calls it “the inescapable interdependence of market phenomena.” At another point, in HUMAN ACTION, he has a section on “Connexity of Prices.” Mises regarded the market as a vast mosaic or tapestry of interwoven colors and forms. To arbitrarily change any one part is to affect the whole. Thus the interventionists who think they have developed a foolproof scheme for establishing a “more just” condition invariably find that their intervention has caused serious disturbances in other sections of the market. Unfortunately, the interventionist is never cured of his folly, but generally insists that what is needed is more power for him to cure the new disturbance.

“Connexity” Of Monetary Policy And Labor Laws

We can see the workings of Mises' principle of “connexity” in one very vital area—one which affects prices and production of practically every product and service on the market. I refer to the intervention of Labor Laws which are intended to protect workers, but which have the practical effect of robbing them of some of their income and creating a condition of general inflation in the nation. The various Labor Laws of this country—the original Wagner Act, the Norris-LaGuardia Act, the Taft-Hartley Law, etc.—all protect the monopoly power of labor unions. Thus unions are able to demand and get, through the weapon of the strike, wage rates which are clearly uneconomic and far in excess of the true market. This has long been apparent and conceded by practically all observers.

But what has not been apparent to all but a handful of conservative economists is the fact that this power of labor unions is directly related to the uncontrollable inflation which is undermining this country. This is the “connexity” which is now being realized by nearly everyone.

It is indeed surprising that despite the obvious effect of labor unions and inflation, no popular figure, and very few economists, have offered the correct prescription—change of the labor laws. It seems strange that economists who admit the problem invariably prescribe “an incomes policy”—which is some form of wage and price control. Since there is practically no disagreement about the correct diagnosis of our galloping economic malady, it is remarkable that the economic prescriptions are so far afield.

These facts are now apparent: because of their monoply power, which was granted to them by the U. S. Congress and confirmed by the courts, labor unions are able to demand and get wage rates far in excess of productivity. Employers naturally attempt to recover the excess wage demands by raising prices. However, there comes a time when rising wages and rising prices decrease the consumer's ability to pay. The result is recession and unemployment.

At that point tremendous pressure is brought to bear on the government to prevent recession. Every administration seeks to avoid at all costs the consequences of an economic debacle. Therefore it is the tendency of every administration and of the Federal Reserve Board to validate the spiralling wage-price level by printing enough money and extending enough bank credit to increase general demand and thus increase employment and production.

Precisely such a syndrome is now becoming obvious as I write these words. An annual increase of 6 percent in the money supply is not sufficient to create full employment, say administration officials. Therefore they are urging the Federal Reserve to increase the money supply to 8 or 9 percent. In effect they are demanding a tremendous inflation.

Thus it becomes clear that the power to regulate the quality of money and credit is no longer solely in the hands of the Federal Reserve Board, which has been given that authority by Congress. As a practical matter, at crucial times that power resides with the labor unions and their leaders. If they demand and get uneconomic wage rates far in excess of the market they will inevitably cause recession and consequent action by the Federal Reserve to inflate the money supply.

Despite this very obvious cause of the current inflation, it is strange indeed that there is so little demand for revision of our labor laws. Quite the contrary. It would seem that public figures as well as most economists carefully avoid any attack on the underlying cause—the monoply power of labor unions—and instead offer the old nostrum, wage and price controls in some form or other.

There is no better example of “connexity” inherent in the market system than that of wage rates and monetary policy. Mises has for many years expounded this viewpoint.

Many modern economists and politicians think they know better than the market what the relationships should be. A familiarity with Mises would convince them that such intervention is not the road to wellbeing and prosperity but the road to crisis and national unrest.

Economic historians of the 21st Century may well be impressed by this lesson, which will be clearly revealed in the history of the previous era. In their evaluation Mises undoubtedly will be considered a colossel figure in the world of economic theory.

Perhaps they will come upon these pregnant sentences in an editorial in the Wall Street Journal of June 17, 1963, which commented upon presentation to Mises of an honorary Doctorate of Law by New York University.

The editorial writer said that Mises had impressed upon the world the lesson that “the free market and the free society are indissoluble.” Then he concluded, “In this sense von Mises is the champion not merely of an economic philosophy but of the potential of man.”

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On Behalf Of Profits Percy L. Greaves, Jr.

Profits Are Priceless

Contrary to popular opinion, profits cost consumers nothing. They actually add nothing to the prices consumers must pay to obtain the quantities of goods and services offered on the market. Also, contrary to popular opinion, profits are not obtained by holding wage rates down. In a free market, competition tends to force all employers to pay wage rates that represent the full amounts that consumers are willing to pay for each worker's contribution.

Profits are earned in the service of consumers. Profits are always an incentive to increased investments, higher wage rates, greater production and lower prices. Profits act as a beacon to investors and entrepreneurs, guiding them into the production of just those goods and services that consumers want more of most urgently. Profits are acquired only to the extent that individual market suppliers succeed in serving consumers better than their competitors have done.

Profits Poorly Understood

Before the days of the Austrian School, profits were generally considered something that producers and sellers added to the costs of production to arrive at and set market prices. Many still think this is the way market prices and profits are determined. This includes large numbers of academic "economists" who are unable either to refute the validity of the subjective marginal theory of value, or to comprehend the full significance of its universal application to all human actions, as revealed in the lucid irrefutable writings of Mises.

Just as many "economists" talk of "administered prices" and so-called "excess profits" as though these were phenomena of an unhampered market, so many shopkeepers and small businessmen still total up their costs and then add what is popularly called a "mark-up" to set their asking prices. This is probably why there have been so many failures among such ventures.

It is certainly a reflection on the economics teachings and textbooks of our schools, colleges and universities that, today, one hundred years after Menger wrote his Principles of Economics, large numbers of uninformed people still think prices and profits are determined objectively by sellers, rather than by the subjective values of the ultimate consumers.

While many now realize that all businessmen are not able to set their prices and that profits are not always made on every business transaction, many people, including some called economists, still think that prices are determined primarily by costs of production rather than by the market interplay of the subjective values of the ultimate consumers. Consciously or unconsciously, many students and non-students of economics still hold an objective theory of values. Many still embrace the labor theory of value on which Marx built his house of "scientific socialism." Many others sincerely believe in some form of "just price" and "just wage" that they seem to think can be objectively determined by some "fact-finding" body. Many in high places, not only in labor unions but also in the academic community and the political arena, still think that entrepreneurial profits are "unearned incomes" purloined from either employees, or consumers, or both employees and consumers.

The Poor Also Pay Taxes

Such economic ignorance has created, and is responsible for, a great deal of the anti-profit mentality that is abroad in the world today. It has also led to the high repute of so-called "non-profit" organizations. There is an almost universal feeling in today's society that profits are something antisocial that are obtained at the expense of the general welfare. Nothing else can account for the unquestioned acceptance of the very popular fallacy that rich individuals and "big business" can continually be "soaked" without hurting those at the bottom of the income ladder.

Actually, in a market society, the burden of taxes levied on businesses and high income earners do not fall only on them. Such taxpayers are often able to offset all or part of the tax by raising their incomes. As long as a market exists, shifts in prices, workers' wages, executive salaries and interest rates will determine how the ultimate tax burden will be shared.

People do not go into business for charitable reasons. If those taxed cannot pass these taxes on in the form of higher prices or lower wage rates, they will sooner or later reduce their contributions to society or go completely out of business. Then their discharged workers will have to be satisfied with the next best, i.e., lower, wages they can earn elsewhere. And former consumers will have to settle for goods and services less valuable to them.

In a market society, there is just no way to place the tax burden solely on "big business" and the rich. Those who want and buy bread, shoes, gasoline and whatnot will pay part of such taxes. Governments may pass tax laws, but short of a complete dictatorship, it is always the market that allocates the tax burden.

Economics Is A Science

True economists are scientists. They do not talk in terms of good or bad any more than do chemists or physicists. Sound economists talk in terms of what is and what is not. They try to appraise human actions objectively and deduce the significant inevitable consequences of proposed actions or policies. They are not opinionated partisans, but searchers for the truth, spurred on by the hope their teachings will help all mankind and reduce unnecessary human sufferings.

Mises, the greatest economist of our century, builds all economics deductively and scientifically from the two words: "Man acts." Basically, he elaborates step by step the full significance of what these two words really mean. The present writer elaborates these two words into three a priori postulates:

> (1) Every man seeks to improve his situation from his viewpoint, based on his limited knowledge and understanding;
> (2) The factors available to each man for improving his situation are limited; and
> (3) All men make mistakes.

All men always seek success in achieving their ends. They choose those available means which they hope, believe or know will best help them attain their objectives, whatever these may be. They constantly strive to keep their mistakes to a minimum. In all human actions, all men seek a psychic profit, an increase in their satisfactions or happiness.

All Actions Are Unequal Exchanges

Every human action is an exchange of something the actor has for something he prefers. In a market economy, it is frequently an exchange of a quantity of money for a specific commodity or a service. However, it may be an exchange of his limited time, skill, energy, or of some other scarce good in his possession for something on which he places a higher value. It is a characteristic of every human action that it is an exchange of something a man has for something he prefers. It is never a transfer of equal values.

A man may make a mistake, but at the time he commits himself to any action he expects that action will produce a psychic profit for him. He never enters into a transaction without such an anticipation. Men enter into society when they participate in the division of labor and the resulting indirect exchanges of the market place. As Mises states, "The market process is an interaction of men deliberately striving after the best possible removal of dissatisfaction."[1] Men do this all in keeping with the three above-stated a priori postulates. In fact, everything every man or woman does is in harmony with these postulates. So profits are the goal of every living man. They are sought by everyone. They are merely another term for what all men consider success. The more profits a person gains, the happier he is in terms of his own valuation of the returns from his efforts and his use of his other scarce factors of production.

Source Of Profits

As Mises has taught us, entrepreneurial profits are "the prize" the market place awards to those who remove a maladjustment in production and thus satisfy consumers better than their competitors. Profits "disappear as soon as the maladjustment is entirely removed."[2] In his greatest work, Human Action, and in his remarkable paper, "Profit and Loss," reprinted in Planning for Freedom, Mises has demonstrated, beyond cavil, that profits are earned payments to entrepreneurs for successful foresight, speculation, and resulting actions in using available factors of production to satisfy consumers' needs, wants and desires better than their competitive entrepreneurs.

"Entrepreneurial profits result from a better-than-others ability to anticipate and satisfy market demands. This is done by directing the use or combination of the factors of production available on the market in such a way that the goods or services produced bring a higher market price than other products made with the same factors of production.

Entrepreneurial profits and losses emerge due to the following ever present market factors:

> (1) The uncertainty of future consumer demand;
> (2) The ceaseless changes in the demand for and supply of the various human and physical factors of production, which constantly create new opportunities for better adjusting production to anticipated future consumer wants;
> (3) The fact that all production takes time;
> (4) Differences in entrepreneurial ability to foresee, at the time production must start, what the most urgent wants of consumers will be at the various future times when the available alternative processes of production might be completed.

Entrepreneurial profits and losses are society's appraisal of the contributions of individuals and other business units to societal welfare or satisfaction. Entrepreneurial profits and losses are the means that consumers use to shift the control of capital, and the direction of production, into the hands of those who have demonstrated their ability to serve consumers best."3

Prices Not Determined By Prices

At any given moment, prices have no relation to the cost of production. At any given moment, the market process allocates the available supply of all goods and services, regardless of their cost of production, to those who place the highest market value (price) on the units available. The more units available, the lower the unit price must be, as additional units must always be sold to those who could not, or would not, buy them at the higher price for which a smaller number of units can always be sold.

As Mises tells us, "The consumers do not care about the investments made with regard to past market conditions and do not bother about the vested interests of entrepreneurs, capitalists, land-owners, and workers, who may be hurt by changes in the structure of prices. Such sentiments play no role in the formation of prices. The prices of the past are for the entrepreneur, the shaper of future production, merely a mental tool. The entrepreneurs ... merely transform what the past has transmitted in better adapting it to the altered conditions."4

As has often been said, in economics bygones are always bygones. Only the future counts. This applies to past costs. The consumers are not interested in the costs of sellers. If they want something, they ask only: Can they buy it for less than its value to them, and if so, how little need they pay for it.

The cost of producing the present available supply of any good or service never affects its present market price. The prices of scarce flash-lights, particularly during an electric power blackout, have little or no relation to their cost of production. The sole question is always how much can and will the consumer voluntarily pay for the available units. The more units available, the lower the price will be and the larger the number of consumers who can be satisfied with the available quantity.

How Prices Are Determined

As Boehm Bawerk has shown, and Mises has reiterated, "Exchange ratios are now as a rule money prices. They are determined between extremely narrow margins: the valuations on the one hand of the marginal buyer and those of the marginal offerer who abstains from selling, and the valuations on the other hand of the marginal seller and those of the marginal potential buyer who abstains from buying."5 So that a product owner, who has a larger quantity than he needs or wants for his own use, is dependent solely upon what prospective buyers can and will pay for it in competition with all other offerings in the market.

Prices are always determined at the margin where the number of units to be sold will attract a sufficient number of buyers, each of whom will expect to profit from a purchase at that price. The more units owners desire to sell, the lower that margin price must be. No unit can be sold at a price that the potential buyer does not believe will present him with a psychic gain or profit. The unit price for X + 1 units must be lower than the unit price for X units, just as the unit price for X + 2 units must be lower than that for X + 1 units. Each additional unit is allocated by the market process to a buyer who places a lower value on it than the buyers of the previously smaller quantity. Yet, all buyers at the same time and place pay the same unit price—the marginal market value. At any given moment, it is always the buyers who set prices in the market society. As Mises expresses it: "The ultimate source of the determination of prices is the value judgments of the consumers."6

However, as we know, consumers' demands for the myriads of different goods and services available in a modern society are constantly in flux. Entrepreneurs are led to change their production mix by the ever-changing prices consumers voluntarily pay for labor and raw materials in the forms of different finished products or services that entrepreneurs offer in the market place. This constant shifting of prices helps guide entrepreneurs in their efforts to earn profits by better serving consumers.

Society Rests On Profits

The quantity of any good or service available at any one time is always the result of the earlier speculations of entrepreneurs—speculations that they can obtain and combine certain specific factors of production at costs, including interest on invested capital, that will prove to be below the prices consumers will pay later when the finished good or service becomes available on the market. Entrepreneurs are not infallible and often blunder, but as Mises says, "They earn profit not because they are clever in performing their tasks, but because they are more clever or less clumsy than other people are."7

In the words of Mises, the "market is actuated and kept in motion by the exertion of the promoting entrepreneurs, eager to profit from differences in the market prices of the factors of production and the expected prices of the products. The operation of this market would stop if a situation were ever to emerge in which the sum of the prices of the complementary factors of production—but for interest—equaled the prices of the products and nobody believed that further price changes were to be expected. Thus we have described the process adequately and completely by pointing out, positively, what actuates it and, negatively, what would suspend its motion."8

If there were no hope or anticipation of profits, there would be no entrepreneurs and no production. So all production, all living standards, and all market processes depend on the hope and anticipation of profits. Profits are thus the very lifeline of a continuing society or civilization.

Mises continues, "The pricing process is a social process. It is consummated by an interaction of all members of the society. All collaborate and cooperate, each in the particular role he has chosen for himself in the framework of the division of labor. Competing in cooperation and cooperating in competition, all people are instrumental in bringing about the result, viz., the price structure of the market, the allocation of the factors of production to the various lines of want-satisfaction, and the determination of the share of each individual."9 And all this is done by each person and business firm constantly striving for greater profits.

Prices Direct Production

In the actual market, the marginal producer, or the producer of the marginal unit, tends to make no profit on the marginal unit. He merely recovers costs. Each producer or entrepreneur is intent on increasing his production to the point where he anticipates he can no longer earn a profit from any further increase in his production. He thus limits his production at the point where his costs are expected to equal the price received. The last or marginal unit produced is therefore not expected to yield any net profit.

"The pricing process of the unhampered market," as Mises points out, "directs production into those channels in which it best serves the wishes of the consumers as manifested on the market.... The prices determine which of the factors of production should be employed and which should be left unused. The specific factors of production are employed only if there is no more valuable employment available for the complementary nonspecific factors.... Men are not infallible. A certain amount of malinvestment is unavoidable. What has to be done is to shun policies that like credit expansion artificially foster malinvestment."10

Plans for, as well as actual, production are always speculations. Producers attempt to anticipate, as correctly as they can, all their costs, including interest, and the prices they expect consumers will pay for their finished products. If all their anticipations are accurate, they will earn profits. If their costs are higher, or if the final prices paid by consumers are lower, than anticipated, they may suffer losses. On the other hand, if they can keep their costs lower than anticipated, or if the consumers voluntarily pay higher prices than anticipated, their profits will be higher than anticipated.

Profitable Industries Expand

Profits in any industry are always a beacon to investors. They attract increased investments. This results in increasing production and lowering prices until the profits are eliminated at the point where costs rise to meet the necessarily lower prices obtainable whenever a larger supply is offered for sale. So profits are always a price lowering inducement.

Where profits exist, there is always a temptation for existing businesses to expand their production and for new businesses to compete for a part of the ever-diminishing profits. In a market society, conditions are always in flux. Consequently, new possibilities for profit are constantly emerging.

However, the market process always tends to set the prices of marginal units at figures which barely cover the cost of producing the marginal unit. Consequently, profits are seldom earned on the last units produced. If profits are earned on all units produced, it is because too few units were produced. If this shortage is not due merely to a temporary, unforeseen situation, profit seekers will soon remove the shortage by increasing production and lowering the price of the marginal unit.

So in a free and unhampered market, entrepreneurial profits tend to be earned only by those entrepreneurs or producers able to produce all or most of their production at unit costs below the unit prices buyers will pay for the total available units. This means that those who earn profits in an unhampered market receive them only because their superior efficiency permits them to produce units at a lower unit cost than that of those producing the marginal units which determine market prices. If the producer of the marginal unit should ask for a price which included some profit, the price would be too high for all the available units to be sold. Then, to sell all the available units, the asking price would have to be dropped to the point at which there was no longer any profit from the sale of the marginal unit.

So, contrary to popular opinion, profits actually add nothing to the prices consumers must pay to induce the production of quantities of goods and services for which they are willing to pay the marginal cost of production. If there were no profits, the sellers of the marginal units would suffer losses. They would then reduce their production and consumers would soon find fewer units offered in the market place.

Profits always stimulate an increase in investments, wage rates, and production. They attract investors eager to get a share of the profits. This increases the production of what consumers want more of most urgently. This increased production raises wage rates and lowers prices, providing more of the satisfactions that all men seek.

The Poverty Problem

The main problem of society today, as always, is to reduce poverty. The only permanent way to reduce poverty is to increase production. Mises has demonstrated, beyond any possibility of refutation, that the only logical way to increase production continually is to rid men of all laws, customs and regulations which restrict the voluntary cooperation inherent in a free and unhampered market society. Those who have grasped the full significance of Mises' writings realize that under such conditions even the poorest benefit greatly from the ever-increasing production that inevitably results.

Those familiar with Mises' teachings know that the only sure way to increase production is to increase capital accumulation per capita. This is possible only if more persons can be encouraged to spend less on consumption than they earn and then invest the difference—their newly amassed savings—either in productive enterprise or in improving their ability to increase their own contributions to society.

All such increased savings per capita invested in private productive enterprise must raise the living standards of every member of a market society. All newly invested funds must first be used to offer workers higher wages to attract them to the new jobs. Such investment funds must also compete for and bid up the prices of the needed raw materials. Then the new workers and expanded productive facilities must be used to produce either new goods not previously produced, or larger quantities of goods for which there exists a greater demand than could previously be satisfied.

After these additional goods or services have been produced, they must compete in the market place with all previously existing goods. With more goods competing for an unchanged quantity of cash holdings, the competition of sellers will reduce prices. No one will buy any of the new or additional goods unless he or she considers such goods a better buy than anything else that could be bought for the same sum of money.

So the increased investment must result in higher wages, lower prices, and greater consumer satisfaction before the investors can get their savings back, much less any interest or profits on the increased savings invested. Consequently, workers and consumers must benefit before the savers can. Actually when the savers do not serve the consumers better than their competitors, they stand to lose part or all of their savings.

The Importance Of Profits

So the best way to alleviate poverty and increase the living standards of all members of society is to increase the savings invested in private productive enterprise. Human nature being what it is, no one will save and invest without the hope of earning profits. So the best way to help everyone, including those with the lowest incomes, is to adopt laws and social policies that raise the hopes of earning profits in return for offering consumers more of the goods and services they want most urgently.

Mises has stated: “The attainment of an excess of the value of the product over the costs, a profit, is the goal of every production effort. Profit is the pay-off of successful action.”11 As John Bates Clark phrased it, “Profit is the lure that insures improvement, and improvement is the source of permanent additions to wages. To secure progress, this lure must be sufficient to make men overcome obstructions and take risks.”12

Unquestionably, the best criterion available for judging the folly or wisdom of any proposed law or social policy is: Does it decrease or increase the uncertainties that businesses face in their quest for profits? Does it encourage or discourage people to save and invest in productive enterprise? For it is only increased savings per capita, lured by the hope of profits, that can lead to producing more and better goods and services at ever lower prices.

Once profits are popularly understood to be sums that can only be earned by providing very valuable contributions to society, the many laws which now hamper our market economy will be on the way out and man's eternal vision of peace and prosperity will assume a clearer form.

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Tax Reform: Two Ways To Progress?
C. Lowell Harriss

If Professor von Mises were rewriting HUMAN ACTION in the 1970's, he would doubtless give more space than the dozen or so pages, out of 881, to taxation. The subject has certainly multiplied in significance. Some of the developments were presaged in Professor von Mises's writings of a quarter century ago. One after another of his sentences could serve as the thesis for a full article. Yet the two subjects which I wish to examine briefly here go rather beyond any explicit discussions in HUMAN ACTION.

For one thing, it seems to me, reliance upon the taxation of "business" should be drastically reduced. For another, greater reliance ought to be placed upon the taxation of pure site or location (land) value.

Discussions of tax policy continue to reflect misconceptions whose survival power bodes ill for mankind. Widely accepted views impede improvements which would reduce the adverse effects of taxation on economic progress.

Men and women whose goodwill cannot be questioned speak and write and vote as if they believe that business taxes are not "people taxes". Time and again we have heard that corporation and individual income tax changes ought somehow to be "balanced".

An inferior product will not survive the competition of the market place. But ideas, such as these about taxes, cannot always be subjected to equivalent testing of relative merit. For judging them, analysis may be man's best and only instrument.

Taxes represent the use of the power of government to coerce. They force us to pay over money. And taxes do more. They influence behavior, not only by depriving us of private buying power but also because we know that the amount we must pay will depend to some extent upon how we act. The "we" includes groups—not the least being those known as businesses.

Taxes are paid by people. One may speak of taxes falling on business or corporations, on cigarettes or property, on inheritances or income. Yet it is not things, but people, who are deprived.

All of us dream of a world needing no large defense outlays. Professor von Mises's friends, I suspect, also prefer a world in which nondefense spending rises less rapidly than it does. Yet realities cannot be ignored. Budgets rise to set new peaks year after year. The necessary "tax total" will require "high" tax rates. High tax rates alter human actions.

In the market place, we must pay prices to acquire things; in competitive markets we generally get about as much in value as we pay for. But the services of government which an individual receives are largely independent of the taxes he pays. He has incentive to rearrange his affairs to avoid a tax. The same applies to business organizations.

Taxes do not meet standards of neutrality which are endorsed in HUMAN ACTION. When tax rates are low, it will not often be worthwhile to sacrifice what is otherwise one's best interest in order to save some tax. But when tax rates are high, purely tax considerations can exert a decisive influence. This is especially the case when the differences in the tax consequences of different actions are large. A basically less efficient alternative will sometimes seem best when taxes are taken into account. As taxpayers act accordingly, private benefit conflicts with the public welfare: (1) The part of the cost of government which one person escapes must generally be borne by others. (2) Resources are not used as productively as possible. For one thing, capital investment will flow to take account of alternative tax consequences as well as of productivity; skilled effort is devoted to saving taxes rather than to creating goods and services of positive value or to reducing the input needed for some specific outputs.

Difference Between Taxes And Prices; Role Of Self-Interest

Tax laws take from the individual (or prevent him from getting) what would otherwise be his without offering a specific quid pro quo. In the market place, what a person gives up is presumably matched in worth by what he receives. To get what one wants—whether acting as an individual or in a group known as a business firm—one must provide equal value for others. The pursuit of self-interest in a competitive market economy will generally serve the well-being of others by matching rewards on the two sides of a transaction. The pursuit of self-interest through the political process (in government), however, often tends to conflict with the interest of others—dramatically so when taxes are concerned. A person who gets his own taxes reduced will benefit by the amount saved; and he will expect to continue receiving the same governmental service. The individual or a corporate group has more reason to try to reduce taxes than to cut its outlays for labor or materials.

In choosing to use hidden taxes—those on business which "conceal" the costs of government from the persons who pay—society sacrifices one instrument for helping to make better, rather than poorer, decisions on government spending.

When taxes are not neutral as among alternatives (methods of financing, types of operation, location, and so on), taxpayers will sometimes select ways of producing or consuming which are less than the best by basic criteria of productivity. The true cost to the taxpayer is greater than the receipts by the governmental treasury. The difference is "excess burden." Something which deprives part of the public of benefit without equivalent compensation of others must obviously be undesirable. Taxes at high rates cannot be completely neutral. But the amount of distortion will be larger or smaller depending upon factors under some control by those who determine tax bases and tax rates. In this power to control the tax laws, man has the opportunity to improve the economy by reducing taxes on corporations and raising them on pure land (location) value, as discussed later.

Justice In The Distribution Of Tax Burdens

Taxes, whether borne directly or indirectly, will be not only heavy but also unequal. Some people must pay more than others. Being heavy, unequal, and the result of the use of government's power of coercion, taxes should seem to voters to be generally fair, just, equitable. Notions of what is fair in taxation will differ considerably—and always lack precision.

Yet by any reasonable standard taxes on business income are inequitable. Although the public seems determined to support the continuation of these taxes—levies whose real burdens fall in ways which hardly conform to accepted ideas of justice—the possibility of improvement provides basis for seeking change.

Economic Realities

The supporter of taxes on business net income seems to expect them to “burden the company”. Rather than explaining the expected results, and showing why they are better than alternatives, the advocate of corporation taxes will usually try to change the subject.

The Role of Business. Businesses are the organizations upon which Americans rely for most of what is produced. Although valuable results come from the efforts of government employees as well as from those who work for private universities, hospitals, and other nonbusiness organizations, most real income consists of what people accomplish through business firms.

Business is society's chief agency for organizing labor and capital to produce—and to produce more, rather than less, efficiently. A business firm is a group of people seeking to benefit themselves by serving others. It is this service, whether in producing and distributing things or in rendering services directly, which the public wants.

The process of meeting the desires of consumers can be more or less efficient. A market economy relies primarily upon competition in markets to induce efficiency—and to stimulate economic growth. For it is in business organizations that we find most of the venturesomeness which leads to the innovations that contribute much to rising levels of living.

The public interest calls for each business to do two rather different things. (1) It should turn out products or services which are wanted more than something else, as reflected in freely made consumer decisions expressed in the market, or through government agencies. Part of this task is to identify wants which can be satisfied by new types of goods and services. (2) A second general interest is for each company to produce by methods which economize on labor, materials, capital, and other “inputs” according to their relative scarcities and productivities.

The total accomplishment of people working as business organizations will depend upon many things: the training, inherent ability, and acquired skill of workers; their willingness to exert effort; the amount of capital; the degree of competition; present and expected demand; the state of technology and speed of scientific advance; the competence of management; and other things. Among the "other things" are some for which government is responsible—the system of law and order is one, and the tax structure is another.

Do taxes on business earnings help the community to get the output most desired? Obviously, taxes which vary among corporations according to profits do not improve the process by which consumers indicate the relative importance of their many desires. Nor do taxes on business income help managers learn about the relative scarcities and productivities of inputs. Profits taxes do not relate to the inherent creativities of different resources (capital versus labor or debt versus equity capital) or act to offset deficiencies in the market's guides as to relative scarcities. But taxes do affect the alternatives which a business manager must consider; the incentives open to him when acting for the company do differ as a result of tax laws.

In adopting methods which cut the tax bill, the business does not economize on the "input" of government or reduce in any perceptible way the government's use of resources. Nor in selecting a tax-saving alternative does the firm increase its operating efficiency in the sense of using fewer real inputs per unit of output.

A business, in fact, may wisely adopt methods which as regards the use of resources are "second best." The tax factor makes some alternatives financially the best when in a more real sense they are inferior. Taxes at high rates thus give rise to an element of conflict between private and public interest. They induce the manager to redirect the firm's activities, away from what is fundamentally most efficient.

The distortion of decisions may produce only trifling waste; or the total may be of enough importance to warrant concern. Productive capacity is not allocated to the uses, and in the proportions, which are fundamentally best. Too much investment goes into forms with less burdensome tax consequences; too little then goes where taxes will be high. The economy loses some real income. The loss is a burden—but an "excess burden", one which is largely concealing, which cannot be measured.

Reasons Advanced For Taxing Business Income

How can we account for the heavy taxation of business? Accident and temporizing to meet emergencies—notably war—have played a large role.

From time to time "business", especially big business, has drawn sharp criticism from writers and "reformers." Whatever the bases for such criticisms, America's school books, fiction, and the writings of persons who probably consider themselves "intellectuals" and other molders of opinion, have perpetuated attitudes which contain hostility to business.

There also seems to be a belief that "business" somehow has taxpaying capacity—"business" or "corporations" as distinguished from people as stockholders, consumers, or employees. The big corporation, seeming to be so impersonal, appears as an inviting target. Moreover, on the assumption that the shareholder bears the burden, and recognizing that shareholders, especially the owners of large numbers of shares, are the more prosperous members of society, advocates of corporate taxation defend it as progressive.

Any resulting progression, however, is crude at best. It is not the type which can be defended as leading to either verticle or horizontal equity. Furthermore, it is not true that a corporation income tax resting on shareholders imposes no burdens on low income groups. Some shares are held by people with "low" incomes. Considerable amounts are held by philanthropic, educational, hospital, and other organizations whose activities serve even the very poor. Pension funds for employees of businesses, nonprofit organizations, and some state and local governments own substantial amounts of corporation stock.

High U.S. corporation tax rates went into effect during time of war and postwar boom when employees, owners, and government could all increase their "take". Concurrently, the rise in rates of tax on personal income, it was argued, justified substantial increases in the rates on corporations. As the years have passed, justification has also been found in the argument that burdens have been capitalized in the prices of shares and in a sense constitute no disadvantage to present stockholders, especially those who have bought since current tax rates went into effect.

In the formative years of income taxation in the United States, some economists introduced another argument. Pure economic profit, they said, is a true surplus. To tax it is not to burden the reward paid for an essential cost of production. That concept of pure profit, however, is not the income concept used for tax purposes. Lawmakers have defined "taxable income" in terms very much broader than the notion of pure profit as a true economic surplus.

Today's tax in the United States gets some support from another fact. The corporation income tax qualifies as an "automatic stabilizer" of considerable force.

To some extent corporations are separate from their owners—and in ways which can have tax significance. Two aspects demand mention: (1) the equality of tax burdens on incorporated and unincorporated activity, and (2) the possibility of tax avoidance.

Not all corporation profit is paid out in dividends. Amounts kept in the business are not subject to personal income tax. Most owners are not so well off, presumably, as if they had received the income in cash. The persons in control of the corporation, however, must expect those whom they serve to be better off than if they had gotten the earnings in cash and paid the personal income tax. The growth of assets (or decline in liabilities) resulting from the plowing back of earnings enlarges the ownership interest in the business. What would have been dividends will presumably be converted into capital gains. Any such possibility of transforming dividends into capital gains obviously has tax significance, but not in any simple relation. The possibility of delaying payment of tax also has value. Clearly, the existence of the corporation does make a difference in taxes on the owners because of the retention of profit.

For logical solution to the problem of taxing retained earnings, however, one will hardly look to the present tax, one which falls on all corporation earnings.

Uncertainty About "Who Really Pays"

Among those who give serious thought to the shifting of the Federal tax on corporation income as among consumers, stockholders, employees, or others, some will confess to great uncertainty. Others feel considerable assurance.

One problem is to distinguish between shifting in the short run of a year or two and over the longer run. Changes in tax on business earnings—whether resulting from fluctuations in pre-tax earnings or from a change in the tax rate or the definition of the tax base (depreciation deductions) or the tax structure (investment credit or treatment of multiple corporations) or in the case of regulated public utilities the decisions of regulatory authorities—will be reflected for a while in what remains for stockholders. As time passes, however, adjustments take place.

A business must have equity (ownership) capital. Supplying it costs something. The stockholder sacrifices the opportunity to use his wealth in some other way—lending or buying assets such as real estate. Such sacrifice is an economic cost. Although income tax law and traditional accounting do not recognize this cost as a deductible expense of doing business, consumers of the output of corporations will not get equity capital to work for them—and employees will not get equity capital to work with—unless the people who can provide ownership capital expect to receive total net benefits which will equal those obtainable elsewhere.

In other words, suppliers of capital in equity (ownership) form expect to be rewarded. What counts are the rewards after tax.

A "normal" after-tax return on equity capital is an essential economic cost. The net after-tax yield which a supplier of equity capital will insist upon, in expectation, will be as high a yield (conceived as a total net benefit, including growth in the value of stock, and hope of sharing in economic growth) as he could obtain from any alternative use of his funds.

The equity capital already in a business, of course, is largely sunk, except as depreciation permits gradual withdrawal. Expansion of an enterprise, however, calls for new capital; in the modern world mere survival of a business in fact often requires growth. To get new capital, the firm must offer attractions which are equal to those otherwise available to the suppliers of funds. Where can the company, in turn, get dollars to compensate the persons supplying capital? It must look to customers. If the corporation income tax rate is 50 percent, and if potential suppliers of new equity capital insist upon an expected return over the years of 8 percent, then the corporation must expect to get a price from customers which will give a pre-tax yield of 16 percent on ownership capital. Then only those new projects which offer a firm prospect of a 16 percent gross return will get equity financing in competitive markets.

The corporation will not succeed in selling new stock unless the prices which it expects from its customers will bring an adequate after-tax yield. The expansion of output (in a growing economy) will lag until prices are high enough to give profits which after tax do satisfy investors. In relation to demand, the supply of output from corporations adjusts to affect product prices. Over the long run, then, some or much of the corporation income tax will be paid by consumers. The indirectness of the process conceals most of it; but the result does include a tax on consumption. Some tax, however, will fall on shareholders whose expectations have been disappointed perceptibly. The tax falls capriciously, unevenly, and not in line with any concept of fairness familiar to me.

Will a reduction in tax on corporation earnings be followed by price reductions? Not obviously within the month. But competition works. Gradually rather than quickly, the decline in the cost of equity capital will increase productive facilities, and larger supply will mean lower prices.

The actual shifting to the consumer of a tax increase or reduction will depend to some extent upon what happens to the total supply of, and total demand for, capital. The amount of capital available for new investment in business is not fixed. The amount available for equity investment in corporations is certainly not fixed.

Let us assume that the tax on corporation earnings rises to make the prospective yield on corporation earnings less than otherwise and less after tax than will be available in some alternative uses. The potential supply of equity capital for corporations (out of a given total of funds for investment) will decline; more of the total of new savings will seek investment in debt form. The rate of return on debt will then fall. Thus, a rise in the tax on corporation income will tend to reduce, not only the after-tax yield on equity capital (until shifting to consumers gets under way) but also the yield for suppliers of debt capital. The corporation tax thus becomes a more generalized burden on the suppliers of capital. The magnitude and the distribution of this burden cannot be measured nor compared with the amount passed on to consumers. Nor do we know how the amount of saving and the type of capital formation are affected.

This country apparently tries to put more of the cost of government (per dollar of income produced) on people in their capacity as suppliers of capital rather than as consumers or recipients of earnings from labor. What are the reasons and the results? The role of capital is central to economic progress. Extra taxes burdening those who supply it cannot help, and will hamper, the achievement of objectives which most of us believe are important—output and efficiency.

Any process of shifting operates in an environment in which conditions constantly change. Lags and frictions inevitably slow the process. No single set of forces has an opportunity to work itself out fully. Profit results depend on all the many factors which affect a company's costs and selling prices. The reasons why some corporations are more successful than others differ widely. Businesses competing with others which are free from tax—perhaps those operated by government—must expect considerable difficulty in passing the tax to consumers through the market process. Other factors are foreign competition, the extent of production from firms with large proportions of debt finance, and “special features” of the tax law (or its administration) such as deductions for depreciation, depletion, and reserves for losses. In a dynamic economy flows of new equity capital depend upon many factors, a few of which are neither rational nor farsighted. But exceptions are just that, not typical.

One conclusion seems clear to me: A major tax whose economic effects are so difficult to identify and measure—but some of which wise men of goodwill must shun rather than seek—can hardly be the best that men can devise. As a tax on consumption the levy on corporation income is haphazard and capricious. As a burden on suppliers of capital it has effects which are certainly not clear but which include both reduction of capital accumulation and investment in the equities of business.

Taxation Of Land Values

Although it may seem impossible that man fails to take advantage of one good means of getting revenue, such is the case. We fail to tax land, especially in and near cities, as thoroughly as would be desirable. If government must be financed, then in land values we have a most appropriate base to tax—and tax heavily.

Land in the sense of space is the creation of nature far more than of man. And land as location value depends largely, as a rule, upon the developments of society rather than of the individual owners. The quantity and quality of human effort and of capital offered for production will differ according to the weight of tax. Not so, land. It cannot get up and walk away or take a vacation. The amount in existence does not depend upon the tax, but the tax can influence the way in which land is used. The kind of tax policy which will get substantial revenues from (urban) land without reducing the quantity will also tend to direct land use into better rather than poorer channels—“higher and better use”.

God, or nature, created land—certainly not the owner. The quantity is limited, most strikingly in cities. As demand presses on supply the price goes up. To get the use of space, even the little space of congested city living, people pay “high” prices. Such payments are necessary to allocate a scarce resource efficiently. But the high prices do not, as for other items of production and consumption, call into existence more, rather than less, land.

Obviously there is an excess of payments over what would be needed to make this resource available in the sense of existence. Such payment is an “economic surplus.” Here is pure land rent in the Ricardian sense. It serves a constructive economic purpose in allocating the scarce resource—but not in calling it into existence. The “payment” can be a periodic amount, so much per year. Or it can be converted into a capital sum and realized upon sale.

Use of land is a continuing thing. Payment will be made continually, as an outpayment to a landlord each month or in the form of an owner-user's sacrifice of alternative uses of what he paid in buying the land (adjusted for what he could get from sale currently). Since the periodic cost does not go to create the land, as the payment for shoes goes to get them produced, government can interject its authority and take much of the payment to pay for governmental services.

Rising population and rising purchasing power (excluding inflation), lead to higher land prices (rents). In the United States, and many other places, the rise in urban land values rests to considerable degree upon school buildings, streets, and other governmentally supplied capital facilities. In places the governmentally provided facilities costs, apparently, over $15,000 per residence. Would not society be better off if much of the rise in land prices went to finance local government? Yes.

Taxation can do more than recapture for public treasuries much of the values created socially. It can put pressure on owners to find the best use possible of land. Withholding of land from a more productive use imposes costs upon society. For a variety of reasons, some logical, some not, landowners ("speculators") do keep land below the most productive use possible. A tax based upon values representing the best potential use will induce owners to seek out higher yields.

For reasons which I have developed elsewhere, present property taxes as they fall upon buildings and other improvements have substantially undesirable results. One possible means of reducing them would be to raise the tax rates on land while lowering them on buildings. These changes would alter profoundly the economics of land use and investment in structures. The net benefits to society could be many times the cost of making the shift. The communities moving first in this direction would benefit far more than those coming later because of the greater ability to attract new capital.

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The Future Of Capitalism
Henry Hazlitt

At the present time the outlook for capitalism is far from hopeful. This is not owing to any inherent defects of capitalism considered as a system, but to the fact that great evils and injustices are attributed to it and that its merits are so little understood. As a result it is being maligned, thwarted, sabotaged, and slowly regulated to death.

But before we discuss the probable future of capitalism, we ought to be clear concerning exactly what it is. Capitalism is free enterprisè. The two terms are synonymous in what they denote, though much different in what they connote. Capitalism was originally coined as a smear word in 1854 by Karl Marx and his followers. It was intended to imply a system run by the capitalists and for the capitalists, to exploit the workers. Yet even this smear word unintentionally emphasizes one great merit of the system, which is that it tends to promote the accumulation and increased use of capital, and so tends constantly and acceleratively to increase the production of wealth.

Capitalism may be thought of as a combination of two institutions—private property and the free market. Private property means that everyone is free to keep the fruits of his labor, or to put them to any use he sees fit, as long as he does not infringe the similar rights of others.

It should be obvious that without the right of private property men would lose most of the incentive to produce anything of permanent value. If a farmer knew in advance that after he had plowed and planted and tended a field, anyone else would have as much legal right as he to harvest the crop, or to appropriate it even after he had harvested it, he certainly would not bother to plant the crop in the first place. If any man knew in advance that after he had built and furnished a house, anyone else would have as good a legal right as he to occupy it, he would not build the house in the first place. Private ownership is absolutely essential to give any incentive for sustained work and sustained production of durable wealth.

Again, the free market, the right to sell or exchange one's property for the best bargain one can make, is also essential to the maximum production of wealth. It is through the mechanism of the free market—through the search by the individual as producer for the maximum monetary profit, combined with his search as consumer for the most advantageous exchange for what he wants for his own use—that production is not only maximized but optimized—that it goes into the creation of tens of thousands of different goods and services in the amounts and proportions in which they are wanted by the great body of consumers.

Let us look closely at the way in which this productive balance is brought about. When production is in equilibrium there tends to be approximately the same profit margin, relative costs and risks considered, in the production of each of the thousands of different commodities and services. Now let us say that there is suddenly an increased demand for commodity X. The competitive bids of consumers against each other will raise the price of that commodity. This will raise the profit margin in making it above the prevailing profit margin in making other things. The firms that are already producing commodity X will tend to increase their production of it. They will hire more workers away from other producers and increase their investment in inventories or equipment. Other firms will also try to start producing X because it is more profitable than producing Y or Z. In this way the price of X, or the profit in making it, will tend to fall again to the prevailing level in other lines. Meanwhile the comparative production of X will have increased.

The opposite result will tend to happen if the demand for commodity Y declines. Comparatively less of it will be produced, until the profit margin in making it is once again at least as high, relative risks considered, as in making other commodities.

As a consequence of this market mechanism, in short, the thousands of different commodities and services tend to be produced at minimum cost and in the relative proportions in which they are socially wanted. This is the way in which a capitalist system solves the problem of economic calculation, which a dominantly socialist system is utterly incapable of solving. (The first economist to demonstrate this conclusively was Ludwig von Mises.)

We should notice in passing that the success of this capitalistic process does not require that producers or sellers earn a so-called "fair" profit. It is not the absolute height of the profit that determines the direction of output; it is the comparative profit that serves as the spur and the guide. A uniform "fair" profit would leave production without a yardstick, map, or compass. It is a mistake to call the capitalist system "the profit system." It is a profit-seeking system, of course; and a perfectly proper name for it would be a profit-and-loss system. It is just as essentail to its proper functioning and health that under it inefficient operations or the creation of unwanted goods should be penalized by losses as that efficient operations or the creation of wanted goods should be rewarded by profits.

We may also note parenthetically here that normally profit is not something "added to the price"; it is not a cost that falls on the consumer. The bulk of profits go to those producers who are making better goods than their competitors, or producing them at less than average cost.

Many economists contend that there is no net profit at all in a stationary economy; the profits of producer A are offset by the losses of producer B.

This statement will seem startling to most laymen, but mainly because "profit" in the popular sense is a much wider term than "pure" profit as defined by economists. Profit in the popular sense includes nearly the whole return going to the entrepreneur or the capitalist, or both, whereas much of this return, according to economists, should really be counted as a form of interest on the entrepreneur's invested capital, or "rent" on his self-owned factory, or "wages" for the entrepreneur's own work of management, and therefore under a proper accounting system should be imputed to interest, rent, and wages respectively, counting only the remainder as pure profit.

In an economy that is expanding, there is presumably a net total of pure profits for the producers. But even if these are counted (as they should not be), as a net cost to the consumers, they are at most a temporary cost; for the greater part of the profit is reinvested in additional and more efficient plant that reduces costs of production (and hence prices) and increases output.

So capitalism is a system of both incentives and deterrents. This system does not maximize incentives to all production; it maximizes incentives to the more efficient production of the goods that are most urgently wanted.

Capitalism accomplishes this result in still another way. It is continually putting capital into the hands of those who have shown that they know how to make the most productive use of it. Those who exercise the best judgment in directing production into the most profitable channels, and in choosing the most efficient methods and the ablest managers, make the highest profits. This means that they obtain still more capital to reinvest wherever they think it will reap the highest returns. Those who use their capital to make unprofitable investments or who choose poor managers will lose their capital and will have less or finally none to reinvest.

Many people talk as if "production" and "distribution" were two separate processes, as they would be under socialism, and as if goods were first produced and then distributed. Nothing like this happens in a market system. Goods come on the market as the property of those who have produced them. Under a free competitive market system, as the American economist John Bates Clark was the first to point out explicitly, each factor of production tends to get the specific marginal product that it contributes to production—which means that for the most part each man tends to get what he himself produces. To quote Clark:

"Free competition tends to give to labor what labor creates, to capitalists what capital creates, and to entrepreneurs what the coordinating function creates ... [It tends] to give to each producer the amount of wealth that he specifically brings into existence."

Let us take a very simple—indeed an oversimplified—illustration. Suppose Peter and Paul are two chairmakers, working as individuals. They turn out chairs of equal quality, but Peter, working hard and well, turns out a chair every day for a working week of six days; and Paul, working more leisurely or less efficiently, turns out only three chairs a week. Each sells his chairs for $40 apiece. Then Peter has a gross income of $240 a week, and Paul of only $120. It would be absurd for Paul to complain that he is a victim of unfair "distribution" of income. There is no "distribution"; each gets the value of what he produces.

And this happens whether we are talking of chairmakers, shoemakers, tailors, builders, or lawyers. Each gets the value that his individual customers or clients put on his product or services, multiplied by the quantity he turns out. If there are a dozen chairmakers in a town, and each decides to increase his output by taking on helpers, it will pay them to take on a helper for any amount up to what his services add to their own revenue from sales; and the competition of the employer-chairmakers for helpers will tend to bring the helpers' wages up to this amount. Each will tend to get the value that he adds to production.

We cannot indict such a system as being “unjust.” Under it, rewards are proportionate to quantity and quality of output (quality as judged by the market). The system is one which maximizes incentives to effort and production.

The free market system is also one which permits and encourages freedom of competition. Competition is often denounced by socialist writers as being duplicative and wasteful. Its effect is exactly the opposite. As we have seen, one effect of competition is to take production constantly out of the hands of the less competent managers and put it more and more into the hands of the more efficient managers. Competition constantly promotes more and more efficient methods of production: it tends constantly to reduce production costs. Competition rewards most those who reduce their production costs most; it penalizes most those who are tardiest in getting costs down. As the lowest-cost producers expand their output they cause a reduction of prices and so force the highest-cost producers to sell their product at lower prices, and ultimately either to reduce their costs or to transfer their activities to other lines.

But capitalistic or free-market competition is seldom merely competition in lowering the cost of producing a homogeneous product. It is almost always competition in improving a specific product. And in the last century it has been competition in introducing and perfecting entirely new products or means of production—the railroad, the dynamo, the electric light, the motor car, the airplane, the telegraph, the telephone, the phonograph, the tape-recorder, the camera, motion pictures, radio, television, refrigerators, air conditioning, the computer, and an endless variety of plastics, synthetics, and other new materials. The effect has been enormously to increase the amenities of life and the material welfare of the masses.

Capitalistic competition, in brief, is the great spur to improvement and innovation, the chief stimulant to research, the principal incentive to cost reduction, to the development of new and better products, and to improved efficiency of every kind. It has conferred incalculable blessings on mankind.

The free market system, finally, is a great system of social cooperation. This cooperation exists between producer and consumer, buyer and seller. Both gain from the transactions in which they engage. That is why they make them. The consumer gets the bread he needs; the baker gets the monetary profit which is both his stimulus to bake the bread and the necessary means to enable him to keep baking it. As Adam Smith put it long ago, the essence of every commercial transaction is: “Give me that which I want, and you shall have this which you want.”

And in spite of the enormous labor-union and socialist propaganda to the contrary, the relation of employer and employee is basically a cooperative relation. Each needs the other. Their relationship is essentially one of partnership. The more successful the employer, the more workers he can hire and the more he can offer them. The more efficient the workers, the more successful the employer, and the better paid the workers.

It should be pointed out here (though the idea will strike many as strange) that even economic competition is a form of economic cooperation. At least, it is an integral and necessary part of an efficient system of economic cooperation. If we look at competition in isolation, this statement may seem paradoxical, but it becomes evident when we step back and look at it in its wider setting. General Motors and Ford are not cooperating directly with each other; but each is trying to cooperate with the consumer, with the potential car buyer. Each company is trying to offer the consumer a better car than its competitor, or as good a car at a lower price. Each company is stimulating the other—one might even say compelling the other—to reduce its production costs and to improve its car. Each company, in other words, is putting pressure on the other to cooperate more effectively with the buying public. Each makes the other more efficient. And so, indirectly—triangularly, so to speak—General Motors and Ford cooperate.

Every great firm is itself a huge cooperative enterprise. A big newspaper, for example, is a cooperative organization in which every reporter, every editor, every advertising solicitor, every printer, every delivery truck driver, every newsdealer, cooperates to play his assigned part. A great industrial company, such as General Motors or General Electric—or in fact any of a thousand successful smaller companies—is a miracle of continuous cooperation.

And on a "macroeconomic" scale, the whole free world is bound together in a system of international cooperation through mutual trade, in which each nation supplies the needs of others cheaper and better than the others could supply their own needs acting in isolation. And this cooperation takes place, both on the smallest and on the widest scale, because each of us finds that forwarding the purposes of others is (though indirectly) the most effective means for achieving our own.

Thus the free enterprise system is a huge system of social cooperation which maximizes incentives to production, miraculously guides production so that thousands of goods and services are produced in the proportions in which they are socially most wanted, maximizes output, and does it by its tendency to reward people on the principle of "To each what he creates." Our main object should be to try to perfect this great system, not to uproot or transform it.

Yet ever since the rise of socialist ideas in the nineteenth century, this great system has been under attack. It is now threatened from a score of directions. The future of free enterprise depends upon its ability to ward off these attacks, to save itself from these alleged reforms.

Let us look at the main present threats to free enterprise, beginning with the most direct and most serious.

In the first half of the present century, the most direct and serious threat to free enterprise was outright socialism—that is, socialism in the "orthodox" form of government ownership and management of the means of production. This is what we have today in rather complete form in the communist world and in a modified and partial form in most of the non-communist world. But government ownership of the means of production has lost prestige. It has proved disillusioning everywhere. It has been tried. Most of the governments of Europe own and operate their country's railroads and telegraph and telephone services. The result has been chronic poor service and chronic deficits. Even the overregulated private railroads in the United States do better, particularly with freight; and the private telephone service in the United States, though also overregulated, is still the best in the world. The service of the government post office is a joke everywhere. The socialist parties of Europe still want to keep nationalized the industries they have already nationalized, if only to save face; but few of them are actively pushing for more nationalization.

Perhaps the biggest threat to free enterprise today is the demand for more equality of personal incomes. Very few socialist or other reformers today demand absolute equality of incomes (as Bernard Shaw did or pretended to) because they sense that this would be completely destructive to all incentives to work and own. If we can imagine a society in which every adult would be guaranteed an income of, say, $4,000 a year, regardless of what kind of work he did, or whether he worked or not, and in which nobody would be allowed to earn or keep more than $4,000 a year, then we can see that if everybody acted in what seemed his immediate self-interest, thinking of himself in isolation, nobody would work and everybody would starve.

The reason for this ought to be clear. Everybody who had been getting less than the $4,000 guarantee (and who would now get just that whether he worked or not) would not need to work productively at all. And no one who had been earning more than the $4,000 guarantee and limit would find it worth while to continue to earn the excess, because it would be seized from him in any case. More, it would soon occur to him that it wasn't worth while earning even the $4,000, for it would be given to him in any case, and his income would be that whether he worked or not. So if everybody acted under an income equalization program merely in the way that seemed most rational in his own immediate self-interest considered in isolation, almost nobody would do any sustained or disagreeable work, and the nation would soon be destitute.

A less extreme equalization would, of course, have less extreme results. But any program to take from those who earn and give to those who don't earn must reduce working incentives to a certain degree. I don't know whether it is possible, or whether it will ever be possible, to determine exactly what levels of income guarantee, or exactly what percentages of income taxation, will reduce incentives and production by exactly what percentages. But it is probably a good prima facie rule of common sense that any income-tax rate above 50 per cent, overall or marginal, must reduce incentives and production and be counter-productive even of government revenue in the long run. The empirical studies of Colin Clark and others suggest that any income-tax rate even over 25 to 35 per cent must in the long run cut very seriously into the growth of national income.

Any program that supplies income to people who don't work must reduce incentives to a certain extent; and all taxes, considered by themselves, must discourage production, depending both on their level and their nature. (Grossly excessive as our progressive personal income tax rates are at present, our excessive corporation tax is probably doing even more to retard our potential growth.)

If excessive government spending is in itself a threat to the free enterprise system, such spending not paid for by taxation, but financed by deficits and inflation, is still more of a threat. A mild inflation in its early stages may seem to be a stimulus to production, but inflation is always a false stimulus; it leads to malinvestment, malconsumption, gambling, waste, cynicism, and corruption, and is as debilitating to a nation as the drug-habit is to an individual.

What is even worse than inflation is price controls which attempt to mask or suppress the consequences of inflation. Price controls, wage controls, rent controls, and interest-rate controls always misdirect, reduce, unbalance and disrupt production. They are nearly always more harmful than the inflation they try to conceal.

A very serious threat to free enterprise today is the excessive coercive "bargaining power" given to the labor unions by present labor laws and bureaucrats. Contrary to the century-old myth, labor unions cannot increase real wages for the whole body of the workers. At best they can increase the money wage-rates of their own members at the cost of reducing employment or reducing the real wages of non-union workers. Whatever gains the unions make by strikes or strike-threats are at best short-run gains even for themselves; for if they gain excessive wage-rates and diminish or even wipe out profit margins and profit expectations, they discourage and reduce new investment. In the long run there is then less production, less employment, and less real income for everybody. If free enterprise is to be preserved, present labor laws simply must be modified.

Still another threat to the free enterprise system, which has increased in recent years, is outright hostility to business. We might divide this hostility for convenience into two types: (1) hostility to public utilities, such as railroad, telegraph and telephone companies, power companies and the like; and (2) hostility to any large and successful business whatever.

The first kind of hostility has been with us for a longer time; it leads to overregulation, to chronic charges of dishonesty and gouging, and to the fixation by governmental regulatory bodies of rates so low that they do not allow sufficient funds for research and development, for improvement and expansion of services, and for reinvestment.

The second kind of hostility has recently grown more frequent and intense. It leads to opposition to mergers of all kinds, to prosecution under the anti-trust laws on so many grounds that no company knows when and for what practice it will be sued. It leads particularly to an immense growth of laws ostensibly designed to "protect the consumer." These laws now attempt to dictate in detail how goods should be labeled and packaged, how automobiles should be made, what interest rates should be charged and how the charges should be stated, etc. Since 1962 new pharmaceuticals have had to surmount so many hurdles before they can be put on the market that there has been a dramatic fall in the number and importance of new life-saving drugs discovered and introduced. When the drug companies are not attacked for their products they are attacked for charging exorbitant prices. And so it goes.

The saddest part of all this is that big business has lost the courage to defend itself even from direct attack. The late Joseph A. Schumpeter commented upon this acidly a generation ago, in his pessimistic book, Capitalism, Socialism, and Democracy published in 1942. He maintained the thesis that “in the capitalistic system there is a tendency toward self-destruction.” And as one evidence of this he cited the “cowardice” of big businessmen when facing direct attack:

They talk and plead—or hire people to do it for them; they snatch at every chance of compromise; they are ever ready to give in; they never put up a fight under the flag of their own ideals and interests—in this country there was no real resistance anywhere against the imposition of crushing financial burdens during the last decade or against labor legislation incompatible with the effective management of industry (p. 161).

So here is the outlook. Capitalism, the system of private property and free markets, is not only a system of freedom and of natural justice—which tends in spite of exceptions to distribute rewards in accordance with production—but it is a great cooperative and creative system that has produced for our generation an affluence that our ancestors did not dare to dream of. Yet it is so little understood, it is attacked by so many and intelligently defended by so few, that the outlook for its survival is dark.

It may still be saved, but only if its merits come to be understood by the masses before it is too late. The world is now in a race between true economic education and catastrophe.

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Prices And Property Rights In The Command Economy
Arthur Kemp

Of the many discussions to which Ludwig von Mises has contributed over his long and productive career, few are more famous or of greater importance than the question of pricing and production in a command economy or, as Mises phrased it, the problem of rational economic calculation in a socialist state. The classic Mises article was titled, "Die Wirtschaftsrechnung in Sozialistischen Gemeinwesen," in Archiv fur Sozialwissen-schaften, Vol. XLVII, No. 1 (April, 1920), and which he subsequently expanded in Gemeinwirtschaft (Jena, 1922; 2d. ed., 1932). An English translation of the original article appears in F. A. Hayek, ed., Collectivist Economic Planning (London, 1935). Gemeinwirtschaft appears in English translation as Socialism (London, 1936) and later as Socialism: An Economic and Sociological Analysis (New Haven, 1951).

Although it may not be true to say that Mises was the first to turn his attention to the problem, the original article together with its subsequent additions became, as Hayek expressed it, "the starting point from which all the discussions of the economic problems of socialism, whether constructive or critical, which aspire to be taken seriously, must necessarily proceed."1/

Mises argued, in essence, that in the absence of market price determination and private ownership of the factors of production such as land and capital, a rational and efficient allocation of productive resources was not possible. This forms the heart of a dispute between socialist economists and market economists which has endured for a long period of time and has produced a very sizeable literature that is still expanding.2/ Examples of it, from both sides, are included in most of the important books of readings concerned with the study of comparative economic systems.3/ Most socialist economists have rejected the Mises criticism dogmatically and categorically, although one should probably except Oskar Lange, A.P. Lerner, and a few others, but none have been able to ignore it.

Indeed, the inter-relationship of prices and the productive process—the problem of rational calculation—could, and perhaps should, be employed as the central theme for a discussion of the differences and similarities among variant economic systems and societies. Prices provide a mechanism facilitating the choices necessary under all economic systems: choices involving the balancing of scarce means against competing ends. We are prone, understandably, to regard prices primarily as a phenomenon of markets and money, but this is a self-imposed limitation for convenience in order to focus attention on measurable, objective prices. In a more fundamental sense, price behavior is not confined to monetary manifestations alone, and in some societies or systems the non-monetary, non-market price behavior may be the most interesting and the most significant.

It also seems clear that, even in economic systems essentially market-oriented, non-market prices may be of considerable economic interest. Each of us would be willing to accept, for example, a lower wage (salary? money income? price?) for better working conditions, or more leisure, or more beautiful (stimulating? provocative? soothing? cooperative?) colleagues with whom we associate. Prices, in this broad sense, are pervasive in the economic process and, whether or not monetary market expressions of price are also employed, the price phenomenon continues to exist and to be worth careful study by economists. Sometimes, of course, even economists overlook the obvious as evidenced by an American economist who once interviewed several hundred British medical doctors in their respective surgeries (offices) during the early years of the National Health Service. He kept careful notes of the conversations but no record of the time he waited to see each doctor, thus losing a potentially significant piece of empirical evidence.

A very large part of modern economic analysis is, at base, price theory relating to an explanation of how goods are priced and how the remuneration of the factors of production (prices) are determined. The former is usually called price theory; the latter distribution theory—although clearly both have to do with price. Even the currently popular terminology contrasting micro-economics and macro-economics is a division of convenience rather than substance. The aggregates of macro-economic analysis without price theory could not be studied intelligently.4/ It may also be worthwhile reminding the reader that true prices are ex post by nature; true prices are past prices at which an exchange has taken place, or a choice made, or a decision reached. Price theory also attempts to provide a meaningful explanation of the factors determining the process of price formation (and in this sense is ex ante). Empirically, price theory is testable by examining the extent to which its principles are successfully predictive.

Certain kinds of price behavior imply certain institutional arrangements of property rights. Imposing a minimum wage law, for example, alters property rights by forbidding a person to offer his services at less than the specified wage, and forbidding others to purchase these services at less than the specified wage. Prohibition alters property rights by preventing a person from using his resources and abilities to manufacture, transport or sell alcoholic beverages. Similarly, if there is abolition of private property rights in capital equipment, different pricing arrangements are induced than where such private property rights exist. Indeed, as Armen Alchian has pointed out often and eloquently," ... Every question of pricing is a question of property rights. We could have asked: What system of property rights shall be used? The existing system of property rights establishes the system of price determination for the exchange or allocation of scarce resources. In essence, economics is the study of property rights over scarce resources. Without scarce resources, property rights are pointless. The allocation of scarce resources in a society is the assignment of rights to uses of resources. So the question of economics, or of how prices should be determined, is the question of how property rights should be defined and exchanged, and on what terms."5/

If this statement is correct, it might be supposed that a system aimed consciously at the virtual elimination of private property rights would mean, at the same time, the elimination of all prices. In point of fact, the first flush of victory of the "dictatorship of the proletariat" in the Soviet Union brought with it a short-lived, idealistic attempt to do away with prices. The necessary condition of doing away with prices, as Alchian points out indirectly, is the elimination of scarcity. In such ordinary, day to day services as street cars and other forms of transport, for example, the Soviets tried zero prices with the predictable results of unbelievable over-crowding. When confronted with the cold facts of reality, the "priceless" experiment had to be abandoned. Of course, there are still some zero prices in the U.S.S.R. (some doctors and other medical care, for example), but this results not in a no-price system but rather a kind of price system that is greatly attenuated.

Two of the several major functions performed by prices can be described as the rationing function and the allocation function. The former is essentially a short run function, serving to adjust consumption to production over short periods—shorter or longer depending on the length of the production process for the particular good. Allocation of resources involves both long run and short run considerations. Both these functions can be performed by prices. Under a pure price system, both functions would be performed by autonomous price movements reflecting both relative price changes within price levels and changes in general price levels. No existing system can be said to be a pure price system. This is another way of saying that property rights are never absolute. But the functions performed by prices are more attenuated in some systems than in others.

As an illustration, let us look at the Soviet "price system" although the functions ordinarily associated with the phrase are so attenuated in the U.S.S.R. that there may be some question whether the term is at all applicable.6/

Prices in the Soviet Union can be considered conveniently in three general categories: (1) agricultural prices; (2) industrial or producer goods prices; and (3) consumer goods prices. Several kinds of agricultural prices are employed, and only one of these can be regarded as determined essentially by market forces of demand and supply. These are prices paid to collective farmers by consumers for produce raised on small private plots. Other agricultural prices are: (1) those imposed upon the collective farms for compulsory deliveries of foodstuffs to government firms; (2) prices paid to state owned farms by state owned marketing organizations; and (3) prices paid for raw or processed foods of the state owned marketing organizations or processing plants by state owned retail stores. All three of these categories of agricultural prices are officially fixed. They are supposed to reflect the average cost of production. In fact, the prices paid to collective farms by the government seem unrelated to cost, and the difference between these prices and those charged to consumers may be regarded as a major form of taxation from which the government obtains funds for the accumulation of real capital.

Industrial prices or producers' goods prices are also fixed prices. In theory, these are also based on the average costs of production in each branch of industry. But in practice these can be altered in various ways by determination of surcharges, allowances, and delivery terms so as to provide the state with an important tool for implementing the basic physical decisions of the central planners. Discretionary changes in producers' goods prices can be used to discourage particular applications, to promote specific techniques, to encourage or discourage use of particular raw materials, to favor particular industries and areas, and in a myriad of other ways. Prices, of course, are essential for accounting and bookkeeping purposes even if their functions as rationing devices and allocative instruments are less important than their function as a supplementary tool in basic planning and distribution.

Consumer prices are also fixed prices except for the foodstuffs sold directly to the consumers by collective farm workers. They include a variety of taxes, such as excises on salt, matches and vodka, as well as sales or turnover taxes. Indeed, these comprise a major source of governmental revenue in direct contrast to the importance of income taxation in most western countries. Consumer prices are not intended as rationing devices, although they do provide the Soviet family with some degree of choice among ways to spend the family income. Overall, consumer prices do perform (somewhat imperfectly, of course) the equilibrating function of adjusting total purchasing power to total value of consumer goods produced. They do not, however, reflect meaningful changes in relative prices of specific goods, nor do they perform a rationing function with regard to specific goods. Rentals of apartments, for example, are very low relative to the prices of clothing. At the official rate of exchange, this might translate to $10 per month for an apartment (if one is lucky enough to get one) as compared with $500 for a woman's coat or $150 for a man's suit. Nor is the relative difference changed by using a more realistic rate as the black market rate for the ruble. The low price of housing apparently is considered a political necessity for the image of socialist society. It also seems probable that certain groups of individuals—such as party personnel, athletes, musicians, literary figures or artists—can be controlled or favored by the exercise of the rationing function on a political basis.

In describing the Soviet price structure, one scholar noted that their practices reverse the usual price behavior in underdeveloped countries. Low real wages in such nations seem normally to be associated with relatively high prices for capital goods; the prices of capital goods are relatively higher than the prices of consumer goods. Professor Jasny remarks that, “the peculiarity of the Soviet price system is that the means of production have become very cheap relative to wages and still cheaper relative to the prices of consumers' goods. This very peculiar type of relationship between the prices of producers' and of consumers' goods is indeed the feature which makes the Soviet price system unique.7/

This may be unique, but it is not difficult to understand why it developed. The overwhelming objective of Soviet economic policy was to force industrialization at a rapid rate. The price structure, enforced by state ownership of the means of production and by centralized dictatorship, brought into being a sort of compulsory saving that channeled a large part of the national product into industrial capital investment. This forced the rate of growth of the industrial sector at the expense of both the agricultural sector (by compulsory deliveries at low prices) and the current consumption sector (by prolonged scarcity of consumer goods).

This emphasis upon real investment in producers' goods—on heavy industry, military hardware and space activity, to be more precise—is a key to an understanding of the Soviet economy. In terms of success or failure as measured by the intent of the central planners, it achieved a substantial degree of success, even after allowing for the tendency of official statistics to overstate the case. Professor Nutter, for example, estimates that total Soviet industrial output increased by between 500$ and 600$ between 1913 and 1955.8/ This cannot but be regarded as a substantial accomplishment. From a truly underdeveloped nation, Soviet Russia has become one of the major industrial powers of the world.

In general Soviet production results from central planning in physical units by commands handed down from above. One exception to this general rule is agricultural production. The U.S.S.R. operates (1) large state owned farms; (2) collective farms; and (3) permits production and sales from privately owned plots. Both ideology and political power preferences would seem to invite complete elimination of private agricultural production and, as well, the complete transformation of the collective farms into state owned farms. This has not proved feasible. In contrast to the success of forced industrial growth by central direction, the poor performance of the agricultural sector has remained one of the most difficult problems for the Soviet economy. As early as 1928, Stalin called for the elimination of the peasant farmer as a class. He attempted to bring this about by a forced collectivization of farms during the nineteen thirties. In effect, his objective was accomplished but at a cost of direct or indirect deaths of perhaps 10 million peasants who resisted; at the cost of forced shifting of 20 or 25 million people to other activities; and at the cost of forcible combination of most of the remainder into collective farm units.

It should be noted that this forced collectivization had a logical basis. Industrialization required food for the favored group of factory workers. The forced collectivization, brutal as it was, prevented the peasant farmers from scuttling the entire program. The previous industrialization program of the twenties was followed by the so-called New Economic Policy—an adaptation forced upon the central planners by the failure of the peasants to furnish sufficient food. Since the thirties, the output of state owned farms has increased but the total output of the collective farms is larger still by far. Except for the output of the privately owned plots, this has been accomplished by forced production of compulsory deliveries at artificially low fixed prices.

The Soviet agricultural sector, in effect, has been forced to pay for the industrial real capital necessary for the growth of the industrial sector. As one scholar states it, “the differences between the prices the state pays for agricultural products and the prices it charges consumers have represented the main source of the state's capital accumulation. The prices of most compulsory deliveries remained virtually unchanged from 1928 to 1955, while consumer retail prices rose approximately eight times during the same period.”9/

Such a peculiar price structure reflects an equally peculiar property right structure. Agricultural performance is spotty, discontinuous and admittedly unsatisfactory. There is an element of private property in agriculture in privately worked acreage and privately owned livestock. In terms of total cultivated land, private acreage is small—something near 3$. In terms of total agricultural output, however, these private works account for between 30$ and 50$ depending upon the vagaries of nature, prices, measurements and biases. Even after allowances are made for the fact that grains for feeding livestock and poultry are not grown on the private plots, and for the artificiality of some prices, there still seems to be a substantial difference in output attributable to an incentive factor based on property rights.

Another feature of the altered property right structure is that the individual peasant is not free to leave the collective farm of his own volition. Permission to leave must be granted by the collective, and internal passports for physical movement can be made difficult to obtain if the authorities so desire. As a result, there seems to be a gradual but continuing deterioration of those remaining in agriculture as the young, presumably better educated, are drawn to the factories. Expert opinion seems to believe that urban workers' real incomes are something near twice those of agricultural workers. In the absence of effective barriers, one would expect a movement away from the farms and toward the more remunerative and rewarding employment in the cities. Evidence drawn from daily papers supports the conclusion.

The underpricing of Soviet agricultural products to obtain state capital recalls the half-facetious comment made a few years ago to the effect that you can tell a developed country from an under-developed country by examining agricultural pricing practices: under-developed countries pay their farmers too little; developed countries pay their farmers too much! No one should read too much into such a statement but it is remarkable how high the biserial correlation seems to be between the degree of industrialization and two kinds of price interference: (1) fixing agriculture prices below the market; and (2) fixing them above the market. Full industrialization may not be reached by the Soviets until they pay their farmers too much!

In brief, the Soviets have used prices as political tools and means for controlling the economy. The practical details to which Mises' original criticism applied in general have not gone unnoticed. Since Stalin's death increasing attention has been paid to alterations of incentives, to some recognition of the applicability of the profit motive to state owned enterprise but not to individuals, to suggestions for decentralization of the planning function, and to somewhat more flexible powers to set prices by the state owned plant manager rather than by central planners. The most widely noted discussions of pricing policies in recent years seem to have stemmed from the writings of Yevsei G. Liberman of Kharkov Engineering and Economic Institute.10/ Liberman proposed a measure of profitability expressed as a percent of capital employed to replace, as a measure of incentive, the fulfillment of assigned plan physical quotas. He also suggested increased autonomy for plant managers in setting prices, and advocated recognizing interest as a cost of production. The literature available in English has come to call these proposals "Libermanism," although the basic ideas have been much discussed and extended by others. One eminent Soviet economist, V.S. Nemchinov, now deceased, forcefully criticized planning techniques in the U.S.S.R. as too centralized and unwieldy, inflexible in practice, and increasingly inapplicable to a world of ever growing complexity. He advocated decentralization, much greater price flexibility, payment of interest by factories on capital employed, and a system of bids and tenders by factory managers.11/

This seemingly significant abandonment of some of the positions long considered basic Marxist-Leninist idology and dogma has led some to suppose that the U.S.S.R.

and its satellites may be moving in the direction of capitalism, and that this may make more probable some kind of rapprochement between planned economies and market-oriented economies. One scholar writes, "When Communists of high rank advance profit as the main measure of economic success and the main regulator of economic activity in lieu of planning, this indeed is something new, for it seems to constitute an admission that self-interest is the most important driving force in economic accomplishment. Such an admission may be the beginning of a deviation straight into the camp of capitalism, although they insist that this is not the case."12/

On the other hand, many voices have been raised to caution against interpreting economic liberalization in pricing and production as part of a deliberate, conscious policy aimed at increasing the freedom of Soviet society and of the Soviet citizen. In the Swiss Review of World Affairs (Zurich), Dr. Willy Linder expressed doubt that there is a growing tendency toward a free market economy in the U.S.S.R. and concluded that the need to achieve some degree of economic rationality in "certain limited areas" is stronger than ideology.13/ Writing in 1960, Professor Wassily Leontiev noted that," ... what the Soviets are about to adopt is Western economic science, not Western economic institutions."14/

For fairly obvious reasons, those who have advocated price and other reforms in the U.S.S.R. and in the satellite countries try to avoid being classified as proponents of capitalism. Yet it seems clear that, by raising questions about the functions of a price mechanism, they are also raising serious questions about individual motivations and incentives and, indeed, private property rights.15/ But Marxism-Leninism in practice as well as in theory involves the abolition of property rights and the centralization of power in the state. The movement toward "market socialism" observed in some eastern European economies is a movement in the direction of market prices and, therefore, away from centralized control. But, automatically, then the question becomes political as well as economic.

Vested interests within the Soviet "establishment" cannot but be subjected to alterations in the distribution of power even if price reforms resulted only in some decentralization rather than major dispersal of power. How far will it be possible to twist and alter dogma so as to permit some market pricing, without forming a political threat to the existing regime? To suppose that an alteration of use rights to the means of production—a recognition of private property rights, perhaps by some other name like socialist use rights—can be reached without a major power clash seems like wishful thinking. Nor does the experience of Soviet armed intervention in Czechoslovakia provide much comfort.

Whatever the outcome (and since the future is always uncertain one is not entitled to predict it with confidence), a steady, rapid movement toward a market system either in the U.S.S.R. or the satellites seems unlikely. In addition to the myth of the disappearance of scarcity to which socialist economists seem forever addicted, there is also the fond hope expressed over and over again that modern electronic computers will provide, in the future, the key element for solving the problems of economic calculation and rationalization in a socialist society. Such a belief, even if it turns out to be as patently impossible as Mises originally asserted, or as impracticable as both

Vilfredo Pareto and Enrico Barone believed, cannot help but to delay movements toward markets and market data experiments within the socialist camps.

Footnotes

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The Inevitable Bankruptcy Of The Socialist State
Howard E. Kershner

The future kingdom of Socialism will be a terrible tyranny of criminals and murders. It will throw humanity into a true hell of spiritual suffering and poverty.

–Fedor Dostoyevsky

A democracy cannot exist as a permanent form of government. It can exist only until the voters discover that they can vote themselves largess out of the public treasury. From that moment on, the majority always votes for the candidate promising the most benefits from the public treasury—with the result that democracy always collapses over a loose fiscal policy, always to be followed by dictatorship.

–Alexander Tyler (in England 400 years ago)

Socialism teaches that a higher standard of living may be attained if the state owns and operates the means of production and distribution. To prove its case a Socialist government must continually spend more money to do more things for more people. Appropriations for welfare are increased. Subsidies for renters as well as home owners tend to grow ever larger. More money is spent for public housing. Social Security, Medicaid and Medicare payments grow larger. Pensions and scholarships rise while qualifying conditions for all of these are made easier.

Wages are increased. Hours are shortened. Fringe benefits are liberalized. There are more holidays, longer vacations and earlier retirement. The state must do all this to try to show that the people live better under Socialism than under free enterprise.

One group gets something. Other groups are unhappy unless they get as much or more. So, group after group, we go leapfrogging up the ladder to higher and higher costs of living. This is true because wages, direct and indirect, account for possibly 90 percent of the cost of goods and services. When they are determined by group or political pressure, they keep on rising year after year.

The Socialist politician who promises the most keeps himself in office. He is quite ready to tax ten people and distribute the proceeds to 20 people. Indeed, he will sacrifice ten votes if he is pretty sure of getting 11 or 12 in return. Once we concede to government the power of taking money from some and giving it to others, the process will not stop until the last bone of the last taxpayer is picked bare and we are all reduced to something approaching a common denominator. That is to say, under Socialism all except the top bureaucrats, their favorites and essential technicians are headed for the poverty line.

Alternatively, under the free market where each one is paid in accordance with the value his fellows place on his contribution to society, each one gets all he earns. This is the just and equitable way to determine wages. When wages are decided by political pressure, as is true under Socialism, large groups that can control many votes or strategic groups controlling essential services are always able to get more than other citizens. That's what drives the cost of living higher and higher under Socialism, leading to more debt, inflation and eventually to bankruptcy.

Many people like Socialism. An increasing number have learned how to live from the labor of others. They get but do not give. They enjoy benefits to which they do not contribute. Others know that Socialism will cost them something, but they think they will get more than they must pay. As long as they believe that, they will continue to vote for more Socialism. Almost any Socialist will vote for his neighbor to get more if the "more" he, himself, expects to get, is a little larger than that of his neighbor. There is almost no limit short of bankruptcy to the amount that can be filched from the treasury by the log-rolling process of approving benefits for others in return for their support of benefits for one's self.

Socialist regimes usually come into power after a long period of prosperity under freedom. As long as the Socialist government can distribute wealth accumulated under free enterprise, it can make a show of conferring benefits upon the public.

No Socialist system has ever shown itself to be the equal, or anywhere near the equal, of free enterprise as a producer of wealth. When wealth accumulated under freedom is all used up, life under Socialism becomes increasingly hard. It is so in all Socialist countries.

One reason why Socialist governments cannot produce abundantly is the difficulty they have of obtaining the necessary capital. There being little incentive to save, the Socialist regime soon finds itself short of capital. As capital investment declines, production declines, and scarcities become the rule rather than the exception.

Under pressure to do more things for more people, the Socialist state increases its indebtedness more and more until inflation brings on partial or complete repudiation.

As the Socialist state taxes its productive citizens more heavily for the benefit of its less productive class, it eventually crushes their initiative and incentive. Their production declines and they, one by one, join the ranks of the less thrifty and less responsible.

Taxes have removed them from the small class of highly productive citizens and have transferred them to the more dependent class. As this takes place, the Socialist state finds it harder and harder to keep up its production. It goes deeper and deeper into debt until bankruptcy, usually through inflation, takes place.

With increasing socialization the state itself is responsible for financing the expanding number of business activities which it takes over. The state is dependent for its tax revenues mainly on businesses operated by itself. These may not be well run and may be losing money, but for political reasons the state cannot permit them to fail. Since there is no private capital involved, there is no possibility of bankruptcy, and the state must continue to finance them by increasing subsidies drawn from tax revenue.

When private industries are improperly managed, the owners go bankrupt and lose their capital. When the state owns the business enterprises, politicians cannot admit this degree of failure and remain in office. They cannot resort to bankruptcy. Because the state owns the businesses, there is no private capital to be lost. All the state can do is to continue meeting growing deficits by the use of tax revenues and by increasing debt. Therefore, the taxing power of government is of necessity dedicated to the maintenance of the mathematical fallacy of long-term, compound interest.

To demonstrate this fallacy let us assume that one million dollars had been loaned at five percent interest, compounded annually, on the day Columbus discovered America in 1492. There would not be enough money in the world today to repay the loan.

At five percent compounded annually, money doubles in a little less than 15 years, or about seven times in one century.

At the end of the first century after Columbus arrived, that is, 1592, the loan would amount to $128 million. At the end of the second century, 1692, it would have grown to $16 billion. By 1792, it would amount to $2 trillion. At the end of the fourth century, 1892, it would have totaled $256 trillion, and by 1970, the total would be above $8 quadrillion.

Obviously, long-continued compound interest is impossible and any government dedicated to maintaining it will bankrupt itself.

Society has devised three ways of attempting to correct this error. The first was the ancient Hebrews' year of jubilee. Every fiftieth year all debts were to be cancelled and real estate returned to the original owner.

What happened under this ancient system is not clear, but it did not last long. It proved inequitable and, administratively speaking, impossible.

The second attempt to correct the error of long-continued compound interest was made by the private enterprise system. Under it, corrections are provided by the bankruptcy of the people who make mistakes; by compromise settlements, scale-downs and other adjustments as between creditor and debtor.

This has the merit of penalizing not the whole public, but only the people who prove their inability to use money wisely. The public is unharmed while the individual alone must atone for his mistakes. If he uses poor judgment, his wealth disappears. If he seeks to produce something or render some service that cannot be marketed, he loses his capital. By such means the accumulation of impossible debt is prevented. Corrections are made at the point of error. Compound interest continues to function only in that portion of the economy which has not resorted to unsound practices, but has earned the interest on its borrowed funds from year to year plus at least a small profit.

Socialism makes no provision for bankruptcy or adjustments of impossible debt. Under it there is little private capital and the State is forced to increase its debt more and more. Under Socialism old debts are rolled over and serviced by new debts. New money is borrowed to pay interest on old debt. Indebtedness mounts higher and higher.

Private enterprise is flexible. Adjustments are being made everywhere all the time. This is not done under Socialism which can only resort to moratoria and to adding accrued interest to principal as debt rises into the stratosphere.

Indebtedness of the Federal government, our states and our cities rises continuously. No knowledgeable person expects that it ever will be paid. This is the way Socialism operates and it leads eventually to progressive devaluation of the monetary unit through inflation.

Public and private debt, plus contingent liabilities of our Federal government, now exceed $3 trillion, or about 50 percent more than the total value of all our public and private property.

The people of this country are now paying out possibly one-sixth or more of their income for interest on various kinds of debts. Under Socialism, as debt increases, an even larger portion of the earnings of the people will be required to pay interest. How long will it be until interest takes half—then still more! What then becomes of the standard of living?

A city, a state or the Federal government borrows at, say five percent. In the course of 20 years it pays out as much in interest as the amount borrowed, and still owes the principal sum. This happens in the various units of government, that is, the Socialist sector. It does not happen to private business organizations. Under continuing abuse of credit they go bankrupt and disappear. Governments go on, with the amount of indebtedness forever growing greater.

A third way of attempting to offset this fallacy has been devised by the USSR. The Kremlin simply declares that one who has, say 100 rubles, now has only ten. This is partial repudiation and, if practised from time to time, will keep the state solvent though the people are robbed of their savings.

By penalizing the individuals who are incompetent or who make mistakes, private enterprise eliminates the less competent and brings to the fore the more competent. Under Socialism, on the other hand, the less competent continue in control and the public pays the bill through increased taxation to service ever-mounting debt.

Only the politicians who control the government, their favorites, and the technicians whose services they desire, can escape the penalties that Socialism imposes upon its citizens.

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Entrepreneurship And The Market Approach To Development Israel M. Kirzner

It is beginning to be realized that the vast literature on growth and development conceals a yawning gap. This void refers to an understanding of the role of the entrepreneur in economic development, both at the theoretical level, and at the level of past and prospective economic history. The entrepreneur, Professor Baumol remarks1 , has "virtually disappeared from the theoretical literature." In a penetrating essay on the entrepreneur's role in economic development, Professor Leibenstein discovers that "received theory of competition gives the impression that there is no need for entrepreneurship."2

In the literature dealing more narrowly with growth models3 , this hiatus is almost complete and hardly surprising in view of its predominant concern with macroeconomic relationships.4 In contrast, the literature dealing with development proper gives some attention to entrepreneurship, although little effort has been devoted to formulating a clear theoretical understanding of the entrepreneurial role. Discussion has revolved primarily around the possibilities of an "entrepreneurial climate" emerging in hitherto primitive economies; around whether the motivation to seek profits is as weak in underdeveloped countries as frequently assumed; around the feasibility of relying upon foreign entrepreneurs, and similar issues.1 However valuable, these discussions appear either to lack an explicit theoretical framework within which to examine the relevant issues, or, at best, to be founded rather shakily on the theory of entrepreneurship in development as expounded by Schumpeter in his justly famous work.2 Frequent, somewhat vague references to Schumpeterian innovators and entrepreneurs are apparently considered sufficient to indicate the theoretical background that is being assumed. Consequently, the real function of the entrepreneur in a developing market economy seems often to have been poorly understood, and the plausibility of rapid development under alternative economic systems to have been accepted uncritically.

This paper will attempt to reconsider the role of the entrepreneur in the theory of the developing market economy. Schumpeter's approach, for all its brilliant and valuable insights, will be criticized at a fundamental theoretical level, both to the notion of entrepreneurship itself and to capitalusing production. Finally, I will attempt to outline the far-reaching implications of these criticisms for the economic policy of developing nations.

Decisions And Decisions

At the heart of microeconomics lies the individual decision. The decision is usually conceived of as an "economizing" decision, i.e. one in which the individual—whether consumer, producer, or resource owner—seeks to achieve his ends to the furthest extent possible within the constraints imposed by the available means. It involves buying where price is lowest, selling where price is highest, balancing the marginal gain from each proposed step against the associated marginal sacrifice, and so on. This essentially allocative, efficiency-oriented, economizing type of decision, is the subject of exhaustive analysis in the theory of price. The theory of the market explores the extent to which economizing decisions of many independent market participants can be carried out simultaneously. The conditions necessary for all such decisions to dovetail together, so that none need be disappointed, constitute the conditions for market equilibrium. The market process enables a state of affairs in which the conditions for equilibrium are absent to lead towards the state of equilibrium.

The essential feature of the "economizing" decision, and the feature which renders it amenable to analysis, is its "rationality" or, more helpfully, its purposefulness. But this purposefulness is viewed exclusively as imposing upon the utilization of means, the importance assigned to the various relevant ends. In particular these ends and means are viewed as given and known, the act of decision-making being seen as essentially calculative, as though the resulting action were already implicit in the relationship between given ends and means.

But economists cannot confine their attention to this narrow notion of the decision. Attention must also be paid to an element in decision-making which cannot be formalized in the allocative, calculative terms. Purposefulness in human decision-making manifests itself along a dimension which is ignored in the analysis of "economizing" decision-making. In addition to the exploitation of perceived opportunities, purposive human action involves a posture of alertness towards the discovery of as yet unperceived opportunities and of their exploitation. This element in human action—the alertness towards new valuations with respect to ends, new availability of means,—may be termed the entrepreneurial element in the individual decision.[1] Awareness of this element in human action leads to the recognition that knowledge by the outside observer of the "data" surrounding a decision-making situation is not sufficient to yield a prediction of the decision that will be made. The calculation by the observer of the optimum choice (relevant to the data) may be profoundly irrelevant. The crucial question concerns what knowledge of the data is possessed—effectively possessed—by the decision-maker. In fact the essence of the "entrepreneurial" decision consists in grasping the knowledge which might otherwise remain unexploited.

Equilibrium, Disequilibrium, And Entrepreneurship.

It is not difficult to understand the traditional neglect by economists of this entrepreneurial element. Much economic analysis was developed against the background of an assumed world of perfect knowledge. The theory of perfect competition and more generally the theory of market equilibrium were developed in terms of perfect knowledge. Decisions were seen as strictly economizing decisions. Indeed, the world of perfect knowledge precludes the entrepreneurial element in decision-making.

Most importantly, for a market to be in equilibrium perfection of knowledge emerges as the essential condition. Equilibrium simply means a state in which each decision correctly anticipates all other decisions being made. In such a situation decision-making involves nothing more than the calculation of the optimum course available to the chooser, within the constraints imposed by the (correctly) anticipated decisions of others. No room exists for the entrepreneurial element.

In contrast, a disequilibrium market means a state of affairs in which decisions do not correctly anticipate all the other decisions being made. Clearly scope exists here for exercise of the entrepreneurial alertness to opportunities for more advantageous decisions than those currently embraced.

It is here that the appropriateness of this concept of an “entrepreneurial element” in the individual decision becomes apparent. It is well known that in price theory the “entrepreneur” has no place in the state of equilibrium. Only in disequilibrium are there opportunities for entrepreneurial profit, for the purchase of inputs at a cost lower than the revenue obtainable from the sale of their potential output. In equilibrium all profits have been squeezed out, costs and prices have become fully adjusted. To imagine all decisions correctly anticipate all others is to assume away all opportunities for capturing a margin between resource costs and product revenues. For the existence of such a margin is inconsistent with the knowledge assumed of resource sellers, concerning the higher product revenues, and of the knowledge assumed of product purchasers, concerning the lower resource costs. The perfection of knowledge, which rules out the “entrepreneurial element” in the individual decision, also rules out all entrepreneurial profit opportunities. The imperfection of knowledge that obtains in the disequilibrium market creates the price divergences between resource costs and product revenues which constitute the opportunities for profitable entrepreneurship in the more usual sense. And the exploitation of entrepreneurial opportunities for profit involves precisely that element in decision-making which we have termed the entrepreneurial element. To win pure entrepreneurial profits, it is necessary to perceive price divergences that have gone unnoticed. What is required is an alertness to the existence of opportunities that have been overlooked—because their continued existence must mean they have been overlooked.

Entrepreneurship-Equilibrating Or Disequilibrating?

All this is elementary enough, although not always clearly perceived, and is not inconsistent with the framework within which Schumpeter develops his entrepreneur-innovator. While, unlike Schumpeter, we have couched our discussion primarily in terms of decisions (and the knowledge possessed by decision-makers of others' decisions), our analysis can easily be seen to correspond to Schumpeter's discussion of the entrepreneurless circular flow and of the way the entrepreneur injects change into the system.

But the emphasis in Schumpeter's presentation, (quite apart from its failure to stress the importance to decision-makers of knowledge of the decisions of others), slurs over an important aspect of entrepreneurial activity. In Schumpeter it appears that the entrepreneur acts to disturb an existing equilibrium situation. Entrepreneurial activity disrupts the continuing circular flow. While each burst of entrepreneurial innovation leads eventually to a new equilibrium, the entrepreneur is presented as a disequilibrating force. "Development ... is ... entirely foreign to what may be observed in ... the tendency towards equilibrium."1

In contrast, our discussion indicates that the existence of an as yet unexploited opportunity for entrepreneurial profit means that the existing state of affairs, no matter how evenly it seems to flow, is a disequilibrium situation. It is a situation in which some decision-makers are at least partly ignorant of the decisions being made by others. This situation is bound to change and the existence of profit opportunities is the leaven that gives rise to the fermentation of change. Thus in our discussion the entrepreneur is seen as the equilibrating force. More precisely we see the entrepreneur as bringing into mutual adjustment those discordant elements which constitute the state of disequilibrium. His role is created by the state of disequilibrium and his activities ensure a tendency towards equilibrium. While it is true that without him a disequilibrium state of affairs might continue indefinitely (so that one could hardly insist upon calling the situation one of disequilibrium), nonetheless it is important to recognize that the changes he initiates are equilibrating changes, i.e. away from the maladjusted state of affairs which invites change, towards the state of affairs in which further change is unnecessary or even impossible.

This contrast, between Schumpeter's vision of the entrepreneur as a spontaneous force pushing the economy away from equilibrium and our view of the entrepreneur as the prime agent in the process from disequilibrium to equilibrium, is particularly important in the context of economic development. We must first, however, explicitly extend our discussion of entrepreneurship to the multiperiod level, in which Schumpeter's exposition suffers further.

Single Period Equilibrium And Intertemporal Equilibrium

In an analysis confined to single period decisions, equilibrium means the state of affairs in which all the single-period decisions made correctly anticipate the other such decisions being made. Entrepreneurship, in single-period analysis, consists in grasping profit opportunities to buy and sell at different prices in a disequilibrium market within the same period.

In an analysis extending to multiperiod decisions, the notion of equilibrium is more complex. In such an analysis decisions extend to plans to buy or sell in the future. A man invests now in his education, intending to sell in the future the skills he is learning. Another man erects a shoe factory now intending to buy regular supplies of leather during future periods of time. The equilibrium that would result from perfect dovetailing of these multiperiod plans must be an intertemporal equilibrium. Plans made today must fit not only with plans by others today, but also with plans made in the past and other plans to be made in the future.1 A state of disequilibrium will exist wherever any plan being made at any date fails to dovetail with other relevant plans (of whatever date) in the entire system being considered. A man who erects a shoe factory and who discovers in later periods that shoe leather is unobtainable, or that consumers no longer wish to buy shoes, made his decision in ignorance of the plans of others on which his own depended. A man who educates himself in a profession for which later demand is lacking, has made a plan based upon incorrectly anticipated plans of others.

Clearly entrepreneurship has its place in the intertemporal market in an analogous way to that occupied in the simpler single-period analysis. Where existing plans do not satisfy the conditions for intertemporal equilibrium, the relevant ignorance by the decision-makers has created opportunities for entrepreneurial profit which can be grasped by those who are able to "see" what others fail to see. These opportunities, (available to market participants with that alertness we have identified as the entrepreneurial element in individual decision-making), consist in the availability of resources today, at prices lower than the present value of the prices at which outputs can be sold in the future. This difference between buying prices and selling prices is similar to entrepreneurial profit in simpler contexts. This profit margin is the result of the failure by those selling the resources today (at the low prices) to perceive the possibilities for selling at higher prices in the future. Entrepreneurial alertness to these opportunities will capture this difference as profit and thereby generate the universal tendency towards the elimination of profit. Their buying and selling activities in the intertemporal market will tend to bring resource prices of one date into line with output prices of later dates (until only pure interest will be left separating them).

Thus, in the multiperiod context (as in the single-period analysis), the entrepreneur finds scope for his specific role in opportunities for the profitable use of resources which others have not perceived. We see him tending to bring about the exploitation of production possibilities which no one has yet noticed. These insights may be extended very smoothly to encompass capital-using production plans.

Entrepreneurship And The Use Of Capital

Everyone knows that economic growth and development requires capital. Our discussion of the entrepreneurial role in the context of the intertemporal market will help us to understand the relation between the entrepreneur and the capitalist.

We have seen that intertemporal production opportunities involve the acquisition of inputs at one date and the subsequent sale of products at a later date. In the context of capital-using production we say that the producer "locks up" resources in the form of capital goods, or goods in process, until the completion of the period of production. For such time-consuming, capital-using productive processes it is necessary for someone to forgo the alternative outputs available by using the inputs in less time-consuming processes of production. That is, someone must perform the capitalist role. If the input sellers (say, laborers) are not willing to wait for payment (wages), someone else must advance the funds for the purchase of the inputs and wait until the end of the productive process for the return of his investment. The producer who borrows the funds to finance his capital-using process of production finds it worthwhile to undertake the commitment necessary to persuade the capitalist to invest. The more productive processes of production, insofar as these involve more investment of capital, will be undertaken only to the extent that the producer "sees" the profitability of these processes. All this is trivial enough. But it focuses attention on the role of the entrepreneur in a way that is important for our purposes.

The technical availability of profitable capital-using methods of production and of savings to provide the necessary capital, is not sufficient to ensure that these methods will be undertaken. They constitute an opportunity for intertemporal exchange which may never be exploited if no one is aware of it. If, at any time, such an opportunity remains as yet unexploited, it offers opportunity for entrepreneurial profit. An entrepreneur will be able to borrow capital, buy resources, and produce output at a market value that will more than repay the capitalist's investment together with the interest necessary to persuade him to advance the capital funds. Only in intertemporal equilibrium (which, in the context of capital accumulation certainly does not mean a stationary state), will capital-using methods of production yield no surplus over the resource costs plus interest. In the world of imperfect knowledge—and in the multiperiod context lack of prescience is hardly a rarity—the harnessing of capital to more productive processes of production must involve entrepreneurial recognition of an opportunity that has hitherto gone unperceived.

Entrepreneurship is necessary in economic development, therefore, for the quite pedestrian purpose of ensuring a tendency towards the adoption of the socially advantageous long-term capital-using opportunities available. So far from being a kind of exogenous push given to the economy, entreprenounial innovation is the grasping of opportunities that have somehow escaped notice. So far from Schumpeter's "spontaneous and discontinuous change in the channels of the flow," disturbing and displacing "the equilibrium state previously existing,"[1] the development generated by entrepreneurial activity is to be seen as the response to tensions created by unfulfilled opportunities, by the unexploited information already at hand.

Schumpeterian Development—A Criticism

We have brought the discussion to a point where out dissatisfaction with Schumpeter's view of the role of entrepreneurship in development emerges in clear focus. Samuelson has captured the spirit of the Schumpeterian vision with an admirably apt metaphor. "The violin string is plucked by innovation; without innovation it dies down to stationariness, but then along comes a new innovation to pluck it back into dynamic motion again. So it is with the profit rate in economic life."[2] Development is initiated by innovators who are generating new opportunities. The Schumpeterian innovators stir the economy from its sluggish stationariness. The imitators compete away the innovational profits, restoring the stationary lethargy of a new circular flow, intil a new spurt of innovational activity emerges to spark development once again.

In spite of the brilliance and power of the Schumpeterian analysis, our own view of entrepreneurial development is quite different. For us entrepreneurship is an equilibrating force in the economy, not the reverse. Our entrepreneur, whether at the single period level or at the multiperiod level, is seen as fulfilling existing opportunities, as the one who generates the tendency towards the satisfaction of the conditions for equilibrium consistent with available information. His role is to fulfil the potential for economic development that a society already possesses.

We may present our dissatisfaction with the Schumpeterian scheme as follows. At all levels of human action, whether in the market economy or the centrally planned economy, we must distinguish two separate problems associated with ensuring that the best possible course of action will be adopted. The first concerns the discovery of the best available course of action, and is essentially a matter of calculation from the relevant data. The second problem is how to ensure that this best course of action—which can be carried out—will be carried out. At the level of the individual decision, economic analysis has all too frequently assumed that the second problem will take care of itself. The decision-maker is simply assumed to seek the optimum position. In other words the analysis overlooks the need for the entrepreneurial element in the individual decision, assuming the relevant ends and means are known. But, as soon as one recognizes the problem of ensuring that the individual "sees" the optimum course of action, the importance of this entrepreneurial element, of ensuring alertness to and awareness of "the data", becomes apparent.

When we consider the economic prospects of developing societies, the same two problems present themselves, and again we find the second problem ignored. The first problem is the discovery of the best course of economic development available to the society. In principle, it is a matter of calculating, of comparing alternative possiblities consistent with available resources and technology, in the light of relevant scales of value (whether of individuals or of planners, and including the relevant time preferences). No matter how elaborately this kind of calculation is carried out, the solutions obtained relate only to the first problem of determining what is best in the light of what is possible. We are still left with the second problem—of ensuring that the opportunities thus perceived will be fulfilled. No matter the form of economic organization, laissez-faire or central planning or some attempted mixture, the second problem must be faced: what can ensure that the opportunities that exist be "seen" and embraced? It is here—in the market case—that the entrepreneurial element comes in.

In the market system the existence of opportunities is signalled by profit opportunities in the form of price differentials. Now signals may not always be seen—but the kernel of market theory is that a tendency exists for them to be seen. The profit incentive is viewed as the attractive force. It is a force which not only provides the incentive to grasp the opportunities once perceived, but which ensures a tendency for these opportunities to be perceived. Entrepreneurship is seen as the responding agency; the alertness of the entrepreneur to profit possibilities is seen as the social mechanism ensuring the capture by society of the possibilities available to it. What the "entrepreneurial" element in individual decision-making is to the individual, the entrepreneur himself is to the market economy. All this is missing in the Schumpeterian scheme.

The literature on growth and development consists of careful, elaborate discussions of what possibilities exist for raising the productivity of labor, for increasing the volume of resources, for the accumulation of physical and human capital, for gains through foreign trade, foreign capital, and so on. The problem of entrepreneurship in this literature seems to be treated in much the same way as are economic resources in general. Although a difference is recognized between the entrepreneur and the manager, the former still appears to be treated as an element that extends the range of possible opportunities-rather than the element needed to ensure a tendency towards the fulfilment of opportunities available in principle without him. Schumpeter's picture of the entrepreneur as the initiator and author of development seems to be at least partly responsible for this failure to grasp the real significance of entrepreneurship. (In this regard Leibenstein makes a valuable distinction between allocative efficiency and "X-efficiency", and recognises entrepreneurship as being concerned with the latter rather than with the former.1))

Our objections to Schumpeter may be summed up. The Schumpeterian view of development is one of spontaneous, disjointed change. The circular flow from which such change occurs is one in which intertemporal plans seem to be somehow suppressed, so that changes, say, in the capital intensity of production, are associated specifically with entrepreneurial activity. This view directs attention from the possibility of intertemporal equilibrium in the sense of an economy fully adjusted—with no scope for entrepreneurship—to a definite pattern of increasingly capital-intensive activity. The role of the entrepreneur to ensure a tendency towards the fulfilment of such a pattern is thus suppressed. Instead of entrepreneurs responding to intertemporal profit possibilities (through alertness to possibilities of commanding additional capital resources), the entrepreneur is pictured as creating profits ("the child of development"2)). Instead of entrepreneurs grasping the opportunities available, responding to and healing maladjustments due to existing ignorance, the entrepreneur is pictured as generating disturbances in a fully adjusted circularly-flowing world in which all opportunities were already fully and familiarly exploited.

The Implications Of The Criticism

Does this criticism of the Schumpeterian view make much difference, or is it another way of seeing the same thing? There are strong grounds for insisting that our criticism does indeed have important implications.

The great neglected question in development economics concerns the existence of a social apparatus for ensuring that available opportunities are exploited. Its solution requires a social apparatus for ensuring that the decision-makers become aware of the existence and attractiveness of these opportunities. We have noticed that the market possesses exactly such an apparatus in the freedom with which it permits entrepreneurs to exploit opportunities for profit of which they become aware. Profit, in the market system, is not merely the incentive to lure entrepreneurs into grasping the opportunities they see, it is the incentive upon which the market relies to ensure that these opportunities will be seen in the first place. One of the major arguments in favor of a market approach to economic development consists precisely in this crucially important element of the system. Whatever advantages the price system possesses as a computer, facilitating an optimum intertemporal allocation of resources, these advantages depend utterly on the entrepreneurial element we have identified. And it is precisely such an element which appears to be lacking in alternative systems of social economic organization.1 It is here, we submit, that Schumpeter's scheme fails us.

For Schumpeter's picture of economic development depends, after all, upon entrepreneurship. Yet, despite having within his grasp this enormously important insight, Schumpeter lets it go. His picture fails to bring out the power of entrepreneurship to ensure a tendency towards the fulfilment of socially desirable opportunities. His picture fails to throw into relief how the tension generated by the existing maladjustments draws the corrective entrepreneurial activity. His picture fails to reveal how it is the market which permits all this to occur. On the contrary, the entrepreneurship around which Schumpeter builds his system is in principle equally applicable to the centrally planned economy.[1] The notion of circular flow and the possibility of its disturbance through creative spontaneous decisions are in principle entirely relevant to the non-market economy. What the Schumpeterian picture of innovational development fails to explain is that the existence of a possibility is not enough, that a social mechanism is needed to ensure that possibilities are perceived and embraced. Schumpeter fails to show how the non-market economy can grapple with this central problem.

Schumpeter's brilliant insights into the nature of innovation and entrepreneurship thus need to be recast into an ex ante mold. Instead of seeing only changes which the entrepreneur has wrought, we must focus attention on the opportunities which were waiting to be grasped by the entrepreneur. Instead of identifying the profits captured ex post by the entrepreneur, we must focus attention on the profit possibilities which serve to attract the entrepreneur. Instead of seeing how the entrepreneur has disturbed the placid status quo. we must see how the status quo is nothing but a seething mass of unexploited maladjustments crying out for correction. Instead of seeing entrepreneurship as jerking the system out of equilibrium, we must see it fulfilling the tendencies within the system towards equilibrium. My belief is that only such a theoretical scheme can be helpful in the great policy questions that face the developing countries of the world.

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The New Science Of Freedom
George Koether

"While other sciences have advanced, that of government is at a stand; little better understood; little better practiced now than three or four thousand years ago." Thus wrote John Adams to Thomas Jefferson in 1813.

"What is the reason?" Adams asked, and then proceeded to answer his own question:

"I say parties and factions will not suffer, or permit improvements to be made. As soon as one man hints at an improvement, his rival opposes it. No sooner has one party discovered or invented an amelioration of the condition of man, or the order of society, than the opposite party belies it, misconstrues, misrepresents it, ridicules it, insults it, and persecutes it. Records are destroyed. Histories are annihilated, or interpolated, or prohibited—sometimes by popes, sometimes by emporers, sometimes by aristocratical and sometimes by democratical assemblies and sometimes by mobs."

Were Adams living today he would be even more dismayed. He would see the progress of most sciences accelerated to an awesome degree, while the "science" of government is worse than "at a stand"—it is in the hands of a spendthrift democratical assembly and a growing mob in the streets. In fact, there is no "science" of government, for government is Force not Knowledge.

There may be a science of politics—a political science—which seeks to establish the principles on which a stable polis can be founded. Government, however, is politics in action—polis in praxis. And government can never become a science, in my belief, until it embraces the praxeological principle which Ludwig von Mises has shown to be necessary to social order.

That principle is simply free choice—maximized for the individual and minimized for the government. As Mises states it:

"Freedom is that state of affairs in which the individual's discretion to choose is not constrained by governmental violence beyond the margin within which praxeological law restricts it anyway."

If this is the true definition of freedom—and I believe it is—then freedom has a scientific basis. No longer does its definition depend upon the value judgments of philosophers, theologians, historians, political scientists or politicians.

Freedom, thanks to Ludwig von Mises, and the other economists upon whose efforts he founded his own great work, now rests upon the certitude of praxeological science. It does not depend upon the contradictory claims of parties or factions.

And if freedom can be thus scientifically defined, then on this foundation it may be possible to build a new Science of Freedom. As praxeology lifted economics out of the limited confines of "economizing scarce means" and broadened it to a general theory of choice embracing all human action, so can praxeology, with the aid of economics, develop a Science of Freedom.

Do we need a Science of Freedom?

Certainly, the human condition cries out for one. The sciences are advancing, yet freedom is declining. We gain in knowledge as we lose our liberty.

It is as if we had been mining the world of Ignorance and digging deep into one vast vein of science after another, one shaft of knowledge penetrating, at one time, more deeply than others, only to be reached and passed by other shafts as they dig deeper seeking Truth.

But each shaft is only partial Truth. And all the while, during this digging, there has been no great supporting structure of Understanding to relate one science to another—to serve as a crossbrace and prevent a cave-in. Meanwhile, the accumulated ores of wisdom are brought to the surface and piled higher and higher—until their weight overwhelms the weakened pillars of knowledge as each shaft goes deeper. Suddenly the whole structure of Knowledge collapses and society comes crashing down into Ignorance and ruin.

Our dilemma results from the failure of philosophy, science and history to find the "unifying principle" for which men have been searching for centuries. For, as Merz says in his History of European Thought, we have not met "the necessity of arriving at some firm and consistent view of the world and life—what we term a reasoned creed."

Early ethical, political and religious philosophy had been trying to find that "reasoned creed"—by seeking to change man from what he was to what they thought he ought to be. History, by trying to derive immutable laws for man's development from a reading of past events, told man what he had to be. Religion tried to displace Reason in man's loyalty, or to explicate it by Revelation. And Reason, in its turn, failed to displace Religion.

Merz described the flagging efforts of thinkers to find "unity of thought" early in the 19th century:

"philosophical speculation was primarily occupied in seeking and establishing the right Principle of unification ... in the middle of the century it was more definitely occupied with the Method of unification, and towards the end of the period, when both the principle and the method of unification had become doubtful or uncertain, the need and Purpose of a unification of thought made itself more and more felt."

In todays' crisis of Western Civilization the need is more than "felt." Western man must find it quickly, if he is to save himself from annihilation.

The crisis of our times is the crisis of science. As Ernst Cassirer describes it:

"science not only multiplied incessantly the number of problems and interests; it compelled also a constantly increasing specialization in research. Therewith the sciences were more and more sharply differentiated but at the same time they became more and more strangers to each other."

And what is even worse: "Everyone pretends to speak not only for his own department of knowledge but for the whole of science, which he believes himself to represent and embody in an exemplary fashion. Thus arise ever new discords and constantly sharper conflicts, and there is no tribunal that can compose these quarrels and assign each party to its respective rights."

Certainly science needs no tribunal. For a tribunal is Force. Nor does science want "unity." For unity implies conformity. What science needs is the cohesive power of a principle.

And the only principle acceptable to all of science is the principle of freedom. It is ironic that Science, which has always stridently proclaimed the necessity for freedom for itself, has done so little to search for a Science of Freedom.

Without the cohesive power of a generally accepted idea, science, like society, loses its cement. It begins to disintegrate.

As Hayek says, in The Constitution of Liberty, "we must show that liberty is not merely one particular value but that it is the source and condition of most moral values." And he states as his aim "the interweaving of the philosophy, jurisprudence and economics of freedom which is still needed."

But nowhere in his interweaving does the eminent author of The Constitution of Liberty, as far as I can recall, define freedom as a law instead of a value—a law of human action.

He does refer to Christian Bay's definition of freedom as "the soil required for the full growth of other values". And he cites W. H. Auden's statement that "Liberty is not a value, but the ground of value."

If freedom is the "ground" of all values, then, it seems to me, freedom can be called a General Principle—a Law. For freedom, certainly, is not a "value" in the same sense that summer is valued over winter, or blue is preferred over red, or release from drug addiction is preferred over slavery to a drug habit. Freedom—the instinct to resist physical restraint, the hatred of coercion, the drive to what one wills—these traits of human character are inborn. They are akin to the instinct for survival.

Of course people, whole nations, give up their freedom ignorantly. But how many people choose, knowingly, to give up their freedom? How many prefer slavery? To a human being—if he is to remain human in the true sense of the word—freedom is a necessity. One cannot have a scale of values unless one has the freedom to choose.

"Nature is inexorable necessity" says Mises, "in nature there is nothing that could be called freedom." So, "man has to adjust his conduct to the world as it is."

But man exists in nature, is a part of necessitous nature, and subject to the laws of his own nature. He is the only "animal" who possesses choice. It is part of his nature. In fact, the necessity to choose is the one thing over which he has no choice. For a man to cease choosing he would have to make his final choice. He would have to commit suicide. Or, he would have to be killed by others.

Mises comes closer, perhaps, to defining freedom as a Law than does Hayek. He says, in Human Action, "the scale of values or wants manifests itself only in the reality of action." Could one assume that "reality of action" is, by definition, a Law?

And he also says "Liberty and freedom are the conditions of man within a contractual society." Can we add that freedom is a "condition of man in any society in the sense that it is an end he desires and a means he must have if he is to attain his end? Or, to satisfy the logician who objects that a means cannot be an end, might we say that one must have freedom in the praxeological sense if one is to enjoy freedom in the metaphysical sense? The first being the means and the second the end.

Perhaps we can say, since choice is immutable in man's nature, and since choice implies freedom, that "freedom is a law of man's nature"—i.e. a law of human action.

We do not say that the Law of Freedom has anything to do with so-called "natural rights" or "natural law." We do not say that the Law of Freedom dictates modes of conduct or that it has anything to do with arbitrary, abstract ideas of "absolute justice"—all of which Mises fulminates against in Human Action.

"Concepts are tools of reasoning" says Mises, "they must never be considered as regulative principles dictating modes of conduct." True. But concepts themselves occur after freedom. They are made possible by freedom. To create a concept a man must think. When thinking he chooses. When choosing he exercises freedom. The concept of freedom as a Law of human action imposes no dictation upon anyone or any idea. It merely states, a priori, what is self-evident, but what is too seldom said or too little realized.

Mises says, "praxeology as a science cannot encroach upon the individual's right to choose and act." In a Science of Freedom we might say: praxeology defines the individual's freedom to choose as given. This may seem like hair-splitting. But from the standpoint of a Science of Freedom the distinction could be important.

The difference between a "right" and a Law—and the ability and willingness of leading thinkers in all sciences to accept that fact—could, quite possibly, open the way to that "integration" of thought so desperately needed to bolster the ideological defenses of Western civilization.

At least (and perhaps most important) it might lead to the necessary study of economics by thinkers in the social and natural sciences. It might, conceivably, awake them to the fact that—since there is a Science of Freedom, and since they wish to defend freedom in their own disciplines,—they must, then, master at least the essentials of the Science of Freedom and the science of economics on which it rests.

I doubt that we can expect them to make that effort until they have become convinced that Freedom is a Law based upon science, and not on a metaphysical mirage blown here and then there by the winds of opinion.

If they do make that effort, they will be confronted, immediately, with the question: whose economics will they study—Mises or Marx, Hayek or Keynes, Hazlitt or Friedman, Rothbard or Samuelson?

Hopefully, they will find time to study all of them and more. They will study the great ideas in economics as they would study them in their own disciplines. And if their minds are truly scientific—and not scientitic as Hayek defined the word in his important Counter-Revolution of Science—we need have no fear of the conclusions they will reach.

And in the science of economics, they will be guided by the test of the free market.

Should there be a Federal Reserve System? Obviously not; there should be free banking. Should money be paper and its supply regulated by the State? Certainly not; money should be specie and its quantity “regulated” by the market. Should there be price and wage and exchange controls? Of course not; there should be a free market. Should there be subsidies and quotas and tariffs? Obviously not; there should be free trade—and so on.

We may hope that their study of economics will give them the same humility in their outlook toward the complexities of human action that they seem to possess in their outlook upon the firmament they are studying, or the history and philosophy they are pursuing.

Certainly we have reason to hope that the great natural scientists and philosophers will arm themselves to avoid such embarrassing errors as this:

“The modern salesmanship associated with mass production is producing a more deep-seated reason for the insecurity of trade.”

(Alfred North Whitehead)

Also, we may hope, that scientists who have not studied human action will gain the insight of Lecomte du Nouy; “We have overlooked, behind the codified and conquered material forces, the directing forces that alone characterize man.... We did not wait to understand the nature of electricity before building dynamos and factories. Had we done so, we would have no electric force, light, or telegraph today. It is no longer a question of increasing our comfort but of saving the house built with so much labor—that house whose very foundations are tottering. To accomplish this, there is only one method: it is to consider man, in his complexity, as a single problem and to cease separating instruction from moral education.”

As for the Science of Freedom, we may hope that social philosophers from all disciplines may contribute to it. Although its main content will be economic its main contributors need not be economists.

It is impossible to foresee the content of the Science of Freedom in anything but the dimmest outline. Economics will pervade it because economics pervades all of life. But highly important contributions will come from masters of other sciences who know economics.

One thinks of Prof. Sylvester Petro whose Labor Policy for a Free Society stands as a keystone in the science of freedom related particularly to the fields of labor and law.

Another example of the "interweaving" of scientific expertise in more than one discipline is the work of Martin Anderson in his Federal Bulldozer, a remarkably effective application of economic understanding to a problem in social philosophy, economic policy and economic history.

And, from the standpoint of pure theory applied to the Science of Freedom, we have the brilliant contribution of Prof. Murray Rothbard, Power and Market.

One can say, with Sylvester Petro, that "if we are to understand the proper excellence of the free society, careful analysis of the unity and harmony of the concepts of freedom ... is indispensable."

And fortunately, one can say, with Eric Vogelin, "that at least the foundations for a new science have been laid."

The new Science of Freedom will, it is hoped, achieve the "interweaving" which Hayek started. It will "open the doors for future development rather than bar others," as he promised. It will remove the materialistic stigma from the word "economics" and reveal the economist as the most humane of all scientists.

And it will offer to every brilliant mind that does not know economics the great opportunity to make the scientific world whole, by interweaving the knowledge of all other sciences with the indispensable science of economics—to the extent that epistemology permits, and that may be a far greater expanse than we can now envision.

Hayek has pointed the way:

"the answers to many of the pressing social questions of our time are to be found ultimately in the recognition of principles that lie outside the scope of technical economics or of any other single discipline."

Whether the Law of Freedom—as formulated here upon the foundation of the Mises definition of freedom—is a valid concept or not is, at the moment, unimportant. It is only one more humble attempt—of many which must be made—to build that "harmony" of science which will provide the "unity of thought" required to face the destructive, monolithic ideology now challenging Western civilization.

At least we can start with a simple proposition that may merit general assent:

To use the powers of nature for his own purpose, man must act in accordance with nature's physical laws—“man commands nature only by obeying her.”

Likewise, says the New Science of Freedom, man can use the powers of his own mind to his own benefit only by obeying the praxeological law of his own nature—i.e. the Law of Freedom.

If we can show that praxeology (including economics) is the only scientific explication of freedom, let us hope that, from now on, any man who claims to speak for Science will have mastered the essentials of economics and the essentials of the Science of Freedom.

And let us hope that Eric Vogelin's prophecy of twenty years ago will someday come to pass:

“The reconstruction of a science of man and society is one of the remarkable events of the last half-century and, in retrospect from a future vantage point will, perhaps, appear as the most important event in our time.”

If Science succeeds in such a reconstruction, the eminent role of Ludwig von Mises in that reconstruction will—perhaps even more than his towering contributions to the advancement of economic theory—place him on the pinnacle of fame with the very few of the greatest social philosophers in history.

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Financing, Correcting, And Adjustment: Three Ways To Deal With An Imbalance Of Payments
Fritz Machlup

I am going to try again. I did not succeed in convincing all those whom I wanted to convince on my first try.1 The issues require conceptual clarification, since this is a matter on which governments make decisions of great importance.

For years economists have distinguished two ways of dealing with imbalances—surpluses or deficits—of foreign payments: financing and adjusting. I suggested that it would be more helpful to distinguish three ways: financing, correcting, and adjusting. These are not, of course, mutually exclusive alternatives: financing will be required while certain processes of adjustment are going on or while some correctives may be at work. Before I start defending my conceptual scheme, I should like to embark on a preliminary exercise: to find out whether similar conceptual problems exist regarding the payments balance of an individual household or firm.

Payments Problems Of An Individual Household Or Firm

If the head of a household suffers a decline in receipts or an increase in unavoidable expenditures, he may have a problem of restoring balance in his payments. Perhaps an illness has caused both his loss of income and in increase in his expenditures. As long as he has a cash reserve which he can run down or has enough credit to run up his debts with the doctor, the druggist, and the grocer, he will be able to finance his deficit. And while he finances the deficit, he can think of how he might adjust, either by raising his receipts—perhaps working harder—or by lowering his expenditures—perhaps cutting down on things he and his family might do without. It is revealing to realize that adjustment is a “problem” only so long as he can finance his deficit. When he is completely broke, has not a penny left, and can find no one to give him any credit, he no longer has a deficit and his adjustment is a fait accompli. The family may now be starving, but his previous problem of having to adjust has been transformed into the misery of an unhappily completed adjustment imposed by lack of finance. Obviously a deficit, with all the problems, headaches and stomach ulcers that it causes, would be preferable to the forced adjustment with unfilled stomachs and wretched poverty.

One lesson from this analogy is that adjustment is not necessarily “good,” and postponing adjustment is not necessarily “bad.” If incomes or other receipts cannot be increased, at least not for the time being, but if there is still some money left or some credit available, the household can continue to finance the deficit in the balance of its payments and may try to work out an adjustment of a sort less unbearable than the one that would be forced upon the family by an immediate disappearance of the deficit and of the victuals or medicines which it represented. Of course, the continuance of the deficit may increase problems in the future; to postpone adjustment is to improve the situation for the moment, perhaps for only a short while, at the cost of the future. But many people prefer to have this option—even if they later regret their choice and wish they had adjusted faster and had resorted less to financing prolonged deficits.

Both running down one's cash balances and running up debts have here been regarded as financing a deficit. But should any kind of borrowing be treated as financing a deficit? This would be logically consistent only if any kind of lending were treated as "financing a surplus;" I think it would be rather awkward to adopt such a convention. Many forms of lending are more reasonably regarded as payments that reduce a surplus than as improvements in one's liquidity position that finance a surplus. Conversely, some kinds of borrowing are more reasonably regarded as receipts that increase a surplus or reduce a deficit than as deteriorations in one's liquidity position that finance a deficit. Is there any convenient criterion by which to decide the issue? Tentatively I suggest that we treat the receipt of a loan as a deficit-reducing receipt in the balance of personal payments if it relieves the borrower of pressing worries and anxieties for a number of subsequent "pay periods," but treat it as temporary finance of a deficit if it leaves the borrower with a feeling of having to repay the loan "tomorrow" or so soon that he incurs sleepless nights with his debts. I realize that some people can sleep well and do not worry even if their debts are overdue. Thus, we cannot really use presence or absence of worries as operational criterion; maturity of the debt will have to be the criterion.

Assume that our broke friend obtains a loan that will mature in more than a year from now; thus we may say his deficit has disappeared for the time being. Would we say that he has adjusted? Assume, alternatively, that he has started to sell some of his possessions—rugs, paintings, furniture—in order to make receipts match his expenditures. Would we regard this disappearance of the deficit an adjustment? It stands to reason that neither the increase in his debts, whatever their terms, nor the sale of his possessions can go on forever; there is a limit to his credit and it may be reached before long; and after a while he will run out of saleable things. I submit that we cannot reasonably speak of completed adjustment if the state of affairs is such that either the deficit will reappear or expenditures will have to be cut in the foreseeable future.

It makes sense to use the designation "adjustment" only if the new situation is sustainable in the long run, that is, as a rule, if there are no items in the receipts or expenditures that must reasonably be expected to change and thereby create an imbalance. Having decided, however, that our friend's borrowings, if not due for quick repayment, or the receipts from selling his possessions, have wiped out his deficit for the time being, our diagnosis of the situation cannot be "financing of a continuing deficit," but it is not "adjustment" either, since the situation is not sustainable in the long run. This is an instance of an intermediate category or removing (or reducing) an imbalance, and a name is needed to refer to it. I propose to call it a compensatory correction of the imbalance.

Our illustration has been of a household in or near poverty, financing or correcting a deficit, or attaining a forced adjustment with sustained misery. It may be misleading, however, if the theme of the three ways of dealing with a deficit is illustrated only by a sob story. To widen our horizon, we shall now choose an illustration of an affluent household with intentional deficit financing leading to a desired adjustment with increased and sustained affluence.

Assume that, at given stock-market prices and given expectations about future changes in these prices, the head of a wealthy household has stayed 50 per cent invested and 50 per cent liquid; but that he is now persuaded to expect stock prices to rise briskly; and that consequently he decides to reduce his cash balance and to purchase securities. This increase in his portfolio investment constitutes a payments deficit financed by a decline in liquidity. When the portfolio adjustment is completed, the deficit will have disappeared. The outcome is exactly what was desired, and the process comes to a happy ending with prospects of capital gains and increased earnings from investments.

A variant of this case of a deficit through increased investment outlays can be shown by assuming that our rich friend stops financing his deficit by drawing down his cash balance but decides instead to borrow. If the loans are not promptly repayable and fully match his payments for the acquired stocks, he has no deficit: the borrowing corrects the imbalance which his stock purchases would otherwise create. As a third variant, we have our rich friend choose another route of paying for his shares of stock: neither borrowing nor drawing down his cash balance, he may forego his annual safari to Africa and his purchases of the 52 annual models of Dior dresses for his wife and of the mink and ermine coats for his mistresses. In other words, he may adjust his other expenditures to pay for his portfolio investments. If he persists in his new frugality, he can from now on expand his portfolio year after year. This is a real adjustment in the use of his resources.

All three ways of dealing with an imbalance of payments can be found also in the transactions of a business firm. Perhaps we may illustrate the different ways this time for the case of a surplus. Assume a firm has increased sales proceeds, or a reduction in the corporate income tax has reduced the firm's expenditures. If the firm allows its cash balance to go up, it finances its payments surplus; this could conceivably continue forever, but it would be rather unlikely, because the firm could put its funds to better uses. If the firm, instead, repays some bank loans or prematurely retires some of its outstanding bonds, it removes its surplus of receipts by increasing its payments of debt; this could not go on after all debts are repaid, and may therefore be regarded as a compensatory correction of the surplus. If the firm, instead of piling up cash or retiring debts, increases its payments of bonuses to management or dividends to stockholders, the surplus disappears through adjustment.

I am not suggesting that the terminology of international finance should be applied to discussions of private finance. It would be clumsy and unhelpful. The exercise in using a taxonomy that is possibly useful in international finance for descriptions of transactions in private finance had merely the purpose of finding out whether similar problems exist in both universes of discourse. We have satisfied ourselves that this is the case. Now we shall retire from the field of private finance with many good wishes, especially that the cultivators of that field may be spared the countless misunderstandings that go with the various concepts of a balance of payments. There is, unfortunately, no hope that these concepts can be expelled from international finance.

Payments Problems Of A Province Or Sector

A more patient exposition of the argument would not go from the individual household or firm immediately to the nation as a whole; it would instead stop on the way and take a good look at the interprovincial or some intersectoral balance of payments. Such an intermediate stop and sightseeing tour could serve to ascertain that the triad—financing, correcting, and adjustment—is fully applicable to interprovincial and intersectoral relations. Satisfied and strengthened in his convictions, the expositor and his readers could then go on to international payments.

I am not sufficiently patient to spend time on the intermediate stop. The curious reader may be invited to do his reconnoitering alone, if he wants to see for himself, perhaps by returning to the province (or the sector) later, after we have together investigated the case for the nation as a whole.

Payments Problems Of A Nation: Statistics And Theory

One of the most troublesome tasks in the analysis of problems of international finance is to reconcile balance-of-payments theory with balance-of-payments statistics. Both have changed and continue to change their conceptual schemes, almost from year to year, and each is hampered by the important requirement of correspondence between theoretical and statistical concepts.

This correspondence is never complete, of course, but even rough correspondence is hard to achieve. The theorist, engaged in rethinking the relevant relationships, labors under constraints imposed by the concepts employed in the estimation and presentation of the statistical material. The statistician, engaged in adapting his material for analysis and interpretation in the light of dominant theories, labors under constraints imposed by contradictions between conceptual frameworks employed in different theories and from frustrations inflicted by the fact that many of the theoretical constructs defy all attempts at operational definition.

Balance-of-payments statisticians have had a back-breaking job of trying to keep up with the changes in balance-of-payments theory. In another essay I showed how the statistical balance of payments of the United States for a single year—1951—was changed at least fifteen times between 1952 and 1959 in accordance with changing conceptions of what “balance” means and which balance matters; but none of the balances then recorded was among the two now featured in our official statistics.[1]

The problem of correspondence and noncorrespondence concerns not only the final “balance” but also most of the items that make it up. This can be illustrated with reference to some financial transactions which may be interpreted either as correcting (reducing) or as financing an imbalance. The statistician has to rely on an operational definition; he may, for example, resolve to treat changes in monetary reserves and in “liquid” foreign claims and debts involving commercial banks as well as monetary authorities as “monetary movements” (to use the expression of the Balance of Payments Yearbook of the International Monetary Fund). He will exhibit these changes “below the line” in the statistical accounts of the balance of payments, implying that they finance the balance of all items “above the line.” Movements of long-term capital, movements of short-term capital not involving the banking system, and unilateral transfers are all shown above the line and may therefore correct the imbalance that would exist in their absence.

This sounds easier than it is in many instances; in several borderline cases the interpretation will be arbitrary. Such cases are of three kinds:

> (1) Some changes in liquid liabilities to foreign banks entered as financing items (below the line) may be more appropriately regarded as financial correctives, that is, as capital inflows reducing rather than financing a deficit. This reinterpretation refers chiefly to those parts of the holdings of dollar balances by foreign banks with American banks that meet a sustained increase in their demand for holding cash. The probability that these balances will be firmly held, or even further increased, is much greater than the probability that they will be withdrawn tomorrow or the next day.
> (2) Some contrived inflows of short-term capital may be more appropriately regarded as financing items rather than as correctives. This refers to “nonliquid” funds that are more likely to flow out again than to stay. The usual operational criteria for regarding them as nonliquid (and hence placing them above the line) are the form of the credit instruments, the stated terms of maturity, and the type and nationality of debtors and creditors; the theoretical criterion, however, is the probability of quick withdrawal.
> (3) Some contrived changes on long-term capital account, known to be reversed before long, may be more appropriately regarded as financing items. This refers to flows of long-term capital that are almost certain to be reversed. We do not know how we could statistically divide movements of long-term capital—called long-term because of the terms of maturity—according to the likelihood of their reversal. But this is what really matters.

In other words, the operational definitions guiding the balance-of-payments accountants cannot do justice to the economic character of the transactions in question. Many financial correctives, producing changes in the balance of payments on capital account, will foreseeably prove of only temporary effectiveness—and will therefore merely postpone the need for real adjustment—and some will almost inevitably reverse themselves and will therefore be completely ineffective over an economically relevant period. Hence, one must frequently question the statistical or economic interpreter's decision to record as an improvement what is in fact only a device for gaining time—a financing device.

Payments Problems Of A Nation: Correctives And Adjustment

In my first attempt to distinguish “real adjustment” from mere correctives and mere financing, I concluded that “temporary financing is a stopgap, often embarrassing and, of course, of limited duration”; that “policies designed to bring forth the desired compensatory corrections will, more often than not, have repercussions that frustrate the attempts" and, even if they work, will not be "consistent with the economic principle"; and that "real adjustment" was therefore the only reliable cure of an imbalance in international payments.[1]

My terminological proposals and theoretical arguments have met with severe criticism: I was rebuked for having proposed "persuasive definitions" and for having violated my own rules in concealing my value judgments by a clever choice of concepts and assumptions. I admit that some of my theoretical judgments, especially the policy implications of of my arguments, may look like a sketch painted entirely in black and white, using black for what I defined as real and financial correctives, and white only for what I defined as real adjustment. I shall try to defend my distinctions and restate my arguments in less vulnerable terms.

These arguments will be based on a number of distinctions which I consider relevant for judging the effectiveness and efficiency of policy measures to correct an imbalance of payments. For each argument and each conclusion we shall ascertain whether and where it may involve a departure, overtly or covertly, from the rule of "value-neutrality" and where the proposed classification of policy measures may depend on indirect effects expected on the basis of theoretical arguments that rely excessively on "special" (perhaps specious) assumptions.

Real Flows Or Financial Flows

Since I distinguish "real adjustment" from correctives, and "real correctives" from "financial correctives," the first issue bears on the significance of the modifying adjectives used here. The distinction between policy actions designed to affect real flows and those designed to affect financial flows is fairly straightforward—to the extent that one agrees on what is "real" and what is "financial". The traditional distinction in the international accounts between balances of visible and invisible trade, on the one hand, and balances on unilateral transfers and capital movements, on the other hand, seems to correspond roughly to the meanings of real and financial flows. The correspondence is too rough, however, and exceptions should be pointed out.

For certain items that are usually entered among services or invisible trade, one may question whether they are properly characterized as "real" (in the sense of "products made with the aid of real resources"). I refer particularly to returns on foreign investment, such as payments of interest, dividends, and profit shares, but also to royalties, license fees, and other payments for rights or titles to things produced and delivered in the past. None of these payments are for services sold in the accounting period to foreign buyers, or bought from foreign sellers; or for products of inputs which the selling country in the period of the report either diverted from domestic to foreign use or failed to divert from foreign to domestic use; or for outputs which buyers purchased because relative incomes and relative prices were what they were and which the sellers supplied because of a given comparative-cost situation. Real flows, in the economist's theoretical system, are those international transactions the changes of which he attempts to explain by changes in comparative costs, relative prices, and relative incomes. Sound analytical practice, therefore, will remove payments of the other type, such as those described above, from the balance on goods and services and treat them, like unilateral transfers, as a special class within the current account, representing a financial flow.

Such a rearrangement of the current account does not imply any criticism of now customary statistical conventions. There is economic sense in the procedure, in balance-of-payments accounting, of putting tourist expenditures and forwarders' commissions in the same box as patent-license fees, interest payments, and dividends: all these are payments for services rendered and all figure in the income accounts of national-income statistics. But what is useful for one purpose need not be so for another purpose. For questions involving real-location of resources, a switching of inputs to alternative outputs, not all payments for services rendered can reasonably be treated alike. For these questions, certain payments are not indicative of real flows and are therefore regarded as financial flows. Whether this theoretical “insight” is accepted or rejected, surely no value judgment is involved in the distinction.

For Good Or Only For A Time

Policy measures may be designed to remain in force for good or only for a time. This is a distinction that implies neither value judgments nor theoretical arguments. One merely has to take at its face value what the governmental authorities say when they adopt the policy or take the action in question.

A temporary measure is, of course, only a means for gaining time, either because one hopes that the imbalance will go away or an expected event will soon straighten things out, or because one wants to put off a really remedial action for a while. Examples of such temporary measures are the border-tax arrangements by Western Germany from 1968 to 1969, the surcharge on imports to the United Kingdom from 1964 to 1966, and the Interest Equalization Tax on foreign securities in the United States from 1963 on for a supposedly brief period, which has not ended as yet (1971).

In none of these instances did the authorities expect that their measures would restore balance; they expected the measures to tide them over until balance was restored by other means or events.

Lasting Or Only Temporary Effects

Policy measures may be expected to have lasting or only temporary effects. This distinction is free from value judgments, but it presupposes theories linking causes and effects under stipulated conditions. One may disagree on such theories, especially because effects are predicted on the basis of assumptions about human behavior as affected by a variety of motivations, expectations, fears and hopes.

The validity of such assumptions may change over time. For example, exhortation and moral suasion may be successful for a time, but less so after people have found out that noncompliance pays; mandatory restrictions and prohibitions may be violated at an increasing rate after people discover that others have gotten away with their infringements; new regulations regarding taxes, tariffs, foreign-exchange transactions, etc., may achieve the intended results only until loopholes are detected and techniques of getting around the legal obstacles are developed.

Thus, even a supposedly permanent policy may have only temporary effects; a measure adopted "for good" may "wear off" after a while.

Sustainable Flows Or Exhaustible Stocks

Judgments of the effectiveness of a governmental policy or action depend on assumptions not only regarding human behavior but also regarding several other matters. One important difference is whether the policy or measure acts chiefly on sustainable flows or on exhaustible stocks.

To give an example, an incentive for enlarging the international movement of capital funds may affect the supply of newly saved funds (current saving) and of liquid funds held in given amounts. The former may be in amounts recurring period after period, whereas the latter will be limited to available balances.

The distinction between these effects may be of great importance, but the conclusion in every case will depend both on factual judgments and on theoretical arguments. No value judgments, however, are involved.

Market Forces Or Direct Controls

Measures may work either through market forces or through direct controls—and this distinction does have certain connotations in normative or evaluative economics. The bias in favor of economic liberty and "free market" forces and against "regimentation" that has developed from liberal or libertarian philosophy, or the opposite bias found in much bureaucratic and technocratic thinking, may-but need not - be inseparably intertwined with the economic analysis of the effectiveness of the measures in question.

It is possible, I submit, to discuss the effects which specified changes in costs, prices, or disposable incomes are likely to have upon exports or imports of commodities, and to contrast the findings with those of an analysis of the effects of quantitative restrictions (quotas) on trade, without being carried away by any pro-market or anti-market bias. On the other hand, I admit, there may be a correlation among (a) particular ideological prejudices, (b) factual assumptions judged to be realistic, and (c) results derived from the supposedly objective theoretical argument. However strong or weak this correlation may be, the distinction between the two techniques of achieving a desired effect remains significant.

Automatic Processes Or Discretionary Actions

Similar ideological prejudices may color the distinction between automatic processes or mechanisms and discretionary actions.

To illustrate, any purchase of foreign currency (directly or indirectly) from the central bank automatically reduces the stock of domestic money unless it is deliberately offset by an extension of domestic loans or purchase of domestic securities by the central bank. On the other hand, changes in discount rates, reserve requirements, credit lines or rationing, tax rates, tariffs, quotas, and so forth, are clearly discretionary measures. There have been biases in favor of or against automatic processes; and many who distrust discretionary policies have preferred mechanisms that operate fully automatically or, as a second-best solution, the adoption of rules that simulate the operation of such mechanisms and leave little to the discretion of the managers.

In the examples given above of discretionary changes I omitted foreign-exchange rates, because changes of exchange rates can be fully automatic (if the monetary authorities do not intervene and allow rates to be fully flexible, determined by “free market” forces), or formula-determined (assuming that any authorities will ever be willing to submit to the dictates of a rigid formula), or discretionary (subject to the judgment of the authorities in charge).

I believe it is possible to use these distinctions without being unduly influenced by political value judgments. Of course, in recommending or choosing the most suitable arrangements one cannot help being influenced by assumptions about the honesty, wisdom, and intelligence of the men in authority as well as by one's value judgments derived from political philosophy.

Universal Or Selective, Neutral Or Discriminatory

There are two pairs of distinctions that overlap to a considerable extent: universal versus selective measures and neutral versus discriminatory measures. Not all universal measures are neutral in their effects on different sectors of the economy, but one can say, without unreasonable exaggeration, that all selective measures are per se discriminatory (unless one reserves the latter expression for a narrower concept).

The idea in distinguishing universal from selective measures is most easily understood in the case of exchange rates: if a change in the exchange rate applies uniformly to all sales and purchases of foreign currencies regardless of the sources or uses of the funds, regardless of the persons or institutions involved, regardless of the purposes intended or attained, the rate change is universal; it is selective if it applies to specified types of transactions and not to others, for example, to capital movements but not to trade, to imports but not to exports, to some exports but not to others, to luxury imports but not to the import of necessaries, to unlicensed importers but not to licensed ones, etc.

The idea is not so simple in the case of monetary policy. One may say that a reduction in the rate of increase of the domestic money supply qualifies as a universal measure, not a selective one. However, the techniques of implementing the change in the rate of increase may include selective credit controls, arbitrary ceilings to the credit extension of individual banks, interest-rate increases that burden building and construction more than most other activities. Thus, with any of these techniques, the application of the supposedly universal measure becomes selective and discriminatory.

One may still distinguish between measures that are selective and discriminatory by design and those which have non-neutral, discriminatory effects that are not intended but are inherent in the execution or implementation of the measures. There is a significant difference between intentional and innocent deviations from neutrality. After all, no action improving an imbalance of payments can be neutral in its effects upon imports and exports; the charge of selectivity and discrimination (though I admit that the word "charge" reveals an adverse value judgment) can be leveled only against measures which deliberately favor or disfavor particular sectors of the economy, or particular forms of transactions, or particular types of transactors, more than would be necessary under the most universal scheme.

Effective Or Ineffective, Efficient Or Inefficient

Two more pairs of distinction may be included in this review: between effective and ineffective measures and between efficient and inefficient measures. The first pair refers to the probability that the measures in question have the desired results, if not entirely in the desired magnitude then at least to a large extent. The second pair refers to undesired side-effects of the measures and to comparisons of the social and economic costs of attaining the desired results by alternative techniques.

Needless to say, the second distinction applies only to effective techniques; it relates to the question whether the effects achieved by a particular type of action could have been obtained at lower costs by a different course of action. Both pairs of distinction rest on theoretical arguments about causes and effects, arguments on which experts may disagree. Conclusions concerning effectiveness, however, are usually free from value judgments, whereas conclusions concerning efficiency include evaluative elements in that certain social costs can only be sized up in terms of subjective preferences for different social goals such as individual freedom, total output, economic growth, income distribution, and so forth.

Several of the reviewed distinctions are logically prior to conclusions regarding effectiveness and efficiency. For example, whether certain measures or policies have lasting or only temporary effects, perhaps because they rely upon influences either on sustainable flows or chiefly on exhaustible stocks, these are questions that have to be answered before one can decide the degree of effectiveness. Whether certain measures or policies operate through market forces or through direct controls, by means of automatic mechanisms or of discretionary decisions, and whether they are universal or selective, neutral or discriminatory, these are questions the answers to which bear heavily on the efficiency of any scheme.

The Choice Of Definitional Criteria

In my earlier attempts at distinguishing "corrective" actions or events - "compensatory corrections, financial or real" - from "real adjustment," I was inconsistent in my choice of definitional criteria. At some places I stressed the automaticity of adjustment but included also such deliberate governmental actions as were designed to simulate the automatic processes of adjustment which, under "classical" assumptions, are generated by an imbalance of payments. At other places I put chief emphasis on the universality and neutrality of adjustment measures and on the selectivity and discrimination that characterized discretionary correctives. On one occasion I defined real adjustment by enumerating changes (a) in aggregate demand, (b) in general cost-and-price relations, and (c) in foreign-exchange rates, and left all other developments and measures in the crowded box labeled "correctives."

I submit that the inconsistencies are minor and well within the tolerance usually accorded to terminological decisions in applied economics. I also submit that the pollution of the concepts in question by value judgments and ideological preconceptions is no worse than that of most other sets of concepts employed (and, indeed, indispensable) in applied economics. However, it may relieve the conscience of some participants in these discussions if we adopt a single definitional criterion that separates correctives from real adjustment without violating the principle of value-neutrality preferred by most economic analysts.

I nominate for election to this position the nonuniformity of "equivalent" or "effective" changes in exchange rates in different international transactions. That is to say, I propose to use the word "corrective" for those measures that are designed to improve an imbalance in payments by effecting non-uniform changes of costs, or prices paid, or net proceeds received, in certain types of international transactions (concerning goods, services, securities, loans, gifts or what not). Such changes are in a sense equivalent to changes produced by the adoption or alteration of multiple exchange rates. These equivalent taxes or bounties on selected international transactions may take many different forms: they may be customs duties (imposed for balance-of-payments reasons), surcharges or subsidies on imports, positive or negative taxes on purchases from or sales to foreigners, quantitative restrictions on imports, exports, loans, or payments, or anything that increases or reduces the cost of selected types of foreign transactions.

Concluding Judgment

If the non-uniform change in the effective exchange rate is taken as the sole criterion, one may admit that some correctives are adopted to remain permanently in force, that they may have lasting effects, may operate through market forces, may be free from the exercise of administrative discretion, and may conceivably be even efficient. Still, the probability is high that they are adopted as temporary makeshifts, are only temporarily effective, are discriminatory, and inefficient. These are judgments to be established by analysis, however, and not by definition.

There is a difference between a presumption and a judgment. If the policy measures of the type characterized here as correctives of an imbalance of payments are, with a high degree of probability, only temporarily effective and relatively inefficient, any proponent of a corrective measure has the burden of proof that the proposed measure will be effective for a sufficiently long period and will not be more costly than alternative measures and, most importantly, will be less costly than a process of real adjustment. Only very strong evidence to this effect can rebut the general presumption of limited effectiveness and doubtful efficiency of corrective measures.

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On Protecting One's Self From One's Friends
Don Paarlberg

There is an old proverb that expresses a truth known to Professor von Mises and all others who participate in the intellectual forum: "Heaven protect me from my friends; I know how to deal with my enemies."

It is an open question as to whether the brand of economics espoused by Professor von Mises has suffered more from its many avowed opponents or from certain of its professed friends.

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First, let us be sure we know the essential nature of the particular kind of economics Professor von Mises is talking about. It is variously known, with differing degrees of accuracy (and inaccuracy!) as "the market system," "the price system," "the profit system," "the open system," "the free system," "capitalism," "free enterprise," "the enterprise system," "the competitive economy," "entrepreneural economics," and "laissez-faire." In this short essay we shall refer to it as the enterprise system.

In this system, the profit motive is the engine and price the steering wheel. The function of government is: to formulate the rules of the game; to keep the system open; and to protect the public and the private interest from each other's excesses.

Professor von Mises' brand of economics is intent on capturing, to the maximum possible extent, such benefits, public and private, as can be made to flow from individual endeavor. He sees the enterprise system as the economic counterpart for political democracy.

Cornerstones of von Mises' economics are: private ownership of the means of protection; freedom to choose one's vocation; and freedom to enter (or not to enter) the market. While not absolute, these institutions are generally favored.

By this system, the immense problems of supply are left largely to individuals, who follow the signals given by price. Whether a manufacturer produces black-and-white or color television depends on price. Whether a young man chooses to be a farmer, a coal miner, or an electrical worker is strongly influenced by relative returns. By differential rewards, resources are shifted as between the production of food, television, and space technology.

Prices guide not only production but distribution as well. Whether milk should be consumed in its fluid state, churned into butter, pressed into cheese, evaporated, condensed, or dried, depends on relative prices. Whether steel is imported or exported depends on price. Whether laboring people move into Mississippi or California depends on wages, a form of price. The consumer chooses goods largely on the basis of price: turkey or ham, Chevrolet or Cadillac, metal or wood.

This system has built-in incentives for efficient production. The man who puts resources together efficiently and who correctly anticipates the needs of the market is handsomely rewarded. If a man wrongly judges the needs of society or is wasteful in his use of resources, he suffers a loss.

The philosophical and ethical concepts which incline a man to favor von Mises' brand of economics may be described as follows:

Respect for the individual, with all his uniqueness, as the fundamental unit of human society.

Admission of everyone to the market, rather than discrimination based on race, creed, sex, or economic power.

Belief in the ability of the average man to make generally intelligent decisions if he has the facts.

Acceptance of a considerable degree of diversity in human desires and rewards.

Acceptance of the consequences of one's actions.

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This is what von Mises' economic system in fact is. We should be sure we know what it is not.

Obviously it is not socialism, which centralizes decision-making and advocates public ownership of the means of production.

Nor is it the welfare state, which resists differential rewards and greatly modifies the relationship between one's actions and the consequences thereof.

The socialists and the advocates of the welfare state are clearly enemies of von Mises' system. He knows how to deal with them; he opposes them.

Whom can von Mises count on as friends? Those who are philosophically at one with him, in terms previously outlined. These friends are true, lasting and loyal. They are like the "remnant" from whom, according to the Old Testament, the Lord repeatedly revived His People Israel.

These are the true friends. But there are other "friends," professed rather than real, who, through ignorance or design, claim to be supporters and defenders of the enterprise system. Chief among these are people whom we might call "neo-mercantilists," modern counterparts of the eighteenth century elitists and protectionists whom the enterprise system originally overthrew. These people have a philosophy quite different from that embraced by the enterprise economists. The main difference is that they would restrict access to the market, in their own self-interest, and would use the power of government to accomplish this purpose. Another group, much less numerous and more recently arrived on the scene, consists of the new apostles of uninhibited, irresponsible freedom, who want to “do their own thing” and wrongly see in enterprise economics a rationale for license. These people depart philosophically from the enterprise economists in that they do not see the linkage between freedom and responsibility.

Here we introduce a digression, intended to show why it is that enterprise economists resist the labels, such as “reactionary” and “conservative,” that are sometimes thrust upon them. Political labels are usually attached to persons or organizations on the basis of issues. Certain positions are known as “liberal” and others as “conservative.” The difficulty with this form of labeling is that with the passage of time the meanings change. For example, “liberals” once favored liberty; more recently they favor restrictions.

The fundamental and continuing attribute which underlies political issues is the attitude toward change. Some people welcome it and others oppose.

The model with respect to attitude toward change may be presented in the form of a circle. At one point on the circle is the reactionary, who wishes to reinstate what formerly was. Moving toward the left (and the choice of direction is deliberate!) we next encounter the conservative, who looks somewhat askance at change but in certain cases may be persuaded to accept it. Then there is the moderate, a lukewarm individual, to whom change is neither of itself good or bad. Moving still in a leftward direction we encounter the activist, whose presumption is in favor of change and who will embrace it despite considerable risk. Yet further to the left is the revolutionary, for whom abrupt and violent change has merit in itself.

If we consider the moderate as the beginning point in this model, we range toward the right until at the extreme we find the reactionary; we range toward the left until at the extreme we find the revolutionary. The fascinating thing is that the reactionary and the revolutionary are positioned side by side. The reactionary right and the revolutionary left both have deep quarrels with the status quo and advocate precipitate action in order to change it. They are sisters under the skin, in mood if not in specific objective.

Where is the enterprise economist in this model? He is not really in the model at all. He is neither basically pro-change nor anti-change. “Conservative” and “activist” are labels to which the enterprise economist has little direct orientation. His reference point is the fixed idea of individual worth. He may, on a number of current issues, find himself at once conservative, moderate, liberal and revolutionary.

So here is the enterprise economist whose case has been put so well by Professor von Mises, surrounded by his true and professed friends. To the casual observer they all look alike. All are asking for change. All profess to believe in the worth of the individual. All laud enterprise. All see a limited role for government.

The special cross the enterprise economist must bear is the support given him, often vociferously, by his professed friends whose self-serving motives are readily noted by the public, if not by themselves. To be specific:

Industrial people who laud “free enterprise” while lobbying for barriers to keep out competition.

Farm groups who slap one another on the back for their independence but ask Congress for quotas based on historic production, to restrict the entry of new producers.

Doctors who oppose socialized medicine but so restrict their numbers as to command very high incomes.

Professors who espouse the open society but erect barriers of degrees, rank, and tenure to limit eligibility for the preferred posts.

Elitist groups who favor the principles of freedom but would restrict these principles to a certain race, creed, or social class.

Dogmatists who would hold the enterprise economy in the precise mold from which it emerged nearly 200 years ago, who would deny recourse to every constructive innovation since Adam Smith.

Politicians who profess to believe in a free competitive economy but pass innumerable restrictive laws, laying on the free economy burdens greater than it is able to bear.

With friends like these, who needs enemies?

To the average citizen, the motives of these “friends” of the enterprise economy are as transparent as window glass. The low esteem in which enterprise economics is now held may result not so much from effective arguments made against it by its enemies as from hypocritical arguments made in its behalf by its professed friends.

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What to do? Those who both understand and support enterprise economics are relatively few in number, enough to keep the idea intellectually alive but not enough to bring about political change. How deeply should one inquire into the credentials of those who offer to help? Should one insist on purity of thought, word and act as a qualification? If so, the numbers will indeed be few.

The problem is typical for a minority group. It involves a delicate balancing act. It is necessary:

1. To keep the intellectual core of thought true and honest.
2. To incorporate new and improved ideas and practices that are in harmony with the essential nature of the concept.
3. To accept allies in the accomplishment of some political objective even though these allies may be opportunists.
4. To avoid being captured by these allies.

How well have the enterprise economists done on these various counts?

On point number one, intellectual integrity on the part of the leaders, we have done very well indeed. Professor von Mises' contribution has been primarily in this area. He has been intellectually honest and faithful to the central idea of enterprise economics. Using the tools of economic analysis, he has cut through the error and superficialities that might otherwise have misled us.

On point number two, innovation, the record is somewhat uneven. Some, overcautious by nature, have limited themselves to the concepts and forms of earlier times. Others, like Professor von Mises, have been innovative enough to build up the body of economic principle. Professor von Mises has been an educator as well as an innovator, and has avoided the oversimplification and dramatization that so often mislead. He has recruited many.

But not enough to bring about significant institutional change. That calls for use of the political process. Numbers are needed. So those who participate politically have sought to bring in the increased numbers. How well have we done on point number three, bringing in allies? Not so well. Enough have been recruited to pass a piece of legislation now and then, bearing the enterprise label. But these allies have often been the “friends” referred to earlier, who have supposed their natural desire for a protected market to be the stirring of the spirit of enterprise. Or, worse, clever lobbyists who have confused us with misleading slogans. Or, worse still, political charlatans whom we have knowingly embraced in order to get a majority.

These compromises have led to a dismal record in accomplishing the last of the four purposes, to keep from being captured by our allies. For, in large measure, we have been captured, not by an enemy, but by our professed friends. The result is that enterprise economics has an erroneous image.

In the minds of many citizens, an enterprise economist is one who believes in some form of economic Darwinism, who carves out a protected market for himself, who shackles his opposition, and who provides a rationale for the exploitation of his fellows. It is not difficult to see how an observer, noting what is done rather than what is said, would come to that conclusion.

The temptation, in view of all these things, is to confine enterprise economics to the classroom and the textbook, where it can be kept true, and to forego all efforts to bring about political change until such time as, by education, an absolute majority has been brought into being, whereupon, without need for allies, we would march to the polls and bring about the needed reform. Needless to say, this would take forever. Enterprise economics would become irrelevant. There is no real alternative to participation in the world of affairs, making alliances, accepting compromise, bringing about incremental change, experiencing the humiliation of defeat, and returning at intervals to the body of principle, happily kept alive and vigorous for us by Professor von Mises and his associates.

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Is enterprise economics viable in our modern industrial world? A chorus of voices responds in the negative. Von Mises' brand of economics, it is said, appeared in England during the early stages of industrialization, when life was simple, when individual entrepreneurs were numerous, when wide disparities of wealth were tolerated. The ethic of the day came from the Protestant Reformation, not from Sigmund Freud or Karl Marx. Now all this is changed, it is said, and the economics of enterprise is outmoded.

If by this argument one means that the form of enterprise economics in the Twentieth Century must differ from its form during the late Eighteenth Century, then the contention is valid. Any effort to restrict enterprise economics to its original form is certain to fail. But the essence of enterprise economics is that while the central concepts are persistent, the form is fluid. Here again we are in danger of a multitude of ancient errors, each stoutly defended by our professed friends: the mistaking of form for substance, the disciple holier than the Pope, an undue reverence for things past. We must break out of these errors if enterprise economics is to be relevant.

There is one special danger to be avoided. This is to use the rate of growth in the Gross National Product as the criterion for judging various economic systems. Many sincere friends of the enterprise system propose this criterion, confident that, thus judged, their system will prove superior. And indeed it might. But on the other hand, it might not. If rate of growth has been chosen as the criterion and a centrally-directed economy should show the higher rate of growth, logic would lead to adopting the centrally-directed system. Sacrificed would be the true merit for the enterprise system, its concern for the individual and its emphasis on freedom.

The free or entrepreneurial economic system relies for its functioning on some of the most persistent of human attributes:

The desire of the individual to improve his lot.

The wish to participate in decision-making.

The desire for self-reliance, self-fulfillment, self respect.

These attributes are rooted in human nature. They are found in Twentieth Century man, as they were in Eighteenth Century man. They will be present in the Twenty-first Century. The task is to develop institutional arrangements, suited to the modern day, that will permit their flowering. This calls for some changing concepts. For example, one of the precepts of enterprise economics has been a limited role for government. We must rid ourselves of the erroneous idea, propagated by certain of our “friends,” that any act of government is an invasion of individual freedom and is therefore to be resisted. On the contrary, government can be used to restrain those who would abuse individual rights. Government can be used to create free institutions, as it was in the early days of the United States. Government can be used to improve the functioning of the enterprise system, to place a floor over the pit of disaster, to help the individual prepare himself better for his task as a decision-maker, and to see that the market functions as an enlightened institution. In brief, the proper objective for government participation in economic life is to strengthen the process of individual decision-making, not to substitute public for private action.

Many earnest believers in enterprise economics allow themselves to be backed into a corner and forced to defend a system which is not at all what they propose. They unintentionally take on the defense of, not a free market, but a caricature thereof. They are maneuvered into advocating the free market not as it is or as it could be but as it once was or as its adversaries contend it would be. Or, more tragic still, they get maneuvered into defending the free market as some of its professed friends conceive it.

What is needed is a concept of enterprise economics, of the free market, that is free in a modern rather than in an archaic sense. This means a market free from manipulation, free from misrepresentation, free from gross ignorance, and free from senseless gyrations as well as free from government domination. It means the kind of market that intelligent people are capable of creating in the modern day.

This argument against the competitive system often runs like this: “If we were to accept a competitive market and dismantle the protective devices that have been built up during the past third of a century, we would experience dislocation of such magnitude as to bring about disaster.” This is true. The argument is unassailable. It would be quite an accomplishment for the competitive market if it were to cope adequately with the current run of economic problems; our present mixed system leaves much to be desired in this respect. It would be asking far too much to expect the competitive market to handle not only the current run of problems, but the accumulated dislocations of 35 years of government interference as well. One does not indict the free market if he hesitates to put it, abruptly, to such a test. The substitution of market forces for centralized decision-making must be a gradual process, though some “friends” would impose it overnight.

Advocacy of enterprise economics should not be a doctrinaire position that renounces all the enlightened institutions that have developed since the turn of the century, though certain “friends” take this position. Those who believe in enterprise economics should claim as part of their system all developments that lift the capacity for wise individual decision-making.

Must an enterprise economist hold true to the central core of principle unique to his persuasion, despite the entreaties of his professed friends? He must if he is intent on refining the body of economic thought consistent with his values. If one is an educator and wishes to propagate his free enterprise ideas he must reach out to others and help them to reformulate their views. If one is a politician and wishes to move the country in the direction of freedom, he must make alliances and expose himself to the danger of being captured by his allies. Whatever his role, he must know the difference between his true and professed friends. In this day of contrived images, it gets harder all the time.

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Recollections Re A Kindred Spirit
William A. Paton

I didn't have the good fortune to be a pupil of that great scholar and teacher, Ludwig von Mises, but it was my privilege to study under a master logician, a superb critic, an outstanding instructor, and an unexcelled expositor of the neoclassical position: Fred Manville Taylor. Professor Taylor never achieved the world-wide renown of von Mises, partly because of the paucity of his writing, but he was a kindred spirit in breadth of background, thoroughness of analysis, and devotion to the "automatic" mechanism of the free competitive market as the major means of directing man's economic activities. Hence it does not seem to be inappropriate to include some notes on Taylor in a volume designed to honor the foremost living economist.

Brief of Taylor's Education and Career. Professor Taylor, born in Northville, Michigan, July 11, 1855, received his bachelor's and master's degrees from Northwestern University (1876 and 1879). He did graduate work at Johns Hopkins and abroad, and later (1888) received the Ph. D. from Michigan. His brilliant doctoral dissertation was entitled "The Right of the State To Be"—an interesting subject for a scholar devoted to the view that an economic order characterized by individual initiative and freedom of exchange, with government playing a limited role, is more productive and more conducive to the advancement of all classes of citizens, and especially the poor, than any form of socialism or communism.

In 1892, after a period of teaching history at Albion College, Professor Taylor joined the Department of Economics of the University of Michigan, where he was in charge of the basic course in principles, as well as of the advanced work in economic theory, until his retirement in 1929, at the age of seventy-five. He died in South Pasadena, California, on August 7, 1932.

Professor Taylor's writing was limited, as already mentioned, partly because of his conservative evaluation of his own contribution to economic thinking, his passion for thoroughness, his devotion to teaching, and also because of his high regard for the writings of his predecessors in the field, particularly in Austria and England. Aside from his "Principles of Economics" (discussed later) his major written work was his "Chapters on Money", appearing in 1906.

Taylor as Teacher—His "Principles" Course. As a teacher Professor Taylor was truly outstanding. His main concern, always, was to provide a well-organized, meaty, and sound body of subject matter for the student, but he also gave much attention to teaching methods, especially in his beginning course in principles. He took great care in preparing assignments, problem material, and examinations, and had no patience with the view that the in-charge professor should not be troubled by such prosaic chores. To an unusual degree he had the knack of telling his students what was what and at the same time stimulating them to express their understandings and raise questions. He also showed much skill in adjusting his teaching techniques to the level of attainment represented by those in a particular class. Thus there was a marked contrast between the rather rigid program of the basic course, and the exciting breadth of outlook encountered by students in his graduate seminars.

There was never another course in principles of economics like Taylor's, which he operated for many years as a rigorous five-hour, one-semester foundation in theory. (I won't undertake to tell about the departmental complications which led to this somewhat unusual arrangement.) There was a joint meeting once a week for all hands, at which the three or four hour-tests for the term were given. (The lectures were excellent, and entertaining, from the standpoint of graduate students and assistants sitting in the back row, but finding ways of holding the attention of 500 or more sophomores was a problem that Professor Taylor—like most other teachers in similar situations—never solved to his complete satisfaction.) For the other four hours the class was divided into "quiz" sections, as we called them. Size was strictly limited to twenty per section, in part because this would facilitate participation by each class member every session and in part to assure active control by the instructor. The twenty-five or more sections (in a typical term) were manned by a corps of assistants, recruited largely from graduate students, but Professor Taylor kept a tight rein on the over-all operation, in part by taking charge of every section once or twice during the course. (He was also suspected of occasionally listening through an open transom to check on what was going on.) A great believer in graphic presentation, he saw to it that each classroom was provided with an array of large charts. I recall particularly those showing illustrative demand and supply schedules, under various assumed conditions, in which the increments were displayed in squares, with appropriate labeling and shading for those that were crucial. I liked these charts, and have always considered them superior to the typical intersecting curve presentations. Another feature of the program was the requirement that students turn in written answers—once a week or oftener—to particular assigned problems and pointed questions. These papers were read by another group of assistants, also graduate students as a rule but somewhat less far along than the instructing staff, who noted major errors and limitations before returning the papers—promptly—via the section teachers.

Examination procedure in the principles course was unique, and deserves a brief description. Professor Taylor prepared the questions, generally without consultation with the assisting staff (although he did not object if some enterprising instructor proposed a question that might be included). The assistants did not see the examination questions until going on duty to hand out the exam sheets and an accompanying series of numbered cards, and to help with proctoring. Students were previously directed not to write their names on their "blue books" (used for exams in those days). At the exam period each student wrote his name on his card, in the space provided, and put the number of his card on the front cover of his "blue book". The cards were then collected by the assistants. The purpose of this arrangement was to render the examination papers anonymous as they were graded. (The practice was to have each participating instructor grade the results of a particular question, on a numerical scale decided upon, for all students taking the exam.) Professor Taylor was a stickler for this feature. In his view recognition of a name by a grader was likely to have some impact on his judgment of the writer's performance, regardless of how determined he might be to remain strictly impartial. He also stressed the importance of very careful grading of exam papers, in fairness to our students, since final marks for the course were based almost entirely on examination performance. This was not quite the whole story. It was Taylor's practice to compute separately the combined showing of all the students of each instructor, in the hour-tests and final examination, as well as the level of performance of all the students in the course, and we all knew that he considered this evidence important in his appraisal of the accomplishments of the several instructors. I don't think he was unduly suspicious of the integrity of his young men, but he may well have decided that it was desirable to keep them free of the temptation to be too generous—or perhaps too severe—in grading their own students.

The Taylor Text. Early in his teaching career at Michigan Professor Taylor prepared reading material for the principles course, which he revised annually. For some years this was in loose-leaf form, and later was issued in a paper-bound volume. Printing was done by the University and the excess of the fees charged to the students over the cost of printing was accumulated in a fund to be used in improving instruction in the courses in economics. Not until 1921—when he was past sixty-five—was Taylor persuaded to have his “Principles of Economics” published commercially, on a royalty basis. The last major revision of this book, I believe, appeared in 1925, although it remained in print for another twenty years or more.

Not a best seller in the field, the Taylor book was nevertheless highly regarded by many teachers and had a substantial use through the twenties and early thirties. In my view it is the best basic textbook in economics ever written—assuming that careful organization, clear and precise statement, and thoroughgoing analysis, are desired earmarks. Among the noteworthy features is the penetrating discussion of “immediate” and “normal” price determination, and the pricing of the “primary factors”. Especially in his probing of the pricing of labor Professor Taylor stresses the importance of “disutility” as well as marginal “significance”. Mention may also be made of the clarity and insight displayed in his treatment of the nature and function of “capital as capital”, and the distinctive role of the entrepreneur. He doesn't make the common mistake of including the function of day-to-day management (a “labor” activity) in the “ultimate responsibility” assumed by the capital-furnisher and risk-bearer. Sprinkled throughout the book are terse, italicized “principles” and “corollaries”, and stimulating “problems” are included at the ends of chapters. We teachers under Taylor also liked the brief chapter summaries provided.

Professor Taylor considered that the essential purpose of the principles course was to give the student an understanding of the “present economic order”. Here and there he has a comment that might appear to the strict libertarian to be unduly friendly to government meddling in economic affairs, but a careful reading of his “Principles” makes it very clear that his judgment of socialism is unfavorable. The book abounds with statements such as: “In general, industrial efficiency is greater under a regime of freedom, noninterference, laissez faire, than under one of much government regulation”. One of his favorite admonitions, indicating the danger that interference would impair the function of the price system, resulting from the free market, was: “Don't monkey with the thermostat”. He concludes his “critique” of the prevailing market system with:

“We set out ... by asking whether the system of regulating production through freely determined prices works out reasonably satisfactory results. What answer may we draw from the facts presented ...? We ... are compelled to draw an affirmative answer—an affirmative qualified, but still an affirmative. The results are certainly below the best conceivable. Nevertheless ... we must still hold that a verdict for the substantial soundness of the system is practically inevitable ... a thoroughly humane despot with power to substitute any other system ... might very probably—if he took all the facts into consideration—decide that the system now operating was on the whole the very best one possible”.

It is probably fair to add that if Taylor were writing now, nearly a half-century later, his appraisal of the current state of affairs would presumably be quite different. I think he might object to the continuing references by business leaders, politicians, and others to “our free enterprise system”, in view of the degree to which this system has been eroded.

The Graduate Theory Courses. As I have taken pains to point out Professor Taylor was justly noted, among discerning teachers, for his thoroughgoing course in principles. From time to time he also taught an effective intermediate course in theory. But it was in his graduate seminars that his leadership and instruction reached the level of brilliance, and it was his performance in this area that attracted able students from all over the country and on which his great reputation as a “teacher of teachers” was founded. In this graduate program it was his practice to tether the work of the particular seminar to some general concept or issue, such as “value”, “interest”, “capital”, “wage theory”, “foreign trade”, “money”, “business cycles”, and so on. Taylor generally set a limit on seminar enrollment of ten or twelve students. I attended six such classes over a three-year period and I wouldn't trade the experience for all my other schooling put together. As I remember it these seminars met for a two-hour session weekly throughout a semester. The reading assignments per course were heavy—perhaps three or four books and a dozen articles—and if anyone neglected the assigned reading this fact was shortly exposed by our teacher. He had an extraordinary talent for probing the mental make-up and the understanding of each of us with pointed questions, and keeping us on our toes, while at the same time doing a major part of the talking himself, and directing and dominating the discussion, throughout the session. Written work during the term was seldom required and rating in the course depended almost entirely on a rigorous final examination.

As in the basic course in principles, Professor Taylor maintained a down-to-earth point of view in his seminars. He saw little merit in mystical speculation or wheel-spinning analysis that had no relation to the “real world”. He regarded each course in theory as dedicated to a thoroughgoing and critical exploration of actual—not imaginary—problems and issues. A point he always emphasized was the need to sort out the truly salient and significant factors from the trivial and unimportant—bring to light the wheat and discard the chaff.

Professor Taylor was a great reader and student himself, all through his career, and he was amazingly well acquainted with the writings of all economists of any stature in the western countries from the Physiocrats on through the ranks of his own contemporaries. He gave a top rating to Carl Menger and other early leaders of the “Austrian School”, and of course there was careful consideration—in one or more seminars—of the works of Eugen Boehm von Bawerk, especially “Capital and Interest” and “The Positive Theory of Capital” (William Smart's translation). Much less time, as I recall it, was spent on the work of Friedrich von Wieser. Close behind the Austrians in his appraisal were the major English economists. In addition to the famous trio of Adam Smith, David Ricardo, and John Stuart Mill, whose principal works, beginning with “An Inquiry into the Nature and Causes of the Wealth of Nations”, appeared in the seventy-five years prior to 1850, Taylor thought well of a number of the later English writers, including William Stanley Jevons (noted as both logician and economist, and remembered—if not honored—for his speculations about the relation of commercial crises and sun-spots). And it is hardly necessary to say that Professor Taylor regarded Alfred Marshall's “Principles of Economics”, first appearing in 1890, as a truly outstanding treatment of the subject, and that references to Marshall were a commonplace in the seminars. Dennis H. Robertson appeared on the scene much later, but he had started his brilliant writing while Taylor was still teaching and came in for strong praise.

In his seminars Professor Taylor often took note of the special contributions by particular writers, even if their writings were not intensively covered. Thus he did not overlook the stress laid by N. W. Senior on “abstinence”, in connection with capital formation and interest, the famous “Essay on Population” by Thomas R. Malthus as well as his contributions to value theory, the emphasis on “Gresham's law” by H. D. Macleod, and—along with all his contemporaries taking the neoclassical stance—did not fail to credit J. B. Say for his notable contribution to an understanding of the fundamental identity of over-all supply and demand. Among French writers Frederic Bastiat received attention from time to time, and Taylor often recommended “Histoire des Doctrines Economiques”, by Charles Gide and Charles Rist, to those who wanted to improve their skills in reading French. Frederich List was not forgotten but was awarded no great praise for his protectionist position. He introduced us to Gustav Cassel's excellent “The Nature and Necessity of Interest”, and one term—as I recall it—a bit of time was devoted to reviewing Arthur C. Pigou's “Wealth and Welfare”.

Professor Taylor was quite willing to expose his advanced students to the writings of leading socialists, notably Sidney (and Beatrice) Webb and Karl Marx. I remember struggling to read “Das Kapital”, in German, and my initial aversion to Marxist theory was perhaps partly due to the difficulty I experienced in this chore. In trying to fortify my German, I might add, I made some poor choices. In addition to tackling Marx I read “Soziale Theorie der Verteilung” by Michael Tugan-Baranowsky (a small book, fortunately), and I spent many weary hours on Johann H. von Thünen's “Der Isolierte Staat”. I must admit, however, that Thünen was an illustrious Austrian economist, skilled in mathematics and sometimes referred to as the founder of econometrics. And the book I read was his most widely known work.

On the whole Professor Taylor did not hold American economists of his time in very high esteem. He regarded Frank W. Taussig as worthy of respect, but did not place John Bates Clark on a pedestal. For two or three years he assigned Thomas N. Carver's “The Distribution of Wealth” for study in an intermediate theory course. He occasionally referred, not unfavorably, to the work of Francis A. Walker. In our discussion of rent Henry George had his innings and was disposed of. We were of course required to dig into Irving Fisher's work, especially “The Nature of Capital and Income”, in the days before this able man became something of a crank. He found points to commend in Henry R. Seager's textbook. Taylor assigned for review “Economics of Enterprise”, by H. J. Davenport, when this book was published, but his appraisal was not favorable. Wesley C. Mitchell came in for some study—and praise—for his monumental work on business cycles. Not a few well-known professors and writers got scant attention in the seminars because Taylor did not view them as theorists in any legitimate sense; examples were John R. Commons, Richard T. Ely, Thorstein B. Veblen, and Henry Carter Adams, a colleague at Michigan. Professor Taylor had some favorites among the younger American economists coming into prominence in the twenties, including Frank H. Knight, whose excellent “Risk, Uncertainty and Profit” appeared in 1921, and Howard S. Ellis and Edward Chamberlin—both students of Taylor's for a time.

Not reluctant to bestow praise where he considered it due, Professor Taylor was a critic par excellence. Of the many writers whose books were dealt with intensively in his graduate courses there were few if any who were not found wanting at some point in accuracy, consistency, and thoroughness. Undoubtedly his tactics helped us to develop our own critical powers. Occasionally, however, the thought would occur to some of us students that perhaps he overworked his talent for discovering weak spots.

How would Professor Taylor react to the models, diagrams, and mathematical arrays that dominate current presentations in the field of economics? Would he, for example, assign to a graduate group such a book as Kenneth E. Boulding's “A Reconstruction of Economics”, with its more than eighty complex diagrams? Professor Taylor was well grounded in mathematics, and—as I've already noted—relied heavily on graphic presentation in his basic course, but he did not resort to the types of figures now widely used. Sometimes it seems as if the modern theorists are in a contest to see who can produce the most obscure and recondite displays of charts and equations. I recall one seminar in which we were taking a look at a somewhat elaborate chart in one of Francis Y. Edgeworth's books. After, with our teacher's guidance, we had decided what Edgeworth was driving at Professor Taylor leaned back in his chair and remarked, meditatively: “I wonder if he couldn't have told us that in four or five well-written sentences”. It is noticeable that our brilliant Milton Friedman, although fully capable of matching diagrams and mathematics with anybody, generally leans heavily on language as the means of presenting the results of his researches and analyses. And the master economist whom we are honoring with this volume finds writing a quite adequate means of expression.

More on the Personal Side. Professor Taylor was recognized by his associates as a man of the most precious intellectual and social gifts. Some appreciation of the esteem in which he was held may be indicated by recalling the circumstances of a banquet in his honor held at the Michigan Union the evening of August 1, 1925. On that memorable occasion some 150 of his colleagues and friends gathered to pay their respects and express their affection. His portrait—recently completed—was presented to the University (it now hangs in the library of the Graduate School of Business

Administration at Michigan), and a new Buick was presented to him as a personal gift. The following is a free rendering of the remarks of a member of the Department of Economics:

“It would be difficult to describe the spontaneity, the whole-heartedness, and the enthusiasm with which the enterprise which has culminated in this happy occasion has been pursued by all concerned. You will hear, in the course of the evening, many sincere expressions of appreciation of Professor Taylor. They will all reflect a genuine delight in this opportunity to show our esteem and affection for him. If the influence of personalities is the dominant factor in the moulding of our destinies, we regard Professor Taylor as one of the choicest spirits whose impact upon our lives has been fruitful and satisfying. For more than thirty years he has labored in these academic precincts. His students are numbered by the thousands. In every corner of the land may be found men and women in all walks of life who recall with gratitude the inspiration they received from him. And I dare say there is no one among the professional economists in this country who has made a larger contribution than Professor Taylor to the teaching of the science of economics. In practically every important college and university—east and west, north and south—his students have gained a fruitful foothold as propounders of the faith and as searchers of the truth. In a very real sense these economists—ranging from early manhood to upper middle age—are the products of Professor Taylor. It was he who laid the foundation stones of their knowledge; it was he who first kindled their interest in economic speculation. And, quite apart from the matter of specific views and opinions, these teachers are warm disciples of Professor Taylor in this: they are ever striving to approach his high standards of scholarship, his refreshing intellectual honesty, his uncompromising devotion to truth, his keenness of mind, his breadth of spirit, his genial helpfulness, his modesty of demeanor. To do such a man honor is a high privilege”.

Even to his intimates Professor Taylor's breadth of scholarship and range of interests were a continuing revelation. He was equally at home in history, philosophy, and economics, and was solidly grounded in many other fields. The accuracy of his information and the penetration of his thought were noteworthy. But he was entirely lacking in ostentation, in intellectual matters as in all others. He was noted for the hobbies and avocations which he pursued with the intensity and thoroughness which characterized his academic work. Whether devoting himself to golf, boating, fishing, cycling, dancing, rose culture, or some other interest or activity he found opportunity for the application of analytical power and for the achievement of high standards of performance. As I recall it, he usually dropped a particular hobby after two or three years, but he never abandoned his roses, and I suspect he knew more about this field than anyone else in Ann Arbor or even in the state of Michigan.

Although not prominent in social activities, Professor Taylor was an expert in friendship. In addition to his contacts with students and colleagues he made a host of friends in his own community and in other parts of the country—especially in the various areas in which he spent the mid-summer months, in an effort to escape the attacks of hay fever. Inclined to shun formal occasions such as faculty meetings and commencement exercises he was nevertheless recognized as one of the most potent members of the faculty—one who was able to marshal his case so clearly and convincingly as to silence the opposition. He was not active in politics (a field which he regarded as outside the professorial province) but he was drafted in the critical campaign of 1896 and made a number of effective addresses in Michigan in support of the maintenance of a sound monetary system (and he published several short articles in the monetary field in the late nineties). He loved his teaching, and never asked for a leave of absence. His conception of the position of the scholar and teacher was a bit on the ivory-tower side. Thus he never undertook a consulting job of any kind throughout his long career.

I mustn't forget to mention Professor Taylor's kindliness. Although exacting in the management of his staff of instructors and readers, he was both fair and friendly, took a keen interest in the progress and personal welfare of his helpers and went out of his way on many occasions to give us a pat on the back, or some good advice. To illustrate in my own case, I remember walking across the campus shortly after taking the final examination in my first advanced theory course. Professor Taylor passed me on his bicycle, then slowed down and called back to me over his shoulder: “That was an excellent paper you wrote, Mr. Paton”. I walked on air the rest of the day and I truly believe that this was the marginal factor in starting me in the direction of a teacher of economics.

Son of a devout Methodist minister, Professor Taylor as I knew him was not theologically inclined, although he was well acquainted with the writings of religious leaders and philosophers from the ancients to those of his own time. Like Mises, he didn't find it necessary to drag the Deity into an examination of price determination either in the broad view or in a particular set of circumstances. When in the mood, however, he enjoyed metaphysical discussion. He always emphasized the basic point that the ultimate raw stuff of the universe, whatever it is, like time and space has neither beginning nor end (“from everlasting to everlasting”), and he rejected the running down theory of the whole, which had some support in my student days, as well as the notion of a contracting or expanding totality. He accepted what might be called a cyclical view of what was going on, over-all, with respect to the temperature, size, density, and other properties of the stars and other bodies making up the galaxies scattered through space.

Taylor's AEA Presidential Address—and the Sequel. Professor Taylor never sought honors or preferment, and was not active in national or international societies (although holding membership in several), and it was not until 1928, not long before he retired, that he was elected president of the American Economic Association. At that time each president of the several organizations meeting together for their annual conventions was given a half-hour for his presentation at the joint evening meeting devoted to presidential addresses. It was characteristic of Professor Taylor that he took this allotment of time seriously, and he worked hard at condensing and polishing his prepared paper until he could read it in twenty-eight minutes. The subject he selected was “The Guidance of Production in a Socialist State”. It was a closely-reasoned statement of the position that those in charge in such a state must employ value judgments, akin to the determinations afforded by a free market, and founded on trial and error procedure, if efficiency in utilization of available resources were to be a major objective in directing production. The address appeared in print in the March, 1929, issue of The American Economic Review.

There is an interesting sequel that should be considered here. In 1938, a decade after Taylor's address was delivered, the University of Minnesota Press published a small volume under the title “On the Economic Theory of Socialism” and authored, according to the title page, “by Oskar Lange and Fred M. Taylor”; Benjamin E. Lippincott (an assistant professor of political science at Minnesota) was listed as editor. Actually the book consists of an “Introduction” by the editor (38 pages), followed by a reprint of Taylor's address (14 pages), and then Lange's essay which gives the book its title (85 pages), including an appendix dealing with “The Allocation of Resources under Socialism in Marxist Literature”, and a selected bibliography. (The references include writings by F. A. Hayek, F. H. Knight, Ludwig von Mises, and Lionel Robbins, as well as pieces from the pens of Enrico Barone, A. F. Lerner, A. C. Pigou, A. R. Sweezy, and others.)

Before commenting further on this volume, a few words on Oskar Lange's career are needed. Lange came to this country from Poland in the thirties and taught at several major universities. He held a post at the University of Michigan in 1936 and was later a full professor at the University of Chicago. He was an able scholar and instructor (although not a pleasant person); I can testify as to his ability, especially from hearing him speak more than once while we were both on the economics faculty at the University of California, in 1937–1938. He became politically active with the onset of World War II, underground to begin with, gave up his U. S. citizenship, was recalled to Poland, and became heavily involved in the communist cause. From 1946–1949 he was Poland's delegate to the United Nations.

To couple Fred Taylor with Lange in the authorship of “On the Economic Theory of Socialism” was nothing short of literary knavery, and both Lange and Lippincott were undoubtedly aware of this. The “editor” does indeed refer to Taylor as “an orthodox economist”, but his lengthy introduction is full of bias and misinterpretation.

A primary object of both Lippincott and Lange is to discredit “Professor von Mises, the well-known Viennese economist, and the leading opponent of socialism among economic thinkers”, and also to shoot down “Professors Hayek and Robbins of the London School of Economics”, whom they rank next to Mises as supporters of the view that rational allocation of resources is impracticable in a socialist state. Professor Taylor—no longer around to defend himself—is then pushed forward as a successor to Barone and his brief presidential address is glorified, particularly for the purpose of demolishing the position taken by Hayek and Robbins.

In Lange's essay, which is essentially the framework and content of the book, the first half-dozen pages are devoted to Professor Mises. To indicate the flavor of his comments on this truly great thinker and writer I will quote from the first paragraph:

“Socialists have certainly good reason to be grateful to Professor Mises, the great advocatus diaboli of their cause. For it was his powerful challenge that forced the socialists to recognize the importance of an adequate system of accounting to guide the allocation of resources in a socialist economy. Even more, it was chiefly due to Professor Mises' challenge that many socialists became aware of the very existence of such a problem ... Both as an expression of recognition for the great service rendered by him and as a memento of the prime importance of sound economic accounting, a statue of Professor Mises ought to occupy an honorable place in the great hall of the Ministry of Socialization or of the Central Planning Board of the socialist state. I'm afraid, however, that Professor Mises would scarcely enjoy what seems the only adequate way to repay the debt of recognition incurred by the socialists ... he might have to share his place with the great leaders of the socialist movement, and this company might not suit him". There is more in the paragraph in the same nasty vein.

After trying to ridicule Mises for claiming, allegedly, "to have demonstrated that economic calculation is impossible in a socialist society", Lange turns his attention to the modified position he attributes to Hayek and Robbins that even if "rational allocation of resources in a socialist economy" is viewed as a 'theoretical possibility' there is no "satisfactory practical solution of the problem". He regards the Hayek-Robbins position as "a much more fruitful approach than Professor Mises' wholesale denial of the possibility of economic accounting under socialism". He then gets nasty again with: "Whether they, too, will merit an honorable statue, or at least a memorial tablet ... remains to be seen".

The main body of Lange's essay is aimed at undermining the view that under socialism there is no workable method of securing a reasonable allocation of resources. As Lange puts it: "It is, therefore, the purpose of the present essay to elucidate the way in which the allocation of resources is effected by trial and error on a competitive market and to find out whether a similar trial and error procedure is not possible in a socialist economy".

As a student and colleague of Professor Taylor for a period of fifteen years, and quite intimately acquainted with him for a considerable part of this period, I can say with confidence that he was firmly and consistently committed to the position that an economy regulated through the price system resulting from a free competitive market is superior on all counts to any form of collectivism or socialism. And I have long resented the misinterpretation and misuse of his AEA presidential address by the unscrupulous Oskar Lange, aided and abetted by B.E. Lippincott and the University of Minnesota Press.

Defining the Marginal Producer. I have already referred to some of the areas in which Professor Taylor's analyses were noteworthy. In my judgment his total contribution was substantial, particularly in clarifying and sharpening concepts that have been dealt with inadequately, or confusedly, by many writers. But I don't want to conclude these "recollections" without considering an example of his acute insights and formulations, with some comments on its present-day application. For this purpose I have selected the problem of the definition of the marginal producer or firm.

One reason for selecting this topic for brief attention is the popularity nowadays of stressing break-even points and "analyses" at both business management and economic theory levels. I am getting very tired of looking at breakeven charts and noting the persistent preoccupation with this subject. In particular I'm annoyed by the view, frequently encountered, that the break-even producer or firm is in the marginal position. This is sheer nonsense. To paraphrase Professor Taylor, from recollection rather than quoting written material (and I unfortunately threw away my extensive seminar notes years ago): The marginal producer is the one who is just barely induced to stay in the field by the existing conditions and circumstances, and who is so situated with respect to volume of production that his dropping out will influence the price-determining forces and tend to bring about a change in product price.

In pondering this definition perhaps the first point to observe is that producers who are operating at a loss often hang on for years. This is particularly true in the case of relatively small or medium-sized operators with ownership and control residing in a family or small local group. But the condition is not unknown among large concerns. As long as revenues cover current expenditures, including salaries for executives and wages for other employees, immediate management has a tendency to continue operations, even if the outlook is gloomy or not particularly promising. This accounts for the phenomenon of corporations that are worth more dead than alive. There are numerous examples of substantial companies whose shares have been quoted for long periods at less than net liquidation value (that is, at less than could be realized if the concern disposed of all assets for what they would bring, paid all liabilities, and distributed the balance to shareholders). And there are not a few examples of cases where the announcement of a program of liquidation by the directors has caused a sharp advance in the price of the outstanding shares. I recall one example where the price of the stock moved from $1 ½ to $16 per share when liquidation was decided upon and announced. The low price of $1 ½ was of course predicated on the assumption—by those trading in the company's stock—that the management would continue to fritter away the company's resources in unsuccessful operation. (These observations do not deny, of course, that there are many examples where tenaciously staying in there has resulted in a turnabout.) Thus we find that even a producer suffering persistent losses may not be in the marginal, price-influencing position.

The basic difficulty with the so-called break-even approach, from the standpoint of good economic theory, lies in an improper conception of what it means to “break even”. If capital-furnishing is a primary, essential factor in the productive process it shouldn't be ignored in the computation of total cost, in the broad sense of price-influencing cost, and if in a given situation this cost is omitted the producer is not really breaking even. Instead he is operating at a loss (even if this is not the way the accountants look at it). Here is a crucial point in the case for the free market economy as opposed to socialism, and those of us who strongly prefer control by the market to authoritarian directives shouldn't use terms and concepts that play into the enemy's hands.

It follows that the producer who regards an earning rate of 10$ per annum as the necessary lure for capital in a particular field, in view of all the conditions, and who finds that he is consistently achieving a return of only 4$ on the capital employed (computed in terms of current value of resources less liabilities) may well decide to terminate his operations—as fast as practicable—and thus be in the position of the marginal producer.

In practice, of course, the identification of the marginal producer in a given industry and time period may be difficult if not impossible. But this does not justify an improper concept of adoption of an unsound method of identification. We can be almost certain, indeed, that the marginal position is seldom occupied by the concern whose capital-furnishers are willing to continue operations if there is even a trace of compensation for capital above the zero point.

If I were not running out of alloted space I would add a brief statement of my own views on a related but broader subject, the relation of interest and profits. I have long been dissatisfied with the analyses in this area of economists, in so far as I know them, including the work of my revered mentor, Fred M. Taylor. I object, in the first place, to the tendency to treat interest and profits as distinct and separate phenomena. By discussing "profits" as a special factor, apart from interest, the door is opened to the view that this factor is hardly necessary, scarcely justified, and will probably disappear when we once get rid of exploitation and "profiteering" (whatever this widely used term may mean). I prefer to substitute the single concept of the market "price" of capital-furnishing (recognizing—of course—that both decision to save and act of investing are included). This price or cost of capital, varies with the package—the conditions and circumstances under which the commitment of funds is made. One major group of cases includes all the "hired" or contractual money—bonds, notes, current payables (where the capital compensation is often implicit), installment accounts, and so on—plus the subdivision of senior stocks in corporate enterprises. In all these cases there is some legalistic shelter for the fund furnisher, although the risk element is never completely absent, and often is substantial. The second major class of fund furnishers are found in the owners (so-called) in unincorporated enterprises, and the stockholders in corporations who occupy the exposed or buffer position (but in many enterprises having a more secure status than their contractual brethren in other concerns). In this situation the pricing is done by the over-all fabric of the market, which provides a prospect, a lure, sufficient to attract the capital-furnisher. And in high risk situations the lure may be in the form of the possibility—if not probability—of a jackpot type of reward. These few comments, needless to say, do nothing more than suggest an alternative approach.

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Ludwig Von Mises
William H. Peterson

A generation of students at New York University's graduate business school who took the economics courses of Ludwig von Mises remember a gentle, diminutive soft-spoken, white-haired European scholar—with a mind like a steel trap.

Mises, who celebrated his 90th birthday on September 29, 1971, is an uncompromising rationalist and one of the world's great thinkers. He has built his philosophical edifice on freedom and free enterprise and on reason and individuality. He starts with the premise that the concept of economic man is pure fiction—that man is a whole being with his thought and action tightly integrated into cause and effect. All this is subsumed under the title of his 900-page magnum opus, Human Action, first published in 1949.

Mises, a total anti-totalitarian and Distinguished Fellow of the American Economic Association, was a professor of political economy at New York University for a quarter-century, retiring in 1969. Before that he had a professorship at the Graduate Institute of International Studies in Geneva. And before Geneva he had long been a professor at the University of Vienna—a professorship which the Nazis' “Anschluss” take-over of Austria, understandably, terminated. Among his students in Vienna were Gottfried Haberler, Friedrich Hayek and Fritz Machlup. Professors Haberler of Harvard and Machlup of Princeton each have been president of the American Economic Association; Hayek is an economic scholar of world renown.

Starting right after World War II, Mises gave three courses at NYU: Socialism and the Profit System, Government Control and the Profit System, and Seminar in Economic Theory. In each course he carefully established the primacy of freedom in the marketplace. He stated that the unhampered pricing mechanism, ever pulling supply and demand toward equilibrium but never quite reaching it, is the key to resource optimization and, indirectly, to a free and creative society.

Mises believes in choice. He believes that choosing determines all human decisions and hence the entire sphere of human action—a sphere he designates as “praxeology.” He holds that the types of national economies prevailing across the world and throughout history have been simply the outcome of various means intellectually, if not always appropriately, chosen to achieve certain ends. His litmus test is the extent of the market; accordingly, he distinguishes broadly among three types of economies: capitalism, socialism and the socalled middle way—government intervention in the marketplace.

Mises believes in government but limited, noninterventionistic government. He wrote: “In stark reality, peaceful social cooperation is impossible if no provision is made for violent prevention and suppression of antisocial action on the part of refractory individuals and groups of individuals.” He believes that while the vast majority of men generally concurs on ends, men very frequently differ on governmental means—sometimes with cataclysmic results, as in the various applications of extreme socialism in fascism and communism or of extreme interventionism in other types of economies, "mixed" or socialist.

Mises reasons that regardless of the type of economy the tough universal economic problem for the individual in both his personal and political capacities is ever to reconcile ends and choose among means, rationally and effectively. Free, i. e., noncoerced, individual choice is the key to personal and societal development if not survival, he argues, and intellectual freedom and development are keys to effective choices. He declared: "Man has only one tool to fight error—reason."

Mises, well aware of the unlearned lessons of history, thus sees something of an either-or human destiny. While man could destroy himself and civilization, he could also ascend undreamed-of cultural, intellectual and technological heights. In any event, thought would be decisive. Mises believes in the free market of ideas as well as of goods and services—in the potential of the human intellect.

The nature of this leader of the Austrian School of Economics can be seen in an incident during a conference of the Mont Pelerin Society, an international group of scholars dedicated to the principles of a free society, meeting in Seelisburg, Switzerland in the 1950's. Mises expressed fear that some of the members were themselves becoming inadvertently infected by the virus of intervention—minimum wages, social insurance, contracyclical fiscal policy, etc.

"But what would you do," it was put to him, "if you were in the position of our French colleague, Jacques Rueff," who was present and at the time responsible for the fiscal administration of Monaco. "Suppose there were widespread unemployment and hence famine and revolutionary discontent in the principality. Would you advise the government to limit its activities to police action for the maintenance of order and the protection of private property?"

Mises was intransigent. He responded: "If the policies of nonintervention prevailed—free trade, freely fluctuating wage rates, no form of social insurance, etc.—there would be no acute unemployment. Private charity would suffice to prevent the absolute destitution of the very restricted hard core of unemployables."

The failure of socialism, according to Mises, lay in its inherent inability to attain sound "economic calculation." He argued in his 1922 work, Socialism, published five years after the Bolshevik Revolution that shook the world, that Marxist economics lacked an effective means for "economic calculation"—i. e., an adequate substitute for the critical resource-allocation function of the market pricing mechanism. Thus is socialism inherently self-condemned to inefficiency, unable to expeditiously register supply and demand forces and consumer preferences in the marketplace.

Some years later, Oskar Lange, then of the University of California and later chief economic planner of Poland's Politburo, recognized the challenge of the Mises critique on socialist economic calculation. So he in turn challenged the socialists to somehow devise an allocative system to duplicate the efficiency of market allocation.

He even proposed a statue in honor of Mises to acknowledge the invaluable service the leader of the Austrian School had presumably rendered to the cause of socialism in directing attention to this as yet unsolved question in socialist theory. However, notwithstanding some slight shifts of the Polish, Soviet and other Eastern European countries toward freer economies, a statue of Mises has yet to be erected in Warsaw's main square.

But probably to Mises the more immediate economic threat to the West is not so much external communism as internal interventionism—government ever undermining if not outrightly supplanting the marketplace. Interventionism from public power production to farm price supports, from pushing minimum wages up to forcing interest rates down, from vigorously expanding credit to contracting, however inadvertently, capital formation. Citing German interventionist experience of the 1920's climaxing in the Hitlerian regime and British interventionism of the post-World War II era culminating in devaluations and economic decline, he holds such so-called middle-of-the-road policies sooner or later lead to some form of collectivism, whether of the socialist, fascist or communist mold.

He maintains economic interventionism necessarily produces friction whether at home or, as in the cases of foreign aid and international commodity agreements, abroad. What otherwise would be simply the voluntary action of private citizens in the marketplace becomes coercive and politicized intervention when transferred to the public sector. Such intervention breeds more intervention. Animosity and strain if not outright violence become inevitable. Property and contract are weakened, militancy and revolution are strengthened.

In time, inevitable internal conflicts could be "externalized" into warfare. Mises wrote: "In the long run, war and the preservation of the market economy are incompatible. Capitalism is essentially a scheme for peaceful nations.... To defeat the aggressors is not enough to make peace durable. The main thing is to discard the ideology that generates war."

But what if a peaceful nation is nonetheless plunged into inflation-inducing war? Surely then it should clamp on wageprice and other production-allocating controls. No, says this adamant champion of the unhampered market economy; if interventionism is foolish in peacetime, it is doubly foolish in wartime when the nation's very survival is at stake. All the government has to do is to raise all the funds needed for the conduct of the war by taxing the citizens and by borrowing exclusively from them—not from the central or commercial banks. Because the money supply would not then be swollen and everybody would have to cut back his consumption drastically, inflation would not be a great problem. Public consumption, through a greatly augmented inflow of tax revenues and borrowed funds, would advance while private consumption would fall. The upshot would be the absence of inflation.

By the same token, Mises has no stomach for the idea that a nation could simply deficit-spend its way to prosperity, as advocated by many of Keynes' followers. He holds such economic thinking is fallaciously based on governmental "contracyclical policy.” This policy calls for budget surpluses in good times and budget deficits in bad times so as to maintain “effective demand” and hence “full employment.”

But Mises regards the “G” in Keynes' “full employment” formula of Y = C + I + G (National Income = Consumption Spending + Investment Spending + Government Spending) as about the most unstable, politics-ridden and unscientific balancing wheel that the economic managers could employ. For one thing, the formula ignores the political propensity to spend, good times or bad. And for another, it ignores marketsensitive cost-price relationships and especially the proclivity of trade unions and minimum wages to price labor out of markets—i. e., into unemployment.

Thus he holds Keynesian theory in practice proceeds through fits of fiscal and monetary expansion and leads to inflation, controls, and ultimately stagnation. Further, “G” so used, generally means the secular swelling of the public sector and shrinking of the private sector—a trend that spells trouble for human liberty. In a way, he anticipated and rebutted the Keynesian thesis a quarter-century ahead of Keynes in his 1912 work, The Theory of Money and Credit, in which Mises contended that uneconomic wages and forced-draft credit expansion and not capitalism per se carried the seeds of boom and bust.

To be sure, many economists and businessmen have long felt that Mises is entirely too adamant, too unyielding. If that is a fault, he is certainly guilty. But Ludwig von Mises, the antithesis of sycophancy and expediency, the intellectual descendant of the Renaissance, believes in anything but moving with what he regards as the errors of the times. He has long sought the eternal verities. He believes in the dignity of the individual, in the sovereignty of the consumer, in the limitation of the state. He opposes the planned society, whatever its manifestation. He holds that a free society and a free market are inseparable. He glories in the potential of reason and man. In sum, he stands for principle in the finest tradition of Western Civilization. And from that rock of principle, during a long and fruitful life, this titan of our time has never budged.

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The Economic-Power Syndrome
Sylvester Petro

Nature goes its own way, following laws of its own, shaped by forces in which human action—passion, will, thought—is irrelevant. Man's laws and man's societies are something else. The works of Ludwig von Mises, summed up in the monumental Human Action, demonstrate more powerfully than those of any other writer the role played by human will and human thought in the universe which affects and is affected by human action.

Not everything is possible to human action. Nature goes its own way. In the generous realm of the possible, however, man's laws, his rationally directed values, make a difference; perhaps the difference. As a part of nature we share the universal conatus, the striving to be. But our conatus is generic and undefined; we are more than the birds and the bees, or perhaps less, but different, anyway. And our intelligence is correspondingly different. We can kill ourselves, and we can err.

More strangely still, we are capable through intellectual error of killing ourselves by policies which we believe necessary to our survival. I believe that what I call here the "economic-power syndrome" constitutes one of the most destructive combinations of moral and intellectual error that mankind has ever suffered, and I propose to disperse this dark syndrome with the aid of one of Professor Mises' most brilliant contributions to the formulation of sound social policy: his insistence upon a central role for the concept of consumer sovereignty.

I

For a hundred years, more or less, the policies of the United States have had a characteristically anti-business thrust, sometimes compelled, sometimes condoned, by dominant voices of popular opinion. For public opinion in this country has always been infected to a degree by dread, distrust, even hatred of "big business." Thus Mr. Nader and his raiders, J. K. Galbraith, Vance Packard, even Marcuse, are far from representing a new attitude. They express the same fear, the same suspicion, that brought about the Interstate Commerce Act and the Sherman Act in the nineteenth century and the mountain of restrictive legislation and court decisions of this century. In a word, what they fear and suspect is economic power.

The populist antipathy to economic power in general and to big business in particular has not swept all before it. Ambivalence among the populists themselves, the achievements of American big business, and a persistent minority in favor of liberty and its political corollary, laissez faire, have also influenced our public policies. Politicians and bureaucrats have known, too, that they could have $300 billion to spend each year only if the economy produced $700 billion to $1 trillion a year—an unattainable result without large-scale economic activity. Hence they have been astute over the years to balance the Sherman Act and other anti-business laws with appropriations small enough to guard against absolute frustration of the need of businessmen for flexibility and freedom. Likewise they have been careful to mitigate populist insistence upon confiscatory income taxation with many loopholes and with taxes upon capital gains modest enough to guarantee the continued growth of capital, and the survival of the capital markets upon which the progress and well-being of the American economy rest.

However, the dominant trend in the public policies of this country has nevertheless been toward ever-increasing regulation of business. Congress and the state legislatures year by year add to the burden of restrictive legislation. The courts, especially the Supreme Court of the United States, zestfully enforce far beyond its letter and spirit all legislation limiting the freedom of businessmen; at the same time, they read virtually out of existence laws, doctrines, and principles which would tend to preserve to businessmen the rights and the freedom recognized in the classic common law.

In so deciding, the courts leave little room for doubt of the philosophy underlying their decisions. Whether we speak of antitrust or labor-law decisions, or even of private-law decisions in which the common-law courts take sides against business, the same theme prevails: Economic Power—it is as much to be dreaded, and therefore to be confined, apparently, as the threat of conquest by enemies from abroad or of chaos by criminals from within.

Such views and policies, the works of Ludwig von Mises demonstrate, are full of disastrous fallacies. The person who follows Mises' argument emerges, on the contrary, with the conclusions that, far from being an object properly of fear and doom, economic power is in all ways good and wholesome; that there are few, if any, capabilities at once so innocent of social harm and so productive of social benefit; and that the fear of economic power which now threatens to tie up the economy in knots is the product of ignorance, confusion, and superstition.

II

Much of the confusion traces to conceptual complexity in the term “power” itself. The word “power” integrally associated with the problem of causation, refers basically to the capability of affecting reality, of bringing about effects, changes, results. Some results are brought about by strictly individual action, as when primitive man fells a tree with his bare hands or with a tool fashioned by himself. His will, his act, his power is the only human one involved there. In society, things are different. In society, all power, whether of the economic or political variety rests upon cooperation. This is true of the capacity of a criminal to compel a change in the location of money, from his victim's pocket to his own. Without the cooperation of all those sectors of society which feed, clothe, and arm him, the criminal is helpless to bring about the result he seeks—unless of course he does it with no aids other than those available to the bushman, in which case his power analyzes out as the same, equally modest and precarious.

In society, and especially in respect of operations of a certain scale, power of all kinds, to repeat, rests upon cooperative activity; and, more than that, cooperative activity resulting from a coincidence of opinion. Although he was referring to only governmental or political power, David Hume was correct generally in relating power to opinion. One way or another, directly or indirectly, both economic and political power are founded in opinion.

Ortega y Gassett thought it necessary, in The Revolt of the Masses, to distinguish in his discussion of governmental power between political aggression and political rule. Observing the plain fact that Napoleon's conquest of Spain obviously did not accord with the opinion of the Spanish people, he said: “It is necessary to distinguish between a process of aggression and a state of rule.” The distinction, however, is both unnecessary and misleading, Napoleon could subjugate Spain only because its whole people, relative to the people of France, from whom Napoleon derived his power, amounted to a minority. The same situation prevails between the people of Russia and the people of Czechoslovakia today. The power of Russia to quell the Czech revolt was founded in the opinion of the Russian people, or at any rate of the ruling majority of Russians, that it was better to support their government in its domination of the Czechs than to withhold such support. I dare say that the same phenomena of majority rule determined the events in this country in the period 1861–65. The opinion of Northerners prevailed over the opinion of Southerners because there were more of them and they had more hardware.

It is important to observe the comprehensiveness and uniformity of the relationship between opinion and power. Within Spain during the Napoleonic wars, or Czechslovakia today, or the Southern States during the War between the States, the situation was not different in kind from the situation between those countries and the aggressors who subjugated them. Within each, the government, resting upon the opinion of the majority, similarly subjugated nonconsenting internal majorities. The government of Napoleon had to deal with recalcitrants not only in Spain but also in France; and the same was true within the Northern States in 1861–65 and is true today within Russia.

The internal government of any state, in brief, while resting as long as it lasts upon the opinion of the consenting majority, imposes its will by force upon a nonconsenting minority. That is the specific nature of government power.

I have had to emphasize the point because it is common in our time to overlook this feature of political power, and because, in overlooking this obvious feature, much of the confusion relating to economic power rests.

The sharp difference between economic power and political power does not reside in their respective foundations; both kinds of power rest in opinion. The significant difference between economic and political power rests in the purely consensual character of economic power as contrasted to the only partly consensual character of political power. For no businessman, qua businessman, can ever compel a nonconsenting minority to deal with him. It is the very essence of government, however, to impose the will of the majority upon the nonconsenting minority. The difference, then, lies not in the foundations of economic power and political power but in their respective effects and modes of operation.

The productive power of any business has its beginning in the man or men who found it and who are able to convince others to invest their capital and their talents in it. However, the business succeeds only if the consumers approve its production. In a market economy there is no way for a firm to compel any one to deal with it or to purchase its goods and services. As Ludwig von Mises has said so often, the consumers daily vote for and against the products of American business. Those firms which gain the patronage of the consumers prosper; those which do not, lose ground. In rewarding those who best serve the consumers, the profit system constantly insures that current allocation of resources which best suits the current wishes of the community. It expands the assets of those firms endorsed by public opinion; it enhances their capacity to bid in the market for other factors of production and thus to increase their economic power—by which I mean their power to produce.

The secret of the so-called ambivalence of American public policy toward big business resides in the phenomema just described. On the one side, mainly from "intellectuals", we hear much about the abuses, the evils, the dark powers of big business to destroy small business, to exploit workers, and to impose its will upon consumers. But these charges, however often made, and however well publicized, have only a limited effect, frequently no more than the crackling of thorns under a pot. They resound hollowly against the prodigious fact that business grows big only because and to the extent that public opinion favors it with its voluntary purchases. More than that, if the polls are correct, Americans favor and admire big business in greater numbers than they do any other institution, including the government. However, since the anti-business opinion has an effect also, we emerge with fragmentary, inconsistent, and ambivalent policies.

It is impossible to understand properly either the meaning of economic power or the real standing of business in the community without a full and accurate grasp of this fact of consumer sovereignty in the market economy. The late Mr. Adolph A. Berle, in many ways a learned man and a keen observer of contemporary society, illustrated in his well-known writings a characteristic error, tracing to inadequate grasp of consumer sovereignty. Although year by year he grew more moderate in his criticisms of big business, yet, even in his latest book, Power (1969) he continued to hold to a confused view of economic power. He attributed to that power a species of capability, a capacity for decision and action which it simply does not possess. He spoke as though big business had unlimited power in the disposition of resources, the direction of investment, choice of product, amount of production, and level of price. From others, such as J. K. Galbraith, such a blunder might be expected. But Mr. Berle was a different case: he frequently displayed a genuine understanding of consumer sovereignty. For example, in his latest book, he had this to say:

"In economic life every decision made affects, in some way, every life in the modern world. This is the peculiar quality of economics. The impact of economic-power decisions may be imperceptible or great, but it is always there. The woman who chose nylon stockings instead of silk (a choice she still has, though nylon has clearly won the campaign) affected the lives of silk growers in Japan, China, and Southeast Asia."

Once one grasps the significance of the female preference for nylon hosiery, it is no longer possible to mistake the locus of ultimate power. The Dupont Company has power, of course, but it is only the same kind of power to propose, to offer, that everyone else has, in business and out. Business proposes, the consumer disposes. If she disposes favorably the business prospers and may expand. If not, the business must mend its ways or retire from the field.

The business must do more than propose an attractive product. It must have the capability to deliver that product at an attractive price which still exceeds production costs. When it demonstrates that capability, it demonstrates at the same time its social qualification. Profitability and social utility are two names for the same thing. The business that makes losses has abused the society in which it operates; the business that makes profits has served it; and, remarkable as it may seem, it follows that the higher the profit, the greater the service.

Much current literature views the word "profit" and its referent in reality as downright obscene. Nevertheless, the facts are what they are. The firm that must sell below cost and which, therefore, experiences losses rather than profits, has done society in, and deserves to be penalized rather than praised. It has directed factors of production improperly, from the point of view of consumers and society as a whole. It has engaged in a course of production the full costs of which the consumers are unwilling to pay. In refusing to pay those full costs and thus imposing losses upon the incompetent producer, the sovereign consumers redirect production in a manner more to their liking.

III

Current "new-left" literature—faithful to its mentors, Messrs. Galbraith, Packard, Marx, and Marcuse—rejects the foregoing analysis. It insists that economic power involves a form of compulsion even more objectionable than the physical compulsion exerted by gangsters or by the armed forces of the state. Professor Mises' principle of consumer sovereignty, they say, is a pure myth; the fact is that the concentrations of economic power in big business compel the consumers by way of advertising to want certain things and to fulfull those wants in ways which serve the interests of big business, not of the people.

No conscious human being with normal sensory equipment can fairly dismiss these charges out of hand. All media of communication bombard us constantly with commercial exhortations, appealing to every aspect of human nature, from the most elemental to the most sophisticated, from the subliminal to the most obvious and coarse. There can be no doubt about it. Advertising has us all in siege. And its objectives are among others to expand, shape, and direct our desires.

The question, however, is whether, in what circumstances, and to what extent advertising succeeds. It will not do, in seeking an answer, to confine our attention to the claims of advertising agencies and Messrs. Galbraith, et al. They beg the question; they do not resolve it.

Condensed to its meaningful point, the charge is that, by advertising, big business substitutes its will for that of the consumers, thus making the principle of consumer sovereignty a mere abstraction, a myth.

The fundamental weakness in the Galbraithian thesis is its disregard of certain evident aspects of human nature. For better or for worse, mankind is so constituted as to preclude the substitution of one man's will for another's, except fragmentarily and temporarily, and then only by brute force, not by any other means. No matter how often persons may be bombarded by an appeal to buy Pepsodent, or Colgate, or Crest, the actual decisions when they stand at the counter as to whether to buy toothpaste at all and, if so, which brand, must be made inside each person's mind. In all but the autonomous functions of the body, human beings must act, must choose, as Mises says, and their choices, their actions, proceed necessarily from within. Our limbs and organs are all inner-directed.

Some weight might justly be accorded the Galbraithian thesis in a socialist society, where control of all production and all media of communication were concentrated in the same men who controlled also the physical power of society. In such a society the faculty of choice would still remain, but it would, so to speak, lack traction. It would have nowhere to go, like an automobile with bald tires on slick ice. The government control of all media, from the schools to television, would come close to brainwashing the public, and the lack of variety in consumer goods would carry forward the demolition of practical choice. Consumers would still retain their indestructible humanity; notwithstanding the brainwashing attempts, they would still have wants and still have to make their own choices; but they would have little scope to exercise their power or faculty of choice.

Even so, however, traces of the sovereignty which is fully theirs in market economies would remain also in socialist societies, for so long as man is man, he must choose if he is to live. So, in Russia today, there are shortages in some lines of consumer goods and surpluses in others. To that extent, the consumer remains king, even in Russia, though only in rags.

In a market economy, the Galbraithian thesis makes no sense at all. The characteristic features of a market economy all tend toward providing traction for the faculty of subjective choice. Authority to use physical force is confined to the state. The media of communication are free. The consumer is encouraged on all sides to choose from a vast array of competing goods and services. American Motors, Chrysler, Ford, and General Motors must not only compete with each other; they have also to contend with Volkswagen, Mercedes-Benz, Toyota, and Fiat. And all the motor companies must compete with the airlines, the bus lines, the railroads, the subway systems, as well as the firms which encourage consumers to stay at home or enjoy themselves in their gardens. Even American Telephone and Telegraph competes. It urges us to call, not write. The much maligned soap manufacturers have only one thing to say: “Buy our product.”

Ultimately, when one thinks things through, that is the basic message of all commercial advertising.

Advertising agencies claim, quite rightly, I believe (on the whole at any rate), a special ability to bring products and services to the attention of consumers. Their job is to acquaint the public with the fact that such and such a product exists and to urge that it be given a try. From there on, the consumer and the product must fend for themselves. The product must make good on the claim made for it. Thus understood, the specific function of advertising is to promote competition. Any other claim for it, whether made by advertising men or Messrs. Galbraith et al., is mere puffing.

If big business and its advertising had the power attributed to it by Messrs. Galbraith et al., the avidity of men and women for material goods would be a new phenomenon, observable in human history for the first time only in the last fifty years or so. After all, big business is a new phenomenon in the world, and advertising agencies are still newer. But is it true that men and women have grown remarkably desirous only in the last fifty or hundred years? The question answers itself.

On the first page of the first history book ever written, The History of Herodotus, recounting the wars between the Greeks and the Persians, the author reports that "according to Persians best informed in history, the Phoenicians began the quarrel." How was that? Herodotus continues:

"They landed at many places on the coast, and among the rest at Argos ... Here they exposed their merchandise, and traded with the natives for five or six days; at the end of which time ... there came down to the beach a number of women, and among them the daughter of the king.... The women were standing by the stern of the ship intent upon their purchases, when the Phoenicians, with a general shout, rushed upon them. The greater part made their escape, but some were seized and carried off...."

Any one who has ever had the misfortune to be in Macy's on a sales day will know that, whatever Galbraith says about it, big business and advertising have not changed women very much in the intervening two thousand four hundred years.

Nor men, either. Aristotle wrote only for men, it seems, in the Nichomachean Ethics. In discussing and urging the virtue of temperance, headmonished against the development of voluptuary habits. More to the point, he focused upon the inner sources of luxurious desires. "It is absurd," he said, "to make external circumstances responsible, and not oneself, as being easily caught by such attractions." There was hardly any business around at all in Ancient Greece, let alone big business, and B.B.D.& O. were still in the far off future. Such too was the case in 17th century England, when John Locke took note of the insatiable desires of mankind for material goods and services. He said:

"We are seldom at ease, and free enough from the solicitation of our natural or adopted desires, but a constant succession of uneasiness out of that stock which natural wants or acquired habits have heaped up, take the will in their turns; and no sooner is one action dispatched, which by such a determination of the will we are set upon, but another uneasiness is ready to set us on work."

The Galbraithian-SDS thesis is out of touch, not only with the most profound and persistent realities of human nature, but also with the available statistical evidence concerning the use of commercial advertising. Far from establishing the contention that big, concentrated business to some marked extent uses advertising to warp consumer desires, recent researches reveal: (1) that there is no significant correlation between industrial concentration and advertising; and (2) that there is indeed a contrary tendency, with advertising expenditures tending to rise as industrial concentration decreases.

IV

I must deal more briefly with the two remaining major sources of misunderstanding which make up the "economic-power" syndrome—(1) the belief that economic power can buy political power or that, at at any rate, (2) economic power can shape the political opinions of the community more or less at will.

The first of these can be dispatched fairly readily. Certainly it is true that public servants at every level of government are "for sale", as every person is, for that matter. The question is, however, in what medium of exchange do they do business? In contemporary representative government, the medium of exchange is votes. While the wealthy and the big businessmen could and do bid vigorously in the medium of exchange which they are well supplied with, namely, money, the sad fact from their point of view is that they are not very extensively supplied with votes—and votes are what count. If de Tocqueville was correct, this situation has prevailed throughout American history. Writing in 1840 or so about America, he said: "At the present day the more affluent classes of society have no influence in political affairs; and wealth far from conferring a right, is rather a cause of unpopularity than a means of attaining power."

One may argue that while dollars are not convertible into gold, they are convertible into votes, and this is to some extent correct. But only to about the same extent as it would be correct to point out that dollars can buy officials directly. In both cases dollar convertibility is only marginal: a drunken Bowery derelict will sell his vote for a bottle of whiskey; a faithless official will take a bribe here and there.

But the wealthy and the big businessmen are unable to buy public policies with their dollars. If they seek tariffs, exclusive franchises, import quotas and other such measures, they do not succeed unless the measures they seek coincide with public opinion. Only public opinion to the effect that such policies are good for the country on the whole will secure their adoption. And when the public is convinced of the merits of a particular policy, dollars are incapable of affecting the result one way or another.

Subsidies for the poor, for commuters, for farmers, for the maritime industry and pretty soon for everybody else in the country—all these are traded by politicians in return for votes, not in return for dollars. When industry representatives go to Washington for tariffs and import quotas, they are told to return only when they can show some political currency. If they return with trade-union representatives, men who are thought to command votes, and if the union men join in seeking protectionist policies, the tariffs and quotas are forthcoming; otherwise not.

The current situation with respect to tax exemption for interest on municipal bonds makes the point rather well. By and large such bonds are purchased by more or less wealthy people. But if their interest were to be consulted exclusively, there is no doubt that the tax exemption would be removed. The exemption continues because the citizens in local communities, desiring local governmental services, such as public schools, insist upon it. And they insist upon it because, in their (ultimately incorrect) opinion, tax-exempt municipal bonds reduce for the taxpayers the costs of the services in question.

For the disinterested observer, his reason unimpaired by passion and prejudice, there is no need to go on at length with this point. It is sufficient to notice that over the past hundred years in this country, the steady trend of legislation has been against the wealthy and the successful businesses. David Hume was correct in stating as the first principle of government that all public policies are founded in opinion. On the other hand, in declaring that government in capitalist countries serves exclusively the interests of the wealthy, Karl Marx was as wrong as he was when he said that profits come exclusively from the exploitation of labor and that increasing poverty for the masses is the inevitable consequence under capitalism.

V

Strangely enough, the victims of the economic-power syndrome have left almost completely undeveloped an argument which, if they could sustain it, would carry the day for them. They could be arguing that, while it is true that all government rests upon opinion—on political votes rather than dollars—the wealthy and the big businessmen control government by controlling the political and social ideas of the citizenry. Why is this argument so rarely made?

I offer as a possible answer the fact that the argument is so patently at odds with reality. If we confine ourselves to reality we cannot help observing a tremendous disproportion in all the areas of intellectual communication and opinion-forming. A vast majority of instructional personnel from grade-school through graduate school roams somewhere left of center. Most newspaper columnists, moreover, consider themselves leftist-liberals and spend little time vaunting the virtues of capitalism. For every best-selling author on the right, there are at least ten on the left. Foundations established by the wealthy spend infinitely greater sums promoting the welfare state than they do in defending capitalism. Professor Paul Samuelson has become a wealthy man as author of an economic text sympathetic with the welfare state, if not with socialism. Galbraith's books become automatic best sellers. The works of Ludwig von Mises, the most powerful protagonist of capitalism in print, do not sell in sufficient quantities to feed him.

Let us now approach the problem more systematically. The contention that economic power translates into political power by way of political indoctrination of the masses would have to establish, in the first place, that the wealthy and the big businessmen are themselves uniform exponents of a particular policy or set of policies, for the first requirement in any indoctrination is a doctrine. But the argument then stumbles at the threshold. The one outstanding and apparent fact about the wealthy and the big businessmen and the institutions they found and support is ideological diversity. If we place H. L. Hunt on the right, as is customary these days, where shall we place the Rockefellers, the Kennedys, the Fords? And should we place all the Rockefellers in the same category? Where exactly would you place the Kennedys, father and sons?

There is no common ideology among the wealthy and the big businessmen, just as there is no common ideology among the masses. There are only vague, half-formed, often contradictory opinions, which veer one way now and another way again. They spend their money accordingly. The foundations and institutions attacking capitalism and free enterprise and the profit system seem to have plenty of money. As far as I have been able to tell, the few foundations and colleges which promote free enterprise rarely, if ever, are wealthy.

RECAPITULATION

I have tried to make three points:

> 1. Economic power, like political power, rests upon favorable opinion, the sovereign opinion of consumers; unlike political power, however, it produces wealth in the form of goods and services and has no compulsory capabilities. The consumers reward with profits those firms which serve the community and penalize with losses those firms which do not.
> 2. There is no way at all in a market economy for business to substitute its will for that of the consumers in respect of demand for goods and services; it proposes, the consumer disposes; the contention that advertising can supplant the will or implant desires in consumers conflicts with everything we know about human nature as well as with the external facts of life in the market economy.
> 3. Economic power is not convertible into political power. The medium of exchange owned by the possessors of economic power is money; the medium of exchange in politics is the vote. Dollars are produced by economic capability; votes flow in accordance with political opinion. Unless the holders of dollars represent interests which coincide with the independently derived opinions of the voters, the interests of the wealthy are doomed.

I have in this brief paper failed to deal with a number of features of the economic-power syndrome: the relations between big business and small business, the relations between business and employees, the Jeffersonian ideal of a society composed of farmers and small tradesmen, the notion that the managerial revolution heralded by Berle and Means and by Burnham has somehow incapacitated big business for the service of the community. With respect to these I can say only that there was not space. My silence on these points is not to be taken as an admission of their strength.

On the contrary, I believe it a simple matter, on the basis of the points which I have dealt with, to demonstrate equal weaknesses in those which I have not had the opportunity to discuss here.

I wish to say but one thing more, and to quote a statement which sums up what I have had to say here. First, I would not have my remarks interpreted as an apologia for the wealthy or for big business as such. My main interest has been to clarify thought on the subject of economic power. Secondarily my interest is in consumer sovereignty and its principal servant: the system of free competition emerging from those two common law institutions, private property and freedom of contract. Ludwig von Mises has summed up a large part of what I have been trying to say. As he puts it:

“The rich, the owners of the already operating plants have no particular class interest in the maintenance of free competition. They are opposed to confiscation and expropriation of their fortunes, but their vested interests are rather in favor of measures preventing newcomers from challenging their position. Those fighting for free enterprise and free competition do not defend the interests of those rich today. They want a free hand left to unknown men who will be the entrepreneurs of tomorrow and whose ingenuity will make the life of coming generations more agreeable. They want the way left open to further economic improvements. They are the spokesmen of progress....”

It is manifestly contrary to the interest of the consumers to prevent the most efficient entrepreneurs from expanding the sphere of their activities up to the limit to which the public approves of their conduct of business by buying their products. Here again, the issue is who should be supreme, the consumers or the government? In the unhampered market the behavior of consumers, their buying or abstention from buying, ultimately determines each individual's income and wealth. Should one vest in the government the power to overrule the consumer's choices?”

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Ownership As A Social Function
Paul L. Poirot

In the market society the proprietors of capital and land can enjoy their property only by employing it for the satisfaction of other people's wants. They must serve the consumers in order to have any advantage from what is their own. The very fact that they own means of production forces them to submit to the wishes of the public. Ownership is an asset only for those who know how to employ it in the best possible way for the benefit of the consumers. It is a social function.

Ludwig von Mises, Human Action

If one were obliged to list a single cause of our age of revolution, it might be this: the irresponsible use of private property.

Serious enough is the problem of stewardship and responsibility for disposition of one's own property. Infinitely greater are the problems created in the so-called charitable disposition of other people's property, when one votes to tax others for funds to be distributed to the "worthy" poor.

By this process, whole classes of "beneficiaries" may be deprived of their human dignity and of the opportunity to live as responsible, mature individuals:

—the young, publicly schooled to "sit in" and picket for favors;

—the aged, socially secured against productive use of their talents;

—hypochondriacs, medicared into terminal illness;

—the indolent, paid not to work;

—unwed mothers, seduced by subsidy to fuel the population explosion;

—farmers, paid to grow surplus crops, or not to farm at all;

—businessmen, sheltered by tariffs and embargoes and protectionism generally;

—craftsmen and other professionals, guarded against competition through a union or association or licensing arrangement of one kind or another;

—an endless list of personal failures, financed at the expense of everyone else.

Even so, to speak of the irresponsible use of private property immediately calls to mind the widely publicized charges of misbehavior leveled against "merchant princes" and "robber barons" of an earlier century. And it well may be true that some individuals in those days made some mistakes.

In his definitive history of property rights (In Defense of Property, Regnery, 1963), Professor Gottfried Dietze points out that: “In the nineteenth century, private property enjoyed greater protection than ever before ... property rights received far-reaching protection through legislation, adjudication and juridical science.” In other words, the full force of law and order and government protection had been mustered in support of the absolute right of the owner to do with his property as he pleased. That was the juristic attitude toward property rights, nor should it be altogether surprising to find such property-protecting governments occasionally granting to various owners or groups a bit of special privilege and political power. In any event, it is clear that individualism generally was favored over collectivism in America and much of Europe during the nineteenth century—and that the tide now runs strongly in the other direction.

The point at issue here is whether or not the owner's right to his property carries with it any corresponding duty or responsibility toward others. And the tendency of the law in the nineteenth century was to say no; let the owner do with his property as he pleases so long as he doesn't interfere with the property rights of others.

While such a view toward property may be economically and morally sound, it probably reflects poor political strategy. There is every logical reason, in a market-oriented economy, why decisions concerning the use of property are best left to the owner. But the owner may properly be accused of negligence if he relies heavily upon the government to defend his title and does not try to explain to others the general blessings of private ownership and open competition. Without that explanation, and understanding by the people, the same governmental force used to protect property can be perverted into a weapon for plundering, a perversion well advanced in the twentieth century. Owners who would protect private property are now obliged to explain to plunderers why property rights should not thus be violated.

The term “private property” often is narrowly used to signify only the material possessions of the wealthier members of society. But in a broader and more constructive sense, “property rights” are synonymous with “freedom,” and include the individual's right of self-control, self-respect, self-responsibility, and personal choice as to how he'll use his own life. A man without property rights—without the right to the product of his own labor and without respect for the equal right of every other person—is not a free man.

How, then, does one explain to would-be plunderers that their own and the public interest are best served by private ownership rather than public ownership of scarce resources? Perhaps the most likely point of agreement would be this: one does not use a club to explain a good idea to a reasonable person. The point is of great importance: the general welfare is served by reducing violence and fighting to a minimum. Once men agree to stop plundering one another, they are in a position to consider and to act in other ways to satisfy their wants.

When reasonable persons give thought to the ever-lengthening list of unsatisfied human wants, the impressive fact comes clear that resources are scarce. It is of utmost importance that resources be used efficiently, rather than wasted, if the satisfaction of wants is to be maximized. The reasonable person also must realize that the maximum satisfaction of human wants involves thought for the morrow as well as provision for immediate consumption. This means that some resources must be saved today and used as the tools and raw materials of further production for the optimum ultimate service of consumers. The important question, then, among reasonable men, concerns who should own the scarce resources of the world in order to assure the best possible service of the needs of the sovereign consumer, each the judge of his own needs. And the most reasonable answer, in the light of experience to date, is that an unhampered competitive market economy most effectively and efficiently places the ownership of scarce resources in those hands that best serve consumers.

A word about ownership may be appropriate here. Is the owner a producer or a consumer; are we speaking of production goods or consumption goods? As far as the goods are concerned, it doesn't matter. What matters is the owner's purpose, the reason why he wants possession. And the inevitable answer is that he is trying to satisfy his wants. The person who trades or participates in the market economy is both producer and consumer, nor is there any way he can be more one than the other in an open competitive society. A king or dictator or slave master might pretend to be all consumer, leaving the production to others, but that situation does not spell freedom.

Instead of dividing the ownership of all land and tools and other factors of production equally among all men, the general welfare depends upon directing such ownership and control into the hands of the most efficient producers of the goods and services wanted by consumers. Day in and day out, in the market place, consumers are expressing their latest preferences, handsomely rewarding some producers and letting others know they have failed. In the market economy, every owner is continuously obliged to justify, through service, his right to retain control of the resources he claims. Otherwise, consumers peacefully transfer the ownership and control into more capable, more productive, more serviceable hands. How is such transfer effected? Through the market system of recording supply and demand conditions in terms of prices that may be relied upon for the economic calculation of profit or loss. Consumers thereby direct the production of what best serves their needs, placing the ownership of property in the most capable hands.

Not all consumers, of course, are aware of the economic power they can effectively wield in their own interest through the open market. Some of them, forgetful or unaware of the inevitable scarcity of resources and the terrible cost of waste, are forever looking toward a political redistribution of property in the expectation of having more for themselves for immediate consumption. They fail to see that any such political redistribution thwarts the production they had ordered by way of prices bid in the market. Nor is this displacement of economic or market power by political power a simple quid pro quo—a foot gained for a foot lost. The tools of production are like a lever or a pry pole. It is possible to cut off a stove length from the lever for immediate use as firewood, but at a tremendous loss of leverage. It is rarely, if ever, in the consumer's best interest to destroy the tools of production.

As previously mentioned, governments of the nineteenth century may have been somewhat overzealous in the protection of property, trying to maintain the prevailing pattern of ownership even if the market indicated the desirability of change. Producers, once they have served the market demand and acquired title to a considerable block of resources, are not necessarily pleased to see a competitor come forth with a better idea to serve consumers. Established owners sometimes seek governmental protection, to exclude would-be competitors from the market. Such protectionism also curbs production and distorts or weakens the signals consumers send to market. A conservatism on the part of property owners that would use governmental force to frustrate consumer demand in the market is a socialistic form of conservatism, not in the general welfare.

In other words, the market affords no permanent security to the owner. Rather, it obliges him to prove himself over and over and over—endlessly. Consumers entrust property to his use, reward him handsomely if he serves them well, ruthlessly abandon him and reallocate the property the moment he fails to serve them. The market simply will not countenance the idea of property as an exclusive privilege of the owner. The market insists that property rights belong to those who best use the property to serve consumers.

The point for which we are striving here is that the present owners of property are not necessarily the ones one might expect to uphold and defend the competitive open economy—the market system. They are only human, and might well prefer the sort of protectionism nineteenth-century government gave property owners. So, it behooves the least of the property owners to protect his own interest in the market economy—his interest as a consumer. The man who brings his goods or services to market, in trade for property he would consume, is interested in the mobility of property for easy conversion to his purposes, not protectionism and stagnation in formerly profitable uses—and not a political diversion of property to uses no one is willing to pay for.

The market has been severely, and unjustly, condemned of late for allowing or even encouraging the waste of natural resources and the serious pollution of air, water, morals, and other requisites for clean living. But closer inspection will reveal that the properties thus polluted are those not clearly subject to private ownership and control: the atmosphere, rivers, lakes, oceans, parks, streets, schools, Appalachia, the body politic. They have been treated as public property, the responsibility of government, nobody's business in particular. Hopefully, it may be realized in time that such things as air and water and human virtue are scarce and valuable resources, that they should be subject to private ownership and control, and that government's sole responsibility is to protect the owner against robbers and vandals and at the same time hold him responsible if he uses his property in ways injurious to others. Private ownership is a social function.

Dr. Mises is cited as the text for this paper. The elaboration here is intended to be in strict accord with his teachings.

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To Abdicate Or Not
Leonard E. Read

Life is a process of selection and rejection; knowing what to renounce in life and what to embrace are distinguishing marks of a wise man. My theme is Mises and his exemplary achievements in this respect—as much to be noted and honored as the economic enlightenment on which his fame so solidly rests.

Professor Ludwig von Mises arrived in America during 1940. My acquaintance with him began a year or two later when he addressed a luncheon meeting of the Los Angeles Chamber of Commerce of which I was General Manager. That evening he dined at my home with renowned economists Dr. Benjamin M. Anderson and Professor Thomas Nixon Carver, and several businessmen such as W. C. Mullendore, all first-rate thinkers in political economy. What I would not give for a recording of that memorable discussion!

The final question was posed at midnight: "Professor Mises, I agree with you that we are headed for troublous times. Now, let us suppose you were the dictator of these United States. What would you do?"

Quick as a flash came the reply, "I would abdicate!" Here we have the renunciation side of wisdom: man knowing he should not lord it over his fellows and rejecting even the thought.

Few among us are wise enough to know how little we know. Ignorance of limitations is to be expected from every one who does not see beyond himself. The wise man, on the other hand, achieves a measure of self-transcendence: he sees beyond himself, even beyond his environment. Knowing far more than the mill run of us, he measures his knowledge against what might be known and confesses to knowing nearly nothing. Such a rare individual weighs his finite knowledge on the scale of infinite truth, and his awareness of his limitations tells him never to lord it over others. Such a person would renounce any position of authoritarian rulership he might be proffered or, if accidentally finding himself in such a position, he would abdicate—forthwith!

Really, no one ever rules another. The most that is achieved by a Simon Legree, a Hitler, Stalin, or any of our own little dictators of economic affairs, is to keep others from being themselves. True, there is a role for a societal agency to play in keeping others from being themselves if it be their nature to commit theft, murder, deception, violence, and the like. I am not alluding, however, to the retarding of wrongdoing but, rather, to a person's freedom to be himself creatively. The authoritarian mentality is concerned not with inhibiting destructive actions but with the control and direction of creative actions. This no dictator can do; he can only suppress, deaden, destroy such actions. Creative actions can never be ruled but only ruled out!

The wise man, regardless of his superiority among men, realizes that his knowledge is but infinitesimal; that his light, however bright, is but a wee candle in the overall luminosity; that were all others to be made precisely in his image, all would perish.

To illustrate the fractional nature of one's knowledge, sit behind the wheel of your automobile and ask yourself, what part have I had in the making of this remarkable gadget? The answer, be you the President of the United States or of General Motors, is that you have played very little part, if any. Ask next, what do I know how to do that might have played any part in the making of this machine? Your answer remains substantially the same. To my point: Last year several million automobiles were manufactured in the U.S.A. How come? From whence came the knowledge that does not exist, even incipiently, in any discrete human being? It had to come from somewhere.

The knowledge that makes the automobile possible exists in what I choose to call the overall luminosity. This is composed of trillions times trillions of tiny illuminations, discoveries, inventions, insights, intuitive flashes, think-of-thats—an accumulation that had its beginning with the dawn of mankind. The cave man who discovered how to harness fire played his part. So did the Arab who invented the concept of zero. Without each of these, the automobile is inconceivable. These men, whoever they were, had as much a part as Charles Goodyear did in 1839 when he invented the hot vulcanization of rubber. Or those men who treated paper with a mixture of ferricyanide and ammonium ferric citrate and brought forth blueprint paper. Or those who found out how to make paper!

The overall luminosity that makes possible our automobiles, stoves, pencils, and a million or so other things by which we live and thrive is handed down or, better yet, made available to us in countless ways: memory, teaching, books, tradition, folklore, to mention a few. It is a storehouse of unimaginable enormity; no individual can perceive a trillionth of it!

The wisdom in knowing that we know not is sometimes glimpsed in relation to things. For instance, it is easily demonstrable that no single person has the knowledge to make a simple pencil, let alone a jet plane or that fantastic windshield through which the pilot peers. Even so, the realm of things is pestered with know-it-alls, persons who seem unable to relate their tiny glimmers to the overall luminosity and cannot therefore keep themselves in their place.

However, it is when we move from the realm of things to the realm of humanity—man and society—that authoritarians proliferate. Even many who would confess to an ignorance of how to make a dynamo will, with no hesitancy whatsoever, boast of knowing how man and society should be made to perform. Failing to discern that men and their relationships are vastly more complex than any thing or things, they entertain no doubts about their competency to rule mankind.

In the realm of humanity, as in the realm of things, an overall luminosity presides or rules. In social affairs, this may be referred to as “the consensus.” Professor Hayek uses, “Knowledge in society”; Edmund Burke called it “Immemorial heritage”; others refer to it as “Culture” or “Custom.” By whatever name, it is a body of underlying assumptions, of ideas taken for granted and held more or less in common; it is the residual legatee of mankind's history or, as James Coolidge Carter phrased it, “... the imperishable record of the wisdom of the illimitable past reaching back to the infancy of the race ...” It is what is handed down to us plus what we, who live on its growing edge, put into it.

Professor Mises knows that he does not or cannot rule; thus, he abdicates from even the idea of rulership. Knowing what phase of life to renounce is one side of wisdom.

But knowing what phase of life to embrace—to get ever deeper into, from which never to abdicate—is the other side of wisdom. And in this phase, as in the former, we have no exemplar who excels Mises.

This being my analysis, I shall use my own rather than Mises' phrasing: the ruling consensus, I repeat, is what is handed down to us, plus what we put into it.

What we put into it is the key. The improvement of the ruling consensus by you or me requires that our own thoughts and actions be, at the very least, a confirmation of the best that has been handed down to us or, hopefully, an improvement on what the consensus already contains.

We who live on its growing edge can put nothing into the consensus that is not within ourselves. It follows, if we would put anything into it, that life must be devoted to the improvement of what is within us, rather than wasted on the futile attempt to reform others.

I am unaware of any individual who is less the reformer or propagandist than Mises. To the contrary, his life is and always has been distinguished by a search for truth. His remarkable and unmatched economic works are testimony to many virtues but especially to his two-sided wisdom: knowing what phase of life to renounce and what phase of life to embrace.

There are numerous examples in history that lend credence to my prophecy. The seminal thinking of Mises—the improvements he has added to the consensus, manifested in his works over a span of seventy years—gives a light with so much radiance that it will penetrate the centuries—mirror itself through the ages.

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The Book In The Market Place
Henry Regnery

With every penny spent the consumers determine the direction of all production processes and the details or organization of all business activities.... The publishers cater not only to the majority by publishing detective stories, but also to the minority reading lyrical poetry and philosophical tracts.

—Human Action

Few would deny that any more profound, complete or persuasive exposition and defense of the free market has been written than Ludwig von Mises' Human Action. It is no reflection on Professor von Mises nor the market economy, however, to say that no human institution is perfect and that no system of ideas, no matter how well conceived, is without exceptions or contradictions. I would like to make some comments about what seems to me to be a flaw in the workings of the free market system, a flaw which has been mentioned by many others, and which creates a problem which is constantly becoming more critical—the problem of the serious book.

All of us who believe in the efficacy of the free market, who believe, with Professor von Mises, that no system is able to regulate the production and distribution of goods more justly or efficiently, must nonetheless face the fact that the market is not an infallible guide, that other considerations must be taken into account, even in matters which might appear to be entirely of an economic nature. In this connection it is not amiss to point out that Human Action itself was originally published by a university press, by a publishing organization, therefore, neither subject to the disciplines of the market nor to the restrictions that purely market considerations impose. A university press is subsidized in various ways—by free or much reduced rent; by services supplied without charge by the university, services commercial publishers must pay for; by remission of taxes; by being free of the necessity of paying interest or a return on capital. The fact that Human Action was originally published by a university press may, of course, be purely accidental, but I think it quite likely that the size of the book, and particularly the unorthodox position taken by the author—a position many critics and reviewers would certainly not have approved of, might very well have frightened the commercial publishers at the time, 1948, the manuscript was offered for publication.

A manufacturer of shoes, of furniture, of fabrics, or any one of the thousands of every day articles that society wants can rely on the direction provided by the market with a good conscience—what the market demands the producer supplies and no one expects him to do otherwise. For the publisher of books the situation is not quite so simple. It is true, as Professor von Mises says, that "publishers cater to the majority by publishing detective stories," but I am not at all sure that the minority interested in "lyrical poetry and philosophical tracts" comes off quite so well.

As publishing has become more commercial, from having been a "profession for gentlemen" to have become big business, with its shares traded on the stock exchange and all the rest, the demands of the market, not surprisingly, have tended to overwhelm purely literary and intellectual considerations. The typical publishing firm of the nineteenth century, as continued to be the case into the 1930's, was a small business as businesses go, was often run by its owner, whose personality and point of view it reflected, and who took pride in being able to consider himself at least an associate member of the Republic of Letters. He had to operate at a profit, of course, and to do this required skill and business judgement, but overhead, production costs and capital requirements were a fraction of what they are today, profit margins were higher, and, perhaps most important, the whole process of producing and distributing books, from publishing through book reviewing to the book seller, was more attuned to the book as something unique, as the work of the mind rather than as an article of commerce produced to sell. A publisher, of course, had to consider the market, but it wasn't the only consideration. No responsible publisher, even in the 1920's, would have accepted such a hoax as Naked Came the Stranger nor would the reviewers have given it serious attention, nor would a book of the quality and intellectual distinction of Human Action have had to be published by a subsidized press.

When Alfred Knopf, who was a successful and astute publisher, but very much in the old style, took over the publication of Henry Mencken's American Mercury, he didn't do it, I am sure, with the expectation of a large profit. He no doubt hoped to cover his costs, but couldn't be sure even of that, but it was his decision and taken at his risk, and the prospect of association with Mencken in such a venture was certainly attractive to him. Now his old firm is a subsidiary of Random House, which, in turn, is owned by RCA. The considerations that motivated Knopf can play no part in the decisions of a huge corporation which must, by its very nature, operate completely in accordance with the demands of the market and the profit and loss statement.

We must, it seems to me, accept the rather unpleasant fact that as publishing becomes more commercial, its output is increasingly determined by those who wish detective stories or such masterpieces as Naked Came the Stranger or The Love Machine. What happens, then, to the "lyrical poetry and philosophical tracts?" The university presses come immediately to mind, but they can't be relied on, for obvious reasons, to publish books that don't fit the orthodoxy of the academy, although there are exceptions—not only Human Action, but Hayek's Road to Serfdom and Weaver's Ideas Have Consequences were published by university presses. But these, I think, were accidents. In the case of Human Action, the editor of the press possessed a degree of intellectual courage and independence not common in the academy; after his dismissal, the press let the book go out of print and was glad to cede the rights to a commercial publisher. The Road to Serfdom was originally published in this country, quite accidentally and in a very small edition, as an import from England, and the director of the press who brought out Ideas Have Consequences was soon after fired. So not much of a case for university presses can be made on the basis of these three books.

H. G. Wells, in a letter to Wyndham Lewis written shortly after the publication of the latter's great satire Childermass, remarked that the books that make a lasting impression, that move men's minds, are necessarily written not for the masses but the few, and how, in the future, he went on to say, will such books be written and published at all? There will doubtless continue to be individual publishers who, within the limits imposed by the market, will publish books which are written neither to meet the requirements of the reviewers, those stalwart defenders of the orthodoxy of liberalism, nor the demands of the masses, but a publisher's freedom of action is far more limited now than it was in the days when Knopf could publish the American Mercury, or Faber and Faber T. S. Eliot's Criterion, which was one of the most distinguished and influential journals of its day, although it never had more than 800 subscribers. The foundations, if they would, could do something about this situation, but it requires intelligence and imagination as well as money, and intelligence and imagination, as always, are in short supply. If we are to have a vigorous and creative intellectual life, however, we can't, it seems clear, rely on the market alone to provide the impetus and direction.

In conclusion, may I say that Professor von Mises' own career demonstrates his loyalty to values higher than those of the market. Not one of the great American universities, I understand, ever gave itself the honor of offering him a professorship. If, however, he had been willing to adjust his views to the liberal orthodoxy demanded by the academic community, the universities, I am sure, would have felt quite differently about him. For his achievements as a teacher, economist and defender of the free society he deserves our respect and admiration, but perhaps even more for his integrity and unswerving devotion to principle.

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Lange, Mises And Praxeology: The Retreat From Marxism Murray N. Rothbard

Most economists are familiar with the controversy on the possibility of economic calculation under socialism, and with the fact that Ludwig von Mises and Oscar Lange were the two major protagonists of that debate.1 Many are also familiar with Lange's ironic gibe that, for having posed the problem which Lange believed that socialism could readily solve, "a statue of Professor Mises ought to occupy an honorable place in the great hall of the Ministry of Socialization or of the Central Planning Board of the socialist state."2 In the light of the rapid retreat from socialist central planning and toward a free market in the Eastern Europe of recent years, it seems that Lange's irony might well have boomeranged.

Far less known, however, is a parallel retreat from Marxist economic theory in Oskar Lange's last years, a retreat, furthermore, made in long strides toward the economic theory and the methodology of none other than his old opponent. Mises' most distinctive contribution to economics was his concept and elaboration of economic theory as praxeology (or praxiology), the formal, general logic of human action, of human purposive activity using scarce means to achieve the most preferred ends.3 As a leading Polish economist, Lange was very familiar with the praxeological theories of the distinguished contemporary Polish philosopher, Tadeusz Kotarbinski. While Kotarbinski's specific conception of praxeology differs considerably from Mises, stressing analysis of efficient as well as hostile action, they unite in emphasizing the essence of praxeology as a general theory of rational action.45 In his final, posthumous work, designed as the first of a multi-volume treatise on economics, Oskar Lange devoted a great deal of time to the painful acknowledgement that economics must encompass praxeology as well as Marxism. The particular irony is that Lange devoted a great amount of attention to an economic theory of his old antisocialist rival which still remains almost unknown in conventional Western economic thought.

Lange entitled Chapter 5 of his posthumous Political Economy, "The Principle of Economic Rationality. Political Economy and Praxiology." He begins the chapter with the decidedly un-Marxist but praxeological statement that "Human economic activity is conscious and purposive activity", that "consists in the realization of given ends by the use of certain means."6 He proceeds to point out that the capitalist market economy had not only developed gainful activity, but that this gainful activity was a rational one, quantifying ends and means through a calculation in terms of money. Here Lange is implicitly harking back to the old calculation controversy. The economic calculation made possible by money and the invention of double-entry bookkeeping in the capitalist market, enabled action toward the maximizing of money profit and income, and thereby toward the most efficient realization of man's ends. In this way, maximization of profit under capitalism is accomplished by following the economic principle or principle of economic rationality, a principle enabling the maximum degree of realization of one's ends per given outlay, as well as the minimal outlay of means for a given degree of realization of one's ends. The former variant is the "principle of greatest efficiency"; the latter, the "principle of minimum outlay, or economy, of means", or mimimum cost.7 The rational use of means, according to these criteria, is their optimum use; any other use of means Lange agrees to consider a waste. In support of these economic principles, Lange cites Kotarbinski's general praxeological concept: "The more valuable the product of a given experience the more productive is behavior; on the other hand, the less the outlay in the achievement of a given aim, the more economical is behavior."

Lange proceeds to pay tribute to the great achievement of the capitalist market economy in arriving at this rational economic principle. Despite the prevailing private rather than "social" rationality, and despite such problems as the business cycle, Lange declares that "the rationalization of economic activity within the capitalist enterprise, the practice of proceeding according to the principle of economic rationality, and especially the consciousness of this principle in human thought, all constitute an achievement of historic significance ... on a par with the imposing advance in material technique made within the capitalist mode of production ... itself closely connected with the application of the principle of economic rationality in enterprise."8

After rather perfunctorily asserting that socialism will proceed to expand this rationality to social planning, and to such areas of action as input-output analysis, technology, and military strategy and tactics,9 Lange goes on to identify this study of the rational principles of action as praxeology, the logic of rational activity, and details the history of this concept. From Mises, Lange had discovered that the term "praxeology" was first used by the French historian Alfred Espinas in 1890.1011

Proceeding to the more developed praxeological work of Kotarbinski, Lange criticizes the Polish philosopher's narrow and technological treatment of the concept as the science of effective or efficient activity; instead, notes Lange, praxeology is really a broader "methodological rationality", a doing of one's best according to one's knowledge, so that it is better to define praxeology as the science of rational activity. In opting for this broader, more formal, and more general concept, Lange goes a long way from the Kotarbinskian and toward the Misesian formulation of the theory. Praxeology, adds Lange, encompasses under this rubric of rational activity such categories as: ends and means, method, action, plan, efficiency, and economy. Praxeological principles of behavior comprise the relations between the praxeological categories, and the principle of economic rationality (or the "economic principle") is one of these praxeological principles of behavior. In this way, Lange agrees with Mises that the economic principle is itself embedded in the wider praxeological principles of general human action. Furthermore, he agrees that the praxeological principles had until now been elaborated only in the field of economics, as Mises affirms, and in ethics as well.

Lange, however, now found himself at the brink of a precarious position: the Mises thesis that praxeology had so far been elaborated only in economic theory, and that therefore economics and praxeology, while conceivably of different scope in the future, are now virtually identical. To take such a position would mean, for Lange, being close to becoming a Misesian and an Austrian School economist. Drawing back from this precipice, Lange hastens to add that praxeology includes, not only Mises-type economic theory, but also the general theory of statistical decisions, operations research, programming, input-output analysis, and cybernetics. Lange did not seem to realize that by rushing to include these disciplines, along with economic theory, in the rubric of praxeology, he was returning to the very different technological concept—the technological manipulation of means to reach a given end—that Lange had already rejected in Kotarbinski.12 Remembering suddenly to pay his respects to Marxism, Lange adds as an afterthought that dialectical materialism partly bases its cognition on the "praxeological principle" of proceeding according to the "criterion of practice."13

From the praxeological principles of behavior, and especially the economic principle, adds Lange, a considerable edifice of economic laws can be deduced: such as a general attempt to maximize profit and investing capital at the highest rate of profit, thereby leading to a tendency toward a uniform rate of profit throughout the economy. In this way, Lange accepts the essential deductive Misesian methodology for economic theory: beginning with broadly general praxeological principles as axioms, and from these elaborating necessary laws by logical deduction. While Lange attempts to qualify this agreement by stating that empirical testing is needed to see whether various economic actions are "rational" or "customary-traditional", his basic alignment with Misesian methodology still remains.

Later in the book, Lange returns to grapple with praxeology through a critique of subjective utility theory, itself a topic that usually rates little or no space in Marxian works.14 He begins with a history of value theory, and of the basis of economics in the nineteenth century, that is perfectly acceptable to any modern economist: from the classical "economic man" to Benthamite utilitarianism and hedonism to Bastiat's exchange of services and on to the subjective, marginal utility school. The latter began with Jevonian hedonism and then developed into the Austrian, praxeological interpretation of utility not as "pleasure", but as the realization one's aim of economic activity, regardless of the nature of that aim. The aim may be pleasure, money, power, health, or whatever; the Austrian view simply states that economic activity has some aim, or preference, that forms the goal of action. As Lange correctly concludes: "In this praxiological interpretation, the subjectivist trend leaves aside all psychological considerations and transforms itself into a logic of 'rational choice' aimed at the maximization of preference."15

Lange then proceeds to a history of the development of this general, formal theory of utility as ordinal preference. He sees that the Austrian School (Menger, Wieser, Böhm-Bawerk) was far more thoroughgoing in its application of subjective marginal utility theory than the currently far more influential Lausanne School (Walras, Pareto) or than Alfred Marshall. For the Austrians applied marginal utility theory to all gainful activity, whereas the latter applied it only to consumers. In the Austrian and praxeological view, both the consumers' aim of maximizing utility and the producers' aim of maximizing money income or profit fall under the single rubric of maximizing preferences and of marginal utility. Lange's history here is deficient in identifying Pareto partially with the Austrian approach while totally neglecting the praxeological role of Pareto's Italian opponent Benedetto Croce. Moreover, he also neglects the adoption of a general and purely ordinal concept of marginal utility by the Czech Austrian School economist Franz Čuhel, and following Čuhel by Ludwig von Mises in 1912, long before the famous Hicks and Allen article of 1934.16 Lange is correct, however, in citing a praxeological interpretation of utility by Max Weber as early as 1908, in which Weber stated that marginal utility should be formulated, not in such psychological terms as pleasure, but in such "pragmatic" categories as ends and means.17

Thus far our Marxian was willing to go with praxeological economics. But here Lange confronted a precipice even steeper than before: for just as it was important for him to deny that praxeology might be confined to economics, so it was still more important for him to deny that all of economic theory is a subset of praxeology. For if that were really the case, where would that leave Marxism? And so Lange separates himself from the final step in the development of praxeological economics: the transformation of economics into a branch of praxeology. Separated now from concrete objects, economic analysis became a formal science of rational behavior, of the maximization of magnitudes. Conversely, the formal aspects of all rational behavior became analyzable by the economic principle.18

For this transformation of economics into a branch of praxeology, Lange cites Lionel Robbins and his well-known depiction of economics as a certain aspect of all activity, namely the relation between scarce means and alternative ends, and the choice among those ends.19 He also devotes attention to the Austrian economist Hans Mayer, and to Max Weber, who had originated the Robbinsian distinction between economics as choice of means between ends and technology as the choice of means to realize a given end.20 While this distinction is rather simplistic - neglecting, for example, the point that economic as well as technological considerations enter even into the choice of means toward a single end - Lange is incorrect in charging that the distinction is meaningless because the hierarcy of alternative ends are all aimed toward one principal end: the maximization of utility. Lange does not realize that "utility", for the praxeological school, is not a thing or an entity in itself, but is simply the label placed upon the preference rankings which everyone makees among his vrious ends. "Maximizing utility" simply means the formal principle that a man attempts to attain his highest ranking, his most preferred, rather than his less preferred end.21

Lange than points out that this transformation of economics into a branch of the universal science of praxeology culminated in Ludwig von Mises' Human Action in 1949. Classical political economy was now fully transformed into a general theory of human action, of the acts of choice. Economics becomes no longer an empirical science with "real" phenomena, but a formal logic of choice, where the only criterion of truth is agreement with the original axioms. The economic theory becomes empirically true insofar as any concrete action is governed by the economic principle. Lange is particularly critical because all of the laws of praxeological, subjective economics are considered by Mises and the preceding Austrians to be applicable to Crusoe economics as well as to the exchange economy. Lange's hostility to this "unrealism" stems precisely from the fact, as he points out, that application to Crusoe economics implies that the laws of economics are universal and apodictic for every time and place, regardless of the concrete content of social relations or economic activity. By means of praxeology, economics, like the natural sciences, has transcended the concrete and changing data of history and has assumed the character of a universal and apodictic science. As Lange characterizes this position: “Historically conditioned social relations may influence the concrete form in which these laws manifest themselves but they cannot change their basic character.”[22] While Lange is willing to concede this universal and trans-historical character to praxeology, he is not willing to concede economics to be only a subset of praxeology and therefore to take on the same timeless character. For if he were, Marxism, with its proclaimed laws of historical determinism, would have to be completely abandoned.

The characteristic method of the praxeological economists in developing their analysis, Lange points out, is to begin with the economics of an isolated Robinson Crusoe, an analysis which elucidates the basic laws of men in relation to things. Then, other people are brought in, and exchanges between these individuals explained as each person choosing to give up something he wants less in order to obtain something he wants more. Exchanges thus become the resultants of the subjective attitudes and preferences of the participating individuals. Lange complains that this process of beginning with man vis à vis nature is the opposite of the Marxian conception, which concentrates on “economic relations among men - relations of production and relations of distribution.” He further quotes from the Marxist Rudolf Hilferding, in his charge that the Austrian School economics of Böhm-Bawerk “takes as the starting point of its system the individual relation of man to things. It conceives relations from a psychological point of view, as subject to natural invariable laws; it excludes socially determined relations of production, and ... development of the economic process according to definite laws is quite foreign to it.”[23] This, to be sure, is the liquidation of the classical “political economy.”

But while Lange accuses subjectivist economics of ignoring real economic relations between men, he also correctly asserts that this school of thought treats the economic categories of capitalism “as general praxeological categories, categories of rational human activity ...”[24] Wages, capital, profit become universal categories independent of the historical shaping of society, and therefore capitalism becomes a universal requirement of rational economic activity. Lange sees that this leads to the heart of the Mises-Lange calculation controversy on whether rational economic activity requires the private ownership of the means of production.[25] But then Lange can hardly be correct in charging that praxeological economics ignores concrete social and economic relations; on the contrary, his real complaint is that from these abstract, universal economic laws may be deduced the very real necessity for market capitalism in order to sustain a rational economy.

Thus, while Lange is willing to concede the universality of the economic principle, and the achievement of subjectivist economics in discovering a praxeology that can be applied to political economy and to other fields, he is of course not willing to concede that economics is exclusively praxeological. The remainder of Lange's discussion is an unsatisfactory attempt to outline what Marxism or any other economic theory might add to praxeology in the formation of economics. He mentions institutional discussions of the social organization of production, of the State, labor, national income, etc., but the unanswered question is the role of these categories in economic theory as compared to an accumulation of institutional data to which that theory can be applied. Lange also approvingly cites the attack on the subjectivist Austrian School by the Polish economist Stanislaw Brzozowski, who charged that the Austrians merely analyzed the relations between man and given things, and comprised a theory of consumption rather than a "complete theory of society." In the first place, this contradicts Lange's previous insight that the Austrians, in contrast to Marshall and the Lausanne School, had extended their subjectivist analysis from consumption to production and the productive factors; the "given things" constituted only the first step in their complete analysis. Secondly, why should it be a defect of praxeological economics that it does not offer a "complete theory of society?" Is physics to be condemned because it is not chemistry? Has a complete and correct theory of society been offered by any sphere of economics or social science?

Lange proceeds to unworthy and rather absurd attempts to subject the Austrian School economists to a Marxian "sociology of knowledge." The Austrian School, he asserts, is the economics of pensioners and tax officials, because it discusses only consumption and not production; and Nikolai Bukharin is cited in asserting that the Austrian School, with its concentration on consumption, is the "rentier's political economy."26 Not only does this contradict Lange's own previous concession to the Austrian integration of production and consumption, but it also leaves us with the puzzle of how to "explain" such consumption-oriented economics as that of John A. Hobson or J.M.Keynes? Are they too to be dismissed as "rentiers", even the Keynes who called for the "euthanasia" of that very class? Lange's second attempt is to "explain" the abstract and unrealistic Austrian methodology as the product of the professionalization of economics in the universities in the late nineteenth century, which thereupon developed in "isolation from the productive process."27 But while the earlier classical economists may not have been as professionalized, they were also - apart from Ricardo - not businessmen, and thus were equally "cut off" from the productive process. Neither the university professor Adam Smith nor the civil servant Mill were any closer to the productive process than Menger or Böhm-Bawerk. Furthermore, a bit later in the book Lange turns around and salutes the professionalization of all scientific research in the past century as leading to an autonomy of science, a critical attitude toward the social system, and a science that "becomes independent of the social milieu which produces" it.28

Lange declares that since the bourgeoisie had to know what was actually happening in the economy, they couldn't pursue completely the Austrian path of liquidating political economy. Therefore, the more "realistic" Anglo-American neo-classicists continued to study such important economic problems as money, business cycles, growth, and international trade. What Lange ignores here is that the Austrian subjectivists have studied and come to a position on all of these important questions, so that what he sees as their abstract "isolation" applies only to the fundamental laws and not to the more developed and applied branches of the theory. One need only mention the Mises-Hayek "monetary malinvestment" theory of the business cycle to see how praxeological economics has been applied to vital and realistic economic problems. The problem, however, is that Lange cannot be very happy with the policy conclusions of the Austrians in these areas: ultra hard money, the gold standard, laissez-faire capitalism. Again, the problem is not so much the relevance of the method as the kind of conclusions that are obtained.

Lange's remarkable adoption of Misesian praxeology as the major base for economics, onto which Marxian and other approaches were then hastily grafted, met predictably mixed reaction in Marxian circles. Most striking was the laudatory critique of Lange by Ronald Meek, the distinguished English historian of economic thought.29 Professor Meek, summarizing Lange's lengthy chapter on the Principle of Economic Rationality, notes that "significantly, the references to Marx's work become purely incidental."30 Meek considers it "interesting and paradoxical" that praxeology, which "has now become an indispensable adjunct to Marxian economics", was the culmination of a violently anti-Marxist subjectivist trend in "bourgeois" economics.31 The paradox might well be put the other way round: that of a leading Marxian economist adopting the economics of his own and Marxism's major opponents, and then rather desperately trying to insist that there is still room for Marxian and institutional approaches in the wider rubric of political economy.

To Marxian "fundamentalists", on the other hand, the Lange-Meek movement is seen for what it genuinely is: a massive "revisionist" retreat from Marxism. In his review of Meek, Ben Brewster despairingly writes: "... for if the relations of production is a general principle governing society the latter becomes merely the totality of human social interaction; there is no specificity of the economic level at all and the distinction between base and superstructure breaks down. The result is that in the last essay in the book (the title essay), Meek apparently falls for the most general principle of society and the most bourgeois ideology of them all, von Mises' "Praxiology" (the principle of all rational action) in Lange's purely ideological attempt to graft Marxist and Neoclassical economics."32

And so, as Marxian economic thought joins the actual economies of Eastern Europe in a headlong flight from Marxism and socialist central planning to Western and capitalistic modes of thought and economic systems, Oskar Lange's original irony is truly beginning to boomerang: Perhaps the freemarket, capitalist economy of a future Poland will erect a statue of Lange alongside the monument to his old antagonist?

Footnotes

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The Production And Exchange Of Used Body Parts
Simon Rottenberg

"The market economy is the social system of the division of labor under private ownership of the means of production.... Everybody in acting serves his fellow citizens.... Each man is free.... The market directs him and reveals to him in what way he can best promote his own welfare as well as that of other people."

L. von Mises, Human Action, A Treatise on Economics.

When failure occurs in human organs and tissues it is sometimes possible to prolong life and cure illnesses by transplanting parts from one body to another.

This paper will discuss the market, as an alternative to a system of voluntary donation, as an instrument for bringing forth a supply of organs and securing their storage and their appropriate distribution in space and time.

Transplants, or grafts, as they are sometimes called, are either cellular or structural. If cellular, they are of living organs (for example, kidney, liver, spleen or skin); if structural, they are of extracellular tissues (for example, artery, bone or cornea).

G.E.W. Wolstenholme reports that the first transfer of blood (from one dog to another) was done at Oxford by R. Lower in 1666. J. F. Nuboer says that the first recorded article on organ transplantation was published in the Wiener Klinische Wochenschrift in 1902 when Ullmann described the transplantation of a dog's kidney to its neck.

Skin was transplanted experimentally in the 1920s and 1930s by E. Holman and H. L. Smith reports that the first successful kidney transplants in humans was done in 1954 by J. E. Murray in Boston.

According to P.V. Rycroft, the first human graft of the cornea was done in Reisinger in 1817.

Organ and tissue transplantation is not a new medical procedure. The very large resources devoted to bio-medical research in recent years has, however, greatly enlarged the stock of knowledge about transplantation. It has been reported that there are some thirty different body parts that have been transplanted with more or less success. These include, in addition to the parts already mentioned, bone marrow, bones, pancreas, lungs, livers and hearts, blood vessels, cartilage, ovaries, testes, various glands and the intestinal tract.

Not all of these transplants have been executed in humans; some have been done only in animals. Some are still experimental in the sense that the probability sets associated with possible outcomes are unknown. Some are standard (non-experimental) procedures; the probability sets are known.

Transplants are, in some cases, unique therapeutic instruments; the patients will expire if they are not done. In other cases, transplantation is a therapeutic substitute for other procedures as when treatment consists of either renal transplantation or periodic dialysis.

Transplants may be autografts (from one to another part of the same body), or homografts (from one to another body of the same species), or heterografts (from one to another body of different species).

Parts may be taken from living suppliers or from cadavers. If taken from living suppliers, it may be virtually risk-free to them, as when blood, skin, or bone marrow is taken. The risk may be positive, but small, as in the case of paired organs like kidneys when, if one is taken, the suppliers remaining kidney takes up the whole burden previously shared by both kidneys and the risk consists of a certain (small) probability of failure of the remaining kidney and, of course, the risk associated with surgery in the taking of the supplied kidney, itself; in the same subset are ovaries, testes, nerves and small blood vessels. Or the risk may be positive and large, as in the case of unpaired organs essential to life like hearts, livers and pancreas; the taking of such an organ will cause the life of the supplier to come to an end.

There are three phenomena that affect the supply schedules of organs and tissues.

Some organs deteriorate rapidly if preservation techniques are not quickly administered. A kidney must be excised from a cadaver within about an hour after death and quickly perfused and cooled thereafter, if it is to be useful for transplantation. A liver will suffer damage, if it is without a blood supply for more than twenty minutes at 37° C.

Some parts can be stored for longer periods and others for only short periods. Bone, preserved for storage by freezing, has been successfully used for transplantation over a year after excision, but whole blood must be discarded after three weeks or a month have passed.

Nuboer reports that Humphries was able to preserve kidneys for five days by means of perfusion, cooling and hyperbarbic oxygen. R. C. Lillehei reports that unpaired organs can retain their vitality for seventy-two hours, if stored in vitro, but that optimal organ function is impaired after about twenty-four hours. The viability of all tissues is said by F.D. Moore to be a function of the time they have been without a blood supply and the temperature during that time.

Long period inventories can be constructed for some body parts and not for others.

The body tends to reject grafts of "foreign" cellular parts made upon it. K. Landsteiner already pronounced in his Stockholm Nobel Lecture in 1930 that "the success of transplantation stood in a reciprocal relation to the degree of consanguinity". The survival of the recipient of a renal transplant will be most highly probable if the supplier is an identical twin (these are called iso-transplants); somewhat less probable if the supplier is a parent or sibling of the recipient; less probable still if it is a more distant blood relative; still less probable, if it is another, unrelated human; and, finally, least probable if the supplier is of a different species.

The antigenicity of organs (the property of rousing an antagonistic response in the host) varies among organs. Ovaries and parathyroids are least antigenic; kidneys, livers, lungs and adrenal and thyroid glands fall mid-way with respect to antigenicity; and skin is most antigenic.

Structural grafts (bone, artery, cornea) do not involve the question of antigenicity.

Until a condition of non-reactivity can be more effectively induced in the host (as by chemo-therapy), procedure requires the discovery of suppliers who are histo-compatible with recipients.

Thus, there are better and worse substitutes for a diseased kidney, implying a family of supply schedules some lying closer to the ordinate and some more distant than others.

Organs and tissues to be used for transplantation are almost never bought and sold.

Blood is bought and sold in a number of countries. R.M. Titmuss estimates that, for recent years, only nine percent of the blood collected in the United States has had the properties of altruistic gifts which produce psychic utility directly. The rest has been sold for payments in cash, payments in other blood (either already received or to be received in the future in a probability or insurance sense), payments in the form of probabilistic early release from prison, or payments in kind such as holidays, meals, medical care, or admission to sports spectacles.

Almost all blood supplied in Britain, on the other hand, is, according to Titmuss, given freely “to unnamed strangers, there (being) no formal contract, no legal bond, no situation of power, domination, constraint or compulsion, no sense of shame or guilt, no gratitude imperative, no need for penitence, no money and no explicit guarantee of or wish for a reward or a return gift. They are acts of free will; of the exercise of choice; of conscience without shame.”

Of the two systems for securing supplies of blood, Titmuss prefers the British to the American. His grounds are divided into two parts which he calls ethical and economic. We shall discuss the ethics of the question first, leaving the economics to later.

Titmuss' ethical case against the purchase and sale of blood is: it represses the expression of altruism; it erodes the sense of community; it sanctions the making of profits in hospitals and clinical laboratories; it legalizes hostility between doctor and patient; it subjects critical areas of medicine to the laws of the marketplace; it places social costs upon those least able to bear them—the poor, the sick and the inept; it increases the danger of unethical behavior in various sectors of medical science and practice; and it results in situations in which proportionately more and more blood is supplied by the poor, the unskilled, the unemployed, Negroes and other low income groups and categories of exploited human populations of high blood yielders so that blood is redistributed from the poor to the rich.

The ethical case against the commercial transaction of body parts appears in the literature repeatedly. The Ciba Foundation assembled a group of medical practitioners and researchers, teachers of medicine and the law, lawyers and judges, and theologians in 1966 to discuss ethics in medical progress with special reference to transplantation. The reported discussions at that symposium contain frequent references to the “unsavory” character of money exchange for organs. The basic rule, J. Hamburger said, “must be to avoid any kind of pressure (including financial) on the prospective donor.” R.Y. Calne said it is “most deplorable to condone” the sale of organs for money and “a doctor should not be involved in such a financial contract”.

Since society is willing to pay people to put their lives and health at risk in hazardous occupations, it is difficult to see why it should be thought objectionable to risk impairment by the sale of tissue.

The proscription by medical practitioners, on ethical grounds, of commerce in organs and tissue puts power into the hands of the doctors and involves surgeons specialized to transplantation in arduous discussion and the construction of tortured distinctions in defining acceptable behavior.

Justice Cardozo said that each had property rights in his own body, but a conspiracy of physicians has greatly reduced the value of those rights or, possibly, the physicians have taken possession, by collusive fiat, of property rights in the bodies of all.

It is as though a coalition of plumbers had agreed that none of them would install bathroom fixtures that a householder had secured in exchange for money but only those altruistically given away by appliance manufacturers. To this the doctors might respond, “Ours is a different case; we exercise a profession that cares for the health of the citizenry”. But, of course, so do plumbers as anyone knows whose drinking water has been polluted by seepage from sewer drains.

When the doctors decide the rules that will govern whether they will take tissue from a supplier and install it in a host, they either take no account of the utility functions of supplier and host or they must estimate those functions. Since preference ordering and weights are best known by each for himself estimational outcomes are almost bound to be wrong. Decision-making by doctors, therefore, means that aggregate utility is less than maximized.

An exchange system that maximized the community's utility would be required to have properties that took into reckoning, too, the preferences of the doctor; he is optimally the proprietor of his own services and should be able to refuse to sell them. He would not want to execute a graft that would extinguish, with a high probability, the lives of both supplier and recipient because, if he did this often enough, he would find himself to be reputed to be a bad risk as a surgeon and custom would be driven from his door. Alternatively, he might be willing to engage in such an enterprise occasionally, tissue donor and recipient freely desiring its execution, if he were paid a fee that was somewhat higher than the discounted value of diminished and foregone lifetime income produced by failure.

A utility maximizing arrangement would be one in which the preferences of all participants—donor, doctor and recipient—affected the outcome. Such an arrangement permits all freely to decide whether to participate, each calculating personal costs and gains. Such a system is not achieved, if doctors are constrained in choice by rules elaborated by the profession and enforced by such possible sanctions as divestiture of license, ostracism by colleagues, or denial of the right to use hospital, laboratory, or research facilities.

We have such constraining rules in practice although their explicit forms are still unsettled. Under the guise of constructing standards of acceptable professional behavior that have nothing to do with medical outcomes, doctors decide which suppliers' offers of organs and tissues will be accepted and which will be rejected, which organs they will take from living suppliers and which they will take only from cadavers, which aspirant recipients of tissue they will service and which they will not. By this decision-rule system, the medical community imposes its own ethical values upon the lay community; this is clearly to be dispreferred to market arrangements that require consensus of all central participants as an antecedent to action. Then the ethics of all come to influence outcomes.

In any case, the controlling rule of the doctors is a nonsense rule. They will not graft, they say, unless the donor freely and voluntarily gives an organ without "pressure", including without the "pressure" of money payments. They will want psychiatric evidence that a twin gives out of love for his sibling. But they will not inquire whether it is because a man dearly loves his child that he offers to sell a healthy kidney to procure income with which to pay for the child's schooling. They do not see that money can be an instrument for the expression of love. Nor do they see that participation in an act of exchange involving reciprocal payments—an organ for money—can also be a free and voluntary act.

It has already been mentioned that R.M. Titmuss had made a case, "on economics grounds", against the purchase and sale of blood. The case mainly consists of the following.

Paying for blood gives suppliers an incentive to falsify its quality by suppressing information of past histories of serum hepatitis, malaria, syphilis and brucellosis, all of which can be transmitted by blood transfusion.

This is thought to be particularly important in the case of serum hepatitis because laboratory tests for screening out blood from hepatic suppliers do not exist; they are known only ex post when recipients come down with the disease after an incubation of about six months. Titmuss' review of the literature shows that the hepatitis transfusion rate is higher in the United States than in Britain. The risk of infection by hepatitis is enlarged if plasma is prepared in large pools (say of more than ten donors). Large pools tend to be formed in the United States and small pools tend to be formed in Britain. Plasma production unit costs exhibit the property of increasing returns to scale and it is for this reason that large pools are formed in the United States.

Titmuss argues, too, that the commercial blood market in the United States generates waste in the form of unused stocks of blood that are discarded because the blood—a perishable commodity—is kept longer than its shelf-life and because doctors do not use blood that they order in excess of their requirements.

He also argues that shortages develop in blood market economies in periods of peak demand such as weekends, the summer months, and at Christmastime when increased motoring produces accidental injuries that are especially blood-consuming in their repair.

The appropriate measure of the comparative efficiency of the two systems for collecting blood does not appear in Titmuss' calculus. That measure is the comparative quanta of real resources employed in the collection of a stock of some magnitude, in its storage, and in its re-distribution in space.

Titmuss' "economic" critique of the blood market does not hold up under examination. It is true that laboratories cannot screen out blood from hepatic suppliers. But the market can do so. It is known that the incidence of histories of hepatitis varies with the social class of the suppliers. Since there are gains to be made from keeping separate blood coming from different social classes, it would not be surprising to discover firms who certify that they have blood taken from sub-sets of the population in which the incidence of hepatitis is low. It does not matter very much whether individual suppliers give false information or not about their medical histories. The probabilities of infection through transfusion will vary among lots and the probability numbers will be known more or less. Firms may, of course, falsely certify but, if they co, they would be presumably subject to suit for recovery of damages done by their falseness and this will tend to compel truthfulness in them. And, in any case, systematic false certification will, in time, come to be known and competition will deprive a firm engaged in such activities of custom. We would expect, of course, that the market will establish a higher price for high-quality blood and a lower price for low-quality blood. Buyers would be free to choose among the distinguishable classes of blood, taking account of the magnitudes of qualitative difference and the differences in prices.

Similarly, one would expect the market to distinguish plasma formed in large- and small-pools, giving buyers the option of one or the other. Rational choosers might well prefer to run a very small additional risk of contracting hepatitis in order to achieve a very large saving in cost.

Discarding outdated blood may not be wasteful at all. Stocks of blood are kept by hospitals, blood banks, and other institutions and they are kept by surgeons incidentally in the execution of given, particular surgical operations.

The demand for blood is characterized by peaks and troughs. There is a stochastic component in the set of variables that determines the time-distribution of demand.

Institutions may "insure" against running out of stock by keeping somewhat larger inventories. If it turns out ex post that the inventories were too large, some blood becomes outdated. But if they had underestimated, it might have been at the cost of impairment of life. It might be socially cheaper to discard some blood than to run the risk of exhausted stocks when they are needed.

Similarly with respect to the individual surgeon. Until he cuts he does not know with perfect certainty how many units he will need to transfuse to his patient. If it turns out that he has overstocked, his ex ante decision was not necessarily wrong. He had diminished risk. That has value and that value may exceed the value of the discarded blood.

And, finally, if shortages occur in peak accidental injury periods, the market need only offer higher prices to suppliers in those periods to bring forth larger flows.

The first successful kidney transplant was done in 1954. Approximately ten years later, the Registry of Human Kidney Transplants had a record of 627 kidney transplants. N.P. Couch has calculated that, in 1963 alone, 7,644 deaths occured in the United States of persons who qualified for transplants and whose lives might have been prolonged, if transplantation had been done. Couch also estimated that, of those who died of liver ailments in 1963, there were about 4,000 potentia liver transplants recipients.

The best cadaveric candidates for supplying kidneys and livers are those who die of subarachnoid hemorrhage. They could have supplied in 1963 about 10,600 kidneys and about 6,000 livers, according to Couch.

M.F.A. Woodruff estimates that about 2,000 persons die in Britain each year who could be kept alive with an expectation of life of 45 years at the mean by either kidney transplants or twice-weekly dialysis. This implies, as an alternative to these 2,000 per annum deaths, either 2,000 kidney transplants per year or nine million dialyses per year.

Some progress has recently been made in the discovery of more efficient chemo-therapeutic agents for diminishing the antigenic rejection of grafts by the host and the possibility of preventing death by transplantation is enormously higher now than it was a few decades ago.

The fruitful application of new knowledge in this field, however, requires that supplies of organs and tissue make themselves available in circumstances of extraordinarily complex logistical problems that derive from the perishability of organs in cadavers and the necessity to find suppliers who are histo-compatible with recipients.

One way to secure these supplies is to permit the sale of organs and tissue. They could be sold by living suppliers to be taken during life or after death from themselves. They could be sold by kinfolk upon the death of a member of the family. Buyers might be permitted to re-sell, although how much of this could be done would depend upon the length of time for which preservation techniques prevent excessive deterioration.

It surely does not help patients dying of nephritis or hepatoma, if kidneys and livers are made available, if and only if a money price is paid for them, but doctors stand in the way because they find commerce ethically offensive.

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The Education Of Lord Acton
Robert L. Schuettinger

The relevance of Lord Acton for the twentieth century, according to one of his editors, "comes from his prophetic preoccupation with the very questions with which the twentieth century has found itself preoccupied. The great objects of his studies in history were the moral ends of government, the relations of politics to morality, and these are the questions which bitter experience has forced our age to think about more urgently than the Victorians needed to do."1

The great historian of liberty and educator of both Catholics and liberals was never in his life a stranger to the corridors of power, both sacred and profane. For over forty years he was a member of one or the other of the Houses of Parliament; the rough-and-tumble world of polemical journalism was not unknown to him; nor were the most merciless lists of all, the back-alleyways of academic and ecclesiastical intrigue.

He came from an aristocratic and cosmopolitan background. He had an Italian birthplace, an English father, a French-German-Italian mother, a supra-national religion and scores of relatives in high places in Church and State in most of the nations of Europe. His ideas came from many sources; his own philosophy of liberal Catholicism was drawn from traditional conservatism and the newer classical liberals of his own time. With Burke and Tocqueville he was convinced that a liberal and just government could not long exist unless it were founded on moral principles: on reverence for God and respect for the rights and dignity of men. "Liberalism," he once wrote, "is ultimately founded on the idea of conscience." Throughout his life, these were his two great concerns: freedom and morality. He was absolutely convinced one could not exist without the other and that both were required for the fulfillment of man's purpose on this earth.

By examining his early formal education we may see more clearly how the ideas of the great historian of liberty were formed. Lord Acton's schooling, in four countries (Saint Nicolas in France, Oscott in England, the University of Edinburgh in Scotland and the University of Munich in Bavaria) was fully as cosmopolitan as his family life. Following the movements of his parents, Sir Ferdinand and Lady Acton, between their homes in Aldenham, Paris, Naples, Herrnsheim and London, Acton soon learned to speak French fluently and was duly entered in the preparatory seminary of Saint Nicolas du Chardonnet in Paris in the year 1842.

Acton's first teacher was Monsignor Felix Dupanloup. Like the other two priests who were to influence his intellectual development, Cardinal Wisemar and Professor Dollinger, Dupanloup was also a prominent theologian, with ideas of his own on how Peter's bark should be piloted. As the clerical spokesman for the liberal wing of French Catholicism he was deeply involved in the attempt to reconcile the liberal state with the Catholic Church. At the Vatican Council he was to be part of the minority faction which held the definition of papal infallibility to be inopportune. Although liberal, his place in the Church seemed secure; he had been tutor to the royal princes and had received much acclaim for his part in the death-bed reconciliation of Talleyrand with Rome. (When the wiliest of diplomats was about to receive the last rites, he turned his palms downward and said, “Remember, I am a bishop.”)

In 1849, the liberal monsignor was to be elevated to the see of Orleans. A few years later Bishop Dupanloup was to be elected to the French Academy; at about the same time he helped to reorganize the liberal Catholic journal Le Correspondant. He had been a friend and confessor to both the Dalbergs and the Actons and had assisted at the death of Sir Ferdinand Acton. His mother's frequent visits to Paris, Acton later said, were for the dual purpose of visiting her dressmaker and going to confession to Fr. Dupanloup.

When Acton entered the school in 1842, Fr. Dupanloup as the new supervisor had just changed the rules to permit boys who did not intend to enter holy orders to be enrolled. Acton remained at St. Nicolas for only nine months, however. Since the boy was expected to matriculate at Cambridge, as his father and uncle had done before him, the family thought it more suitable that his preparatory education should be in England. Accordingly he was sent to St. Mary's, Oscott, an institution which liked to boast that it was now what Eton once was: “a school for Catholic gentlemen.” Their official announcement, in fact, promised to teach all those branches of learning “becoming either a scholar or a gentleman.” (Emphasis supplied.)

The college at the time was under the presidency of the Right Reverend Nicholas Wiseman, titular bishop of Melipotamus, and destined to wear a Cardinal's hat. Dr. Henry Weedall, his predecessor, who was largely responsible for the growth of the college, was now in charge of the preparatory school. Through a series of moves in the ecclesiastical hierarchy, in which Acton's uncle (then Monsignor Acton) was involved, Dr. Weedall found himself, in his last years, in this relatively humble office. He was an old Catholic gentleman who belonged to the old world when Catholics desired nothing more than to be left in peace. He was thought to be too unassuming and lacking in aggressiveness. This was definitely not the mood of the militant Bishop Wiseman, who felt that “We are like the Jews returned to Jerusalem or like the first family after the Flood - we have to reconstruct everything.”[2]

The future Cardinal had arrived at Oscott shortly after the beginning of the Oxford Movement. Wiseman looked upon this intellectual faction within the Church of England as the foothold upon which he and his Church would build in order gradually to re-convert Britain to the orthodox faith. As things turned out, many of the leaders of the Oxford Movement, which had its origins in the publication of the famous “Tracts of the Times” in 1833, remained High Church Anglicans and did not go over to the Roman communion, despite their sympathies with the ancient church. John Keble and Dr. Edward Pusey, for instance, though they did much to widen the understanding of Anglicans of the Church of Rome, did not make the final break. John Henry Newman, of course, did take the Roman sacraments and was received into the Church at Oscott while Acton was still a student there in October of 1845. The most distinguished of English converts took up residence in the old college buildings, renamed Maryvale.

Encouraged by the small but steady trickle of converts who moved from Oxford to Oscott, Wiseman was convinced that Britain would soon be a Catholic nation once again and that Oscott, strategically placed as it was, was to be the prime mover in this turning point in history. Acton later recalled that Wiseman seemed to take personal satisfaction at each new "conquest" for Rome; "The converts used to appear among us and he seemed to exhibit their scalps," Acton wrote.3

Some of the less far-sighted of the Catholic parents and neighboring clergy sometimes thought that the good Bishop wasn't giving enough of his attention to the job he was being paid for, namely the education of his young charges. To these men of little faith, Wiseman haughtily replied: "Among the providential agencies that seemed justly timed, and even necessary for it (the re-conversion of England) appeared to me the erection of this noble college, in the very heart of England. Often in my darkest days and hours, feeling as if alone in my hopes, have I walked in front of it, and casting my eyes toward it, exclaimed to myself, 'No, it was not to educate a few boys that this was erected, but to the rallying point of the yet silent but vast movement toward the Catholic Church, which has commenced and must prosper.' I felt as assured of this as if the word of prophecy had spoken it."4

Through the outer-directed efforts of its president, a continual train of distinguished men visited Oscott, English nobility, French royalty, famous statesmen both sacred and profane, philosophers and theologians. As Acton later recalled, "We used to see Wiseman with Lord Shrewsbury, with O'Connell, with Father Mathew, with a Mesopotamian patriarch, with Newman ... and we had a feeling that Oscott, next to Pekin, was a centre of the World."5

The faculty of Oscott was by no means provincial, but was drawn from a wide variety of sources. There were, of course, many Oxford converts, some earlier Cambridge converts (including the vice-president, Henry Logan, a Scotsman by birth), Irish Catholics, local midland clergy and some others whom Wiseman had brought with him from Rome. Acton thought later that Wiseman failed to integrate properly these diverse elements or inspire them in any one direction. "The point is," Acton wrote, "that he was an all-round person, and we did not clearly see his drift."6 Wiseman himself was an Ultramontane: that is, he belonged to that party in the Church which favored centralization of power in the papacy. However, he sometimes had visitors to Oscott who would lecture on both points of view within the Church; for instance, he once invited Vincenzo Gioberti, well-known for his belief in the separation of Church and State, and on another occasion invited one of Gioberti's principal opponents, Antonio Rosmini. In later life, Acton was to be critical of his old school; he once wrote to his co-editor, Richard Simpson, that he had recently sent a letter to a friend on the students and divines of Oscott "compared to which X.Y.Z. is a panegyrist, and in February (the friend) told me that things were a good deal worse than I described."7 While he was there, however, he seems to have been perfectly content and making great progress academically. He once sent the following letter to his mother, written at the age of ten.

"Dearest Mamma,—I received your letter this morning and shall tell you what you told me—nothing but good news.... I am now happier here than I have ever been. I am very much liked by the boys, and excell in two principal things: I am the best chess player of all the boys except four, and I am the best pick-pocket (of pocket handkerchiefs) ever known.... I am a perfect linguist, knowing perfectly—that is, so as to be able to speak them—English, French, German, and can almost speak Latin. I can speak a few words of Italian, Chinese, Greek, Italian, Spanish and Irish. I also know Chemistry, Astronomy, Mechanics, and many other sciences, but do not know botany. I am very happy here and perfectly reconciled to the thoughts of stopping here seven more years.—I am in a hurry, therefore good-bye,

Caesar Agamemnon John Dalberg Acton”8

In 1848, at the age of fourteen, Acton left Oscott, and spent the next two years at the University of Edinburgh under the tutelage of Henry Logan, former vice-president of Oscott. It was the fashion among young English gentlemen of this period, especially those with an interest in scholarship, to spend a year or two at one of the Scottish universities either before or after Oxford or Cambridge. In Acton's case, we may presume that he was taking his Scottish interlude in preparation for his entrance into Cambridge. He applied in 1849 and again in 1850 to Magdalene College, Cambridge, where both his father and uncle had been undergraduates. Magdalene, however, was probably worried about the rash of converts to Catholicism which had been unsettling its common-room at the very time Acton applied; accordingly the future Regius Professor of Modern History was refused admission as a student. Two other Cambridge colleges gave the same answer and, in what for a Cambridge family must have been a last gamble, two Oxford colleges received Acton's application. The answer was everywhere the same.9 It was hoped that at least he would learn Greek while at Edinburgh, but after two years he left, dissatisfied with his progress and knowing no more than 500 words of the language.10 The home of the Edinburgh Review, however, must have had some effect on his thought and since he later told a friend that he left Scotland stuffed with Macaulay and raw Whiggery we may assume that that citadel of liberalism had done its work.

Acton's intellectual journey next took him to Munich where in June 1850 he came to live at the house of Professor Johann Ignaz von Dollinger. Munich was chosen as the place for him to continue his studies for several reasons; not only was it a seat of Catholic learning at the time, but it was also the home of his mother's relatives, the Arco-Valleys. Count Arco-Valley (whose daughter Acton later married) had known Dollinger for years; accordingly arrangements were made for him to stay with the Professor in Munich and to visit the Arco-Valley country house at Tergensee on weekends.

Although a priest, Dr. Dollinger was primarily concerned with the life of the mind; he had refused the archbishopric of Salzburg because it would have interfered with his scholarship. Generally considered to be one of the greatest historical scholars in Europe, he was to be more influential than any other single individual on Acton's intellectual development. In the opinion of Miss Gertrude Himmelfarb, “The most decisive fact of Acton's life was his apprenticeship under Dollinger.”11 The priest-scholar was a humble man with the simple tastes and standards of the German bourgeoisie. He was himself the son of a professor of anatomy at the University of

Wurzburg. “His personal appearance,” Acton wrote to his stepfather, “is certainly not prepossessing. His forehead is not particularly large, and a somewhat malevolent grin seems constantly to reside about his wide, low mouth.”12

Despite the minimum of flattery in Acton's description (which is perhaps the inevitable student-teacher relationship on the first day of class) the young Englishman had great respect for the scholar's enormous capacity for work and his austere manner of life. He seemed to be the personification of the cold, dispassionate scholar, interested in nothing but the plain search for truth for its own sake.

Catholic scholarship throughout most of the world in the nineteenth century was in a lethargic condition. The University of Munich by contrast was in the midst of intellectual ferment. At the beginning of the century Protestant scholarship had taken the lead in the German universities. Men such as Ferdinand Baur and David Strauss broke new ground in Biblical criticism, B.G. Niebuhr and Leopold von Ranke were developing whole new schools of history and Friedrich von Schelling and Friedrich Schleiermacher were attracting international attention for their work in the philosophy of religion. The Catholic scholars of Tubingen and Munich took it upon themselves to explore such problems as the relationship of science and religion or the historical analysis of the Old Testament. Their goal was to make Catholicism intellectually respectable by the standards of the most rigorous secular philosopher or historian. They succeeded so well in this task that for decades Munich was the intellectual center of world Catholicism.

Upon Acton's arrival in Munich he threw himself into a course of study as broad and as demanding as the Professor's own schedule. During his first few enthusiastic weeks, Acton later recalled, he read the whole of the Biographie Universelle - a work of some fifty-five volumes. “My day,” he wrote to his stepfather, now Earl Granville, “is portioned out something in this manner - I breakfast at 8 - then two hours of German - an hour of Plutarch and an hour of Tacitus. This proportion was recommended by the Professor. We dine a little before 2 - I see him then for the first time in the day. At 3 my German tutor master comes. From 4 till 7 I am out - I read modern history for an hour - having had an hour's ancient history just before dinner. I have some tea at 8 and study English literature and composition till 10 - when the curtain falls.”13

A few years later Acton, as a more mature scholar, explained his personal philosophy of education to Lord Granville. He admitted that his studies at first glance seemed to be useless or unrelated. There was, however, definite unity in his method. He studied English history, the classics, the history of the Middle Ages and of the Church, theology and the history of philosophy in order to prepare himself both for a role in public life and to lay the foundation for an academic career as a serious writer, not as a dilettante. The common theme that united all his studies, he said, was history; his academic goal was to become an original historian and to teach others of his countrymen to become the same.14 His political goal was to promote in both Church and State the supremacy of principles over interests, of liberty over despotism (whether from above or below), and of plain truth over evasion and rationalization. “He had no desire,” two of his editors note, “to make of intellectual pursuits an end in themselves. His scholarship was to him as practical as his politics, and his politics as ethical as his faith."15

In the 1850's both Dollinger and his young student grew out of some of their intellectual shells and both changed their minds on a number of important issues. Almost on his arrival Acton was told to read Burke in order to broaden his mind and as an antidote to Macaulay; Dollinger had an aversion to Macaulay but recommended Bacon, Newman and especially Burke's Letters on a Regicide Peace, which the Professor called "the literary starting point of Legitimism."16 At the beginning of Acton's stay in Munich, Dollinger, like most of the Munich faculty, was an Ultramontane and monarchist who saw little wrong with the status quo. He was comfortable in his life and derived satisfaction from being an industrious scholar, a loyal subject of the king and a devoted servant of the pope.

Dollinger's first serious quarrel with Rome was in 1854 over the proclamation of the dogma of the Immaculate Conception of Mary. Although there was a long tradition in the Church which maintained that Mary was herself conceived without original sin, Dollinger opposed the intended proclamation on three main grounds. First, he asserted that historically it was not held to be a divinely revealed truth and that many leading Catholic scholars, including St. Thomas Aquinas, had demurred to it. Secondly, it was to be decreed by Pope Pius IX on his own authority without the confirmation of a council of the Church. Thirdly he believed that unnecessary additions to the creed would serve only to make the Catholic Church more isolated and further divide it from the Protestants. After the new dogma was officially proclaimed, however, Dollinger accepted it and consoled himself with the thought that he had fought it as long as possible. Pius XI's early exercise of papal infallibility in this matter foreshadowed the more serious struggle that was to come in 1870 when papal infallibility in faith and morals was itself to be proclaimed by the same Pope as binding on all Catholics.

The latter doctrine was to be ratified by a council of the Church, which presumably vitiated at least one of Dollinger's procedural objections. At that time, however, Dollinger was not to submit; he and a small minority left the Roman Catholic communion and called themselves Old Catholics, continuing to venerate every dogma of the Catholic Church but the last.

The basic transformation of Dollinger's intellectual outlook which ultimately led to his excommunication took place in those years when he and Acton lived together in Munich. On Acton's side there is little doubt that he acquired his lifelong distrust of ecclesiastical power largely as a result of his participation in these early battles in the '50s.

The old Dollinger would have, in fact did, join in condeming any Catholic philosopher or theologian who inquired too deeply into matters which earned him the wrath of Rome. In 1835 a leading German theologian, Georg Hermes, was officially condemned by the Church for over-emphasizing natural reason and nationalistic religion in the tradition of Kant. At that time Dollinger saw nothing improper in this proceeding. Two decades later, however, a similar controversy erupted over the theological works of Anton von Gunther and Jakob Frohschammer. The first philosopher maintained that science and religion were co-equal in the area of scholarship and that science could assert its own truths independent of the teachings of religion. The second writer, Frohschammer, went farther than this and claimed that science must take precedence over religion. In this case, Dollinger reversed his earlier position and came to the defence of the alleged heretics. If Rome were to silence every serious thinker who attempted to explore problems such as the relationship of religion and science, he insisted, Catholic scholarship would be reduced to sterile servility. There must be at least a reasonable amount of freedom of thought for Catholic intellectuals, he said, if the universities were not to become centers of stagnation. Dollinger's efforts met with a cold rebuff, however, and the two scholars were duly condemned.

Dollinger's work in the theory of development, that is, the notion that moral truths and religious dogmas were not fixed for eternity but instead changed and developed as man's civilization and understanding advanced, was eventually to lead the Professor into irreconcilable conflict with the Church. Miss Gertrude Himmelfarb, in her masterly biography Lord Acton: A Study of Conscience in Politics, asserts that it was from Dollinger and not from Newman that Acton adopted his own theory of development. “The theory....” Miss Himmelfarb notes, “is more popularly known in the form given it by Newman in his Essay on the Development of Christian Doctrine of 1845 ... Newman was unfamiliar with German theology, with the work of Brey, Mohler or Dollinger, and it appears that he arrived at the theory independently.”[17] The fundamental idea is of course not new; its origins go back at least as far as the efforts of such men as Gottfried Leibniz, Jean Mabillon, John Robinson and Petavius.[18] Inherent in this way of studying religion are implications which eventually took both Acton and Dollinger to the very limits of the orthodoxy of the nineteenth-century church. Ironically enough, it was the influence of this same theory that led Dollinger to leave the Church after the Vatican Council had persuaded Acton to remain in it. Just because Acton never in his life doubted a dogma of the Church[19] he had nothing to fear from the most rigorous historical criticism of church history or doctrine.

He was convinced, for example, that the Resurrection was an historical fact in the same sense as the Battle of Waterloo was a fact and could be documented by all the usual rules of historical evidence. He had little patience with historians who refused, for one reason or another, to deal with facts. Of F.C. von Baur he once wrote, “According to Baur, the business of history is not so much with facts as with ideas; and the idea, not the fact, of the Resurrection is the basis of the Christian faith. Doctrines are developed out of notions, not out of events. Whether or not the belief is true, he refuses to inquire. In the most characteristic passage ever written by a German historian, he declares that it is a question beyond the scope of history.”[20]

In Acton's interpretation, the theory of development meant that “the action of Christ who is risen on mankind ... fails not, but increases; that the wisdom of divine rule appears not in the perfection but in the improvement of the world; and that achieved liberty is the one ethical result that rests on the converging and combined conditions of advancing civilization ... History is the true demonstration of Religion.”[21] This view, that God will ultimately make clear in his own good time what may appear to us now to be wrong or unjust, enabled Acton to reconcile his submission to the Vatican Decrees with his conscience. As will be seen, Acton believed that God would not allow his Church to remain for long in a grossly imperfect state; that time would “perfect” the doctrine of Papal Infallibility. As we also know, Dollinger did not agree with this interpretation of his former student and left the Catholic Church shortly after the Council.

Once a year, during Acton's residence at the University from 1850 to 1858, he and Dollinger set off on a tour of Italy, England, Austria or Switzerland or Germany, stopping to see old friends or to meet new ones or to attend scholarly conferences. These tours were an important part of Acton's education. Together they explored libraries and bookstores voraciously; they applied at first hand the modern historical techniques of manuscript research learned from von Ranke's lectures on the “new” history at Munich. These journeys revolutionized the attitudes of both Dollinger and Acton to history as well as to the Church. For Dollinger it meant that the work of decades was suddenly obsolete. For Acton, however, it meant that the young historian had found his purpose in life: to aid in that “full exposition of truth which is the great object for which the existence of man is prolonged on earth.”22

Looking back on his Munich experiences after many years of independent scholarship, Acton was inclined to revise his original estimate of the university and even of Dollinger. The Munich faculty, he wrote, was “not remarkable for originality or freshness, or warmth, or play of mind.” He thought them too committed to “defending a settled cause” to start a voyage of discovery. Dollinger, Acton thought, was overly interested in the Romantic school of historical writing and in criticizing Protestant versions of history.23 Apparently Dollinger was successful in teaching Acton many important aspects of the historian's craft; he was not, however, able to impart to his student the attitudes and techniques needed for sustained work. Dollinger himself predicted that if Acton did not write a major book before he was forty he never would.24 In later life Acton was to feel that Munich, like Oscott, had somehow let him down.

Although he spent eight years attending lectures and studying at the University of Munich, he never took a degree. (This oversight was corrected in 1872 when the faculty of Munich awarded Acton an honorary doctorate.) It is doubtful, however, if this changed his attitude toward German universities. In 1867, almost ten years after leaving Munich, Acton wrote an essay on German education which might well have been written about one of the many “multi-versities” of our own century. The function of the German universities, he wrote, “was to prepare candidates for public employment and to teach things necessary to be known in order to obtain a salary under government or in the Church, as a doctor or a schoolmaster. They existed to promote certain public objects of society, not to promote the independent ends of literature and science. They suffer alike from the want of liberty and the want of discipline. They are subject to the patronage of the State and they exert no effective restraint over the lives of the students. The very theory to which they owe their fame and influence has done harm, by the utter sacrifice of educational to scientific purposes; for it supplies a more perfect machinery for the production of good books than of good men."[25]

In 1858, his formal education at the University of Munich completed, Acton returned to England to employ his wealth and education as best he could in order to bring liberalism to his fellow-Catholics, Catholicism to his fellow-liberals and the discoveries and techniques of German historical research to both.

Footnotes

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Chicago Monetary Tradition In The Light Of Austrian Theory Hans F. Sennholz

In the diversity of contemporary American monetary thought the new neoclassicism of the Chicago School has assumed an intellectual position that probably equals that of the new economics. Chicago monetary thought has invaded in force not only the American academy and the deliberations and actions of the Federal Reserve Board, but also the halls of Congress and the economic reports and policies of the President. This remarkable development is also reflected in the growing popularity and prestige now accorded to Milton Friedman, the most influential economist of the Chicago tradition.

We rejoice about this new trend in monetary thought and are appreciative of the effective Chicagoan challenge to the Keynesian orthodoxy. The analytical depth, scientific precision, and overwhelming empirical evidence offered by Professor Friedman and his colleagues have shattered many a cherished doctrine of the new economics and thereby given new life to neoclassicism. In an age of Keynesian supremacy when the discussion of money had given way to debates on the techniques of fine-tuning through fiscal measures the Chicagoans restored money to its rightful place. They successfully reconstructed a version of the quantity theory of money and re-emphasized the importance of monetary policy. And last but not least, they levelled devastating criticism at official monetary managers for having generated feverish booms and disastrous recessions through gross mismanagement of our money.

And yet, this writer casts doubt on the cogency and durability of this new neoclassism. In our judgment, it is built on the quicksand of macro-economic analysis; it misinterprets the business cycles and therefore is bound to fail as policy guide for economic stability; it is inherently inflationary as it makes government the guardian of our money. The intellectual forebears of this new neoclassicism were three Englishmen and one American: William S. Jevons, Alfred Marshall, Ralph G. Hawtrey, and Irving Fisher. As, a generation ago, their tenets gave way to the new economics of John Maynard Keynes, Alvin H. Hansen and Abba P. Lerner, so is the new neoclassicism itself destined to surrender to more statist doctrines. After all, it puts government in charge of economic stability and then prescribes monetary policies that will continue to generate business cycles. Inevitably, frustration and disappointment tend to breed demands for more government intervention.

Almost 100 years ago WILLIAM STANLEY JEVONS had attempted “to substitute exact inquiries, exact numerical calculations, for guesswork and groundless argument” in his analysis of quantitative data on prices and business movements.[1] In a paper on “The Variation of Prices, and the Value of the Currency since 1782” Jevons studied the changing purchasing power of money between 1782 and 1865. He concluded his analysis with the following comment on gold: “in itself gold-digging has ever seemed to me almost a dead loss of labor as regards the world in general—a wrong against the human race, just such as is that of a government against its people, in overissuing and depreciating its own currency.”[2] Instead, Jevons favored a “tabular standard of value" which his own work on index numbers was supposed to promote. He was convinced that some day this system would come into use and that gold coins would cease to be the principal media of exchange.3

ALFRED MARSHALL lent his support to the Jevons plan. Mindful of the great changes in the purchasing power of money and their detrimental effects on contractual relationships, he searched for a stable monetary unit. In a proposal to the Royal Commission on the Depression of Trade and Industry, in 1886, he urged the government to publish tables showing changes in the purchasing power of money so that contracts could be made in terms of units of constant purchasing power.4 Professor Marshall introduced the great dichotomy that continues to guide most contemporary economists, that is, the separation of the micro sphere in which individual prices are determined by supply and demand, from the macro sphere in which the total supply of money and its velocity determine the value of money and the price level.5 Although Marshall did not draw the political conclusion from this doctrine, his followers in Great Britain and America later went the final step: they called on government for price level stabilization through manipulation of the quantity of money stock.

RALPH G. HAWTREY, an economist connected with the British Treasury from 1919 to 1937, developed a purely monetary theory of business cycle on a macro-economic concept of equilibrium. Changes in the flow of currency, in particular bank credit, cause instability in production and employment. At first, total bank credit expands as interest rates are reduced. Total demand for finished goods rises, which causes prices to rise. Businessmen use easy money to expand their inventories. The expansion of credit thus causes incomes to rise, which eventually leads to more currency passing into circulation. And under the gold standard this currency has to be either gold coin or paper money backed by gold. But such a demand encroaches on the available supplies of gold in all gold standard countries and especially in central banks. According to Hawtrey, "the flow of currency into circulation in such circumstances is very gradual, and lags far behind the expansion of credit which causes it. The result is that, if the authorities controlling credit are guided in their action by the adequacy of their stock of gold, their intervention is bound to be very tardy. And the expansion and contraction of credit are both likely to be very slow processes in a group of countries which are all made to keep pace with one another by the rather cumbersome expedient of gold movements."6

In short, the trade cycle which is a credit phenomenon is caused by the defects of the gold standard as a regulator of credit. Guided by their gold reserves the monetary authorities intervene too slowly first in the restriction of bank credit and then in the expansion during periods of recession. The Great Depression, according to Hawtrey, was the result of such defects. Throughout those baneful years he called for more credit expansion by the central banks as the only remedy for unemployment.7 In 1962 Hawtrey restated his conclusion: "When we look back on the monetary experience we have had since 1932, surely the moral to be drawn from it is above all the importance of maintaining stability of the money unit. The depression of the nineteen thirties was due to the doubling of the wealth-value of gold."8

Similar conclusions were drawn by IRVING FISHER, the American economist who spearheaded the new neoclassicism. "The key to the business failure, and therefore the key to the depression," he wrote in 1933, "is the deflated price level; the key to the deflated price level is monetary deflation; the principal kind of money which deflates is our checking accounts at the banks."[9] This is why Fisher called for reinflation throughout the Great Depression. In particular, he urged President Roosevelt to devalue the dollar and later hailed him for having done so. In fact, Fisher went further. "We might even abandon gold altogether, and resort to a managed currency with no base but paper. Several other nations have done this to their distinct advantage."[10]

Professor Fisher had a simple explanation for business cycles. Credit currency perpetuates its own motion in a sort of vicious circle, or rather a vicious spiral—upward or downward as the case may be. But what determines the direction of the spiral? Fisher gave at least three different answers: (1) the motion springs from completely random, uncoordinated, inexplicable "frenzies of enterprise";[11] (2) "if something big enough hits humanity" the spiral may be set into motion. A war may trigger it. According to this explanation, "the depression grew out of a boom which started in a credit currency boom, which started from a debt boom, which grew out of the World War."[12] And (3), faulty monetary management by the central bank may redirect the motion. In 1928, for instance, the Federal Reserve Board brought the speculative movement to a stop through credit stringency, which then began to be felt in legitimate business.[13]

Fisher's crusading spirit led him to be active in many fields of reform, such as health, conservation, prohibition, the League of Nations, and many others. But throughout his active life he crusaded above all for economic stabilization and monetary reform. In numerous writings he presented his plan for the "compensated dollar," a dollar of constant purchasing power, sometimes called the "commodity dollar." The conventional gold standard was to be replaced by a standard that defined the dollar in terms of constant value, which was to be determined by an index number of commodity prices of a given basket of goods. This commodity standard was to be strengthened further by "100$ money," that is, a cash reserve of 100$ against all demand deposits. A "Currency Commission" would issue new money and turn into cash the assets of every commercial bank so that the cash reserve of each bank would be increased to 100$ of its checking deposits. The new money thus would provide an all-cash backing for the checking accounts without either increasing or decreasing the total stock of money in the country. Thereafter the banks would be required to maintain permanently a 100$ cash reserve against their demand deposits. According to Prof. Fisher, his plan would keep banks 100$ liquid, prevent inflation and deflation, cure or prevent depressions, and wipe out much of the national debt.[14]

The Chicago Tradition

The principal successors to this train of monetary thought from Alfred Marshall to Irving Fisher were economists at the University of Chicago. Frank H. Knight, Jacob Viner, Lloyd Mints, Henry Simons and Milton Friedman have made Chicago an important center of contemporary economic thought. While Prof. Knight greatly strengthened the neoclassical structure with his analysis of the role of profit in economic life, Henry Simons led a fierce attack on Keynes and his American disciples.

Simons' theory of money deserves our attention because it is clearly reflected in contemporary Chicago thought and it points up the differences between the new economics and the new neoclassicism, between the "fiscalists" and the "monetarists." In his attacks on Alven Hansen, the leading academic Keynesian, Prof. Simons not only restated the framework of the quantity theory but also sharply criticized the various Keynesian schemes for recovery from the Great Depression. A virulent critic of Keynes[15] Simons nevertheless revealed a striking similarity in premise and analysis, which, in our judgment, affords a common bond not only for Professors Keynes and Simons but also all fiscalists and monetarists.[16] Surely Lord Keynes basically agreed with Prof. Simons' analysis of the gold standard. In Simons' own words, "the worst financial structure is realized when many nations, with similar financial practices and institutions and similar credit pyramids (and narrowly nationalist commercial policies), adopt the same commodity as the monetary standard. When one thinks of the total potential creditor demands for gold for hoarding, in and after 1929, it seems almost beyond diabolical ingenuity to conceive a financial system better designed for our economic destruction. The anomaly of such a system is perhaps abundantly evident in the strong moral restraints and inhibitions which dissuade many people from exercising their legal rights under it. Given the vagaries of commercial, fiscal, banking, and currency policies in the various countries, and given the character of national financial structures and price rigidities, it is to the writer a source of continued amazement that so many people of insight should hold unwaveringly to the gold standard as the best foundation of national policies. The worship of gold, among obviously sophisticated people, seems explicable only in terms of our lack of success in formulating specifications for a satisfactory, independent national currency ..."[17]

Professors Keynes and Simons also were in basic agreement on the causes that generated the Great Depression. While Keynes lamented about the increase in liquidity and lack of investments, Simons deplored the sharp fall in velocity, which of course, are similar macro-economic phenomena. To Simons "aggregate turnover" needed stimulation, to Keynes it was "aggregate demand." But when it came to the appropriate policies to overcome the depression, Messrs. Simons and Keynes differed noisily. Keynes favored stimulation of investment by immediate government spending, while Simons advocated "definite rules of the game." He called upon government to provide a stable framework of rules for monetary authorities to follow. "In the past," Simons wrote, "governments have grossly neglected their positive responsibility of controlling the currency; private initiative has been allowed too much freedom in determining the character of our financial structure and in directing changes in the quantity of money and money substitutes."[18] To Prof. Simons the rule of price-level stabilization appeared "extremely attractive" either as a definite reform or as a transition expedient toward ultimate stabilization of the quantity of money. But no matter what rule of the game was to be adopted ultimately "the power to issue money and near-money should increasingly be concentrated in the hands of the central government."[19] It is true, Prof. Simons summarily rejected the numerous Keynesian schemes that require discretionary authority rather than "rules of the game." But in spite of his virulent opposition to the new economics he took great pains in keeping even greater distance from the economic principles "to which reactionaries would have us return." For these principles "are perhaps worse than none at all."[20]

The Simons student who has captured the imagination of scores of economists and legislators is MILTON FRIEDMAN. To do justice to such a colorful man who, through his tireless work and great force of persuasion set the agenda for most economic debates of the post-World War II era, is an impossible task. We must therefore limit ourselves, in the pages allotted to this essay, to a few observations on his monetary thought. After a brief presentation of his views we would like to aim our observations at the essential differences between the monetary theories of the Chicago tradition, which Prof. Friedman so brilliantly represents, and the subjective theories of the Austrian School of which Ludwig von Mises is its revered elder. For these differences are greater than the similarities, which we gladly acknowledge in so many other fields of economic analysis. Henry Simons clearly perceived the gap when he rejected the economic principles to which "reactionaries would have us return." It is true, Prof. Friedman has rarely directed his critical pen at the literary efforts of subjective economists. His primary target has been the Keynesian orthodoxy that continues to rule the day. With massive empirical evidence he launched a many-pronged counterattack on the new economics and demonstrated the futility of its policies. Above all, he restored money to a position of importance, which Lord Keynes and his followers had denied it in theory and policy. He emphasized the power of monetary policy and questioned the Keynesian faith in fiscal policy. He reconstructed a version of the quantity theory of money, and then reinterpreted the Great Depression in the light of his theory.

Friedman's position is at apparent odds with that of his Keynesian adversaries. Despairing about unpredictable changes in money velocity they doubt the reliability of monetary policy. In contrast, Friedman postulates a satisfactory stability of velocity, that is, a stable demand for money as a stable function of a limited number of variables that can be specified reliably. Therefore, he concludes, monetary policy can be an important factor of economic stabilization.[21] To Prof. Friedman the quantity theory is as valid now as it was in the past. "There is perhaps no other empirical relation in economics" he writes, "that has been observed to recur so uniformly under so wide a variety of circumstances as the relation between substantial changes over short periods in the stock of money and in prices; the one is invariably linked with the other and is in the same direction; this uniformity is, I suspect, of the same order as many of the uniformities that form the basis of the physical sciences."[22]

The problem of maintaining economic stability is far too complex to be left to fiscal finetuners. Therefore, Prof. Friedman advocates a simple rule for steady monetary expansion, which could either be adopted by the Federal Reserve System itself, or be prescribed by Congress. For maximum price level stability he recommends a rate of increase of 3 to 5 percent per year for currency plus all commercial bank deposits. The particular rate of increase is less important than the adoption of a fixed rate that lies within this range.[23] It is the role of the monetary authorities to provide a stable monetary background that facilitates reasonable economic stability. Countercyclical actions as recommended by the Keynesians usually have destabilizing effects as "there is likely to be a lag between the need for action and government recognition of this need; a further lag between recognition of the need for action and the taking of action; and a still further lag between the action and its effects."24 But there are also considerable time lags between monetary changes and their economic effects. According to Prof. Friedman, "there is a connection which is, on the average, close but which may be quite variable in an individual episode. I have emphasized that the inability to pin down the lag means that there are lots of factors about which I am ignorant. That doesn't mean that money doesn't have a systematic influence. But it does mean that there is a good deal of variability in the influence."25

In fact, changes in the stock of money are mainly responsible for changes in money income, which characterize the business cycles. All major depressions from the 1870's to the 1930's are explained in terms of shrinking money stock. But while Prof. Friedman presents massive statistical evidence he is reluctant to develop a precise business cycle theory that would explain the causal relationships. "It is one thing," according to Friedman, "to assert that monetary changes are the key to major movements in money income; it is quite a different thing to know in any detail what is the mechanism that links monetary change to economic change; how the influence of the one is transmitted to the other; what sectors of the economy will be affected first; what the time pattern of the impacts will be, and so on. We have great confidence in the first assertion. We have little confidence in our knowledge of the transmission mechanism, except in such broad and vague terms as to constitute little more than an impressionistic representation rather than an engineering blueprint."26 But Prof. Friedman is fully convinced that the Great Depression was the inevitable result of a sharp and unprecedented decline in the quantity of money, for which the Federal Reserve System bears the main responsibility. It failed to create the necessary bank reserves that would have maintained price level stability and economic prosperity. The Reserve System did nothing, or even raised its discount rate while hundreds of banks succumbed to bank runs and losses.27

One of the reasons for this deplorable failure of monetary authorities to create the needed reserves, according to Friedman, was their domination by "external forces," that is, by gold movements that dictated inaction or even contraction while the internal situation called for expansion. Therefore, national independence in monetary policy is desirable and should be achieved through immediate suspension of gold payments and freely floating exchange rates. Let the price of gold be determined in the free markets of the world, and not by costly "price support" measures on the part of the U.S. Government, If the free world were to adopt such a system, Prof. Friedman assures us, the countries could enjoy independence of internal monetary policy and maximum international cooperation.28

Austrian Theory

Although our space does not permit us detailed discussions of epistemological differences, we cannot ignore the chasm that separates the Chicago School from the Austrian School in all matters of epistemology. For these differences leave their mark on many economic theories, in particular, monetary theory. The Chicagoans, and especially Prof. Friedman, represent variants of logical positivism, while the Austrians view monetary knowledge in the light of a general theory of human knowledge, called praxeology. The Chicagoans like to don the white robe of scientists whenever they deal with economic phenomena. They are seeking knowledge of which experience is the content. Prof. Friedman's "positive" economics comprises descriptions of economic reality, which hopefully provides the tools for predictions. Disagreements usually are not over ends-in-view, but over predictions regarding the effects of policies aiming at certain ends. They can be resolved by empirical evidence.29 Austrian economists view economics in an entirely different light. To them it is a branch of praxeology which is purely theoretical and systematic. Its doctrines are not derived from experience, but are a priori like those of logic and mathematics, and antecedent to any comprehension of economic facts and events. Economics is not "quantitative" and does not measure human action because there are no constants in individual choice and preference. Austrian economists do not search for better technical methods of measurement because they realize its futility on ontological grounds. Statistical research into economic events offers interesting historical information on nonrepeatable data, but provides no knowledge that is valid universally. It does not afford the material of which economic theories are made, nor does it permit predictions of future events.30

To the Chicagoans the ultimate function of money is the measure of values. From Marshall to Friedman money has been criticized for its lack of stability, which frustrates accurate measurement and thereby precipitated grievous economic and social evils. Above all, monetary instability is held responsible for the business cycles that again and again have inflicted havoc on market economies. If only the price level could be stabilized and thus money be permitted to serve its true function! To the Austrians money is the most marketable good a person can acquire. It is never "idle," nor is it just "in circulation"; it is always in the possession or under the control of someone. The demand for money is subject to the same consideration as that for all other goods and services. People expend labor or forego the enjoyment of goods and services in order to acquire money. Thus individual demand and supply ultimately determine the purchasing power of money in the same way as they determine the mutual exchange ratios of all other goods. The quantity theory of money as understood by Austrian economists is merely another case of the general theory of demand and supply. They reject the quantity theory of the "monetarists" as a manifestation of holistic thought and a tool for government intervention.

It is true, the Chicagoans are familiar with the principles that determine individual prices. But their conclusions are drawn in the sphere of macroeconomics in which the total money supply and a given velocity determine the price level. Here they call on government to take measures to stabilize the level and thus cure the business cycle. In this respect they are akin to the Keynesians who, too, seek stabilization through government manipulation. But while the Keynesians recommend compensatory fiscal policies the Chicagoans realize the futility of continuous finetuning and therefore seek long-term stabilization through a steady 3 to 5 percent expansion of the money supply. In the light of Austrian theory such an expansion of the stock of money would suffice to generate some malinvestments and maladjustments that later necessitate readjustments, that is, recessions. Prof. Mises' trade cycle theory envisions economic booms and busts in every case of credit expansion, from one percent to hundreds of percent. The magnitude of expansion does not negate its effects, it merely determines the severity of the maladjustment and necessary readjustment. Even if most prices should decline while monetary authorities expand credit at a modest rate the injection of fiduciary funds falsifies interest rates and thereby causes erroneous investment decisions. If by discretionary decision of the monetary authorities the expansion should be directed at certain industries, instead of being distributed widely over the loan market, the maladjustments would grow even more serious in the industries thus favored. In short, if the monetary authorities expand fiduciary credit and thereby lower interest rates, economic production is distorted. At first, it generates overinvestment in capital goods and causes their prices to rise while production of consumers' goods is necessarily neglected. But because of lack of real savings the investment boom is bound to run aground. The boom causes factor prices to rise, which are business costs. When profit margins finally falter, a recession develops in the capital goods industry. The recession is a period of readjustment, that is, the malinvestments are liquidated, and the long neglected consumer goods industries once again attract their proper share of resources in accordance with the true consumption-investment ratio.31

The monetarists actually have no business cycle theory, merely a prescription for government to “hold it steady.” From Fisher to Friedman the antidote for depressions has always been the same: reinflation. The central banker who permits credit contraction is the culprit of it all. If there is a recession he must issue more money, and if there is inflation, that is, rising price levels, he must take some out. Prof. Friedman himself seems to be aware of his lack of business cycle theory when he admits “little confidence in our knowledge of the transmission mechanism.” He has no “engineering blueprint,” merely an “impressionistic representation” that monetary changes are “the key to major movements in money income.” His “gap hypothesis,” therefore, is designed to fill the gap of theory and allow for the time it takes for maladjustments to be corrected. It endeavors to time the recession without explaining it.

And yet, the Chicagoans proclaim in loud voices that business recessions in general, and the Great Depression in particular, are the result of monetary contractions. Mistaking symptoms for causes they prescribe policies that would treat the symptoms. But the treatment, which is reinflation, tends to aggravate the maladjustments and delay the necessary readjustment. Thus, Chicagoan monetary policy, wherever practised, would not only prolong the recession but also cause many goods prices to rise throughout the recession. Austrian economists see the Great Depression in an entirely different light. They reject the simplicity of fiscalist and monetarist explanations and, instead, endeavor to analyze specific policies in the light of Austrian theory. In their view, the Great Depression was the inevitable outcome of a series of disastrous policies that first initiated the boom and later prolonged the depression. The first phase had its beginning in 1924 when the Federal Reserve System under the Coolidge Administration embarked upon massive credit expansion. During a short business decline the System decided to create some $500 million in new credit, which led to a bank credit expansion of some $4 billion in less than one year. The Federal Reserve System launched yet another burst in 1927 that lasted through 1928. Some $400 million in new Federal Reserve credit were created, discount rates reduced, and bank credit expansion invited. Consequently total currency outside banks, demand and time deposits in the United States increased from $44.71 billion at the end of June, 1924, to $53.4 billion in 1927, and $57.158 billion in October, 1929.32 The United States government thus was sowing the wind and the people were facing the economic whirlwind, which blows with the inevitability of inexorable economic law. The money and credit expansion by the Coolidge Administration made 1929 inevitable.

By 1930 the American economy had fallen in what today would be called a "recession." Under absence of new causes for depression the following year should have brought recovery through readjustment as it did in all other cycles before. What then precipitated the abysmal collapse that was to follow?

Following a long tradition or GOP hostility toward international trade the Hoover Administration began to curtail foreign imports. The Hawley-Smoot Tariff Act of June, 1930, raised American tariffs to unprecedented levels, which practically closed our borders to foreign goods. According to many economic historians, this was the crowning folly of the whole period from 1920 to 1933 and the beginning of the real depression. "Once we raised our tariffs," wrote Benjamin Anderson in his great treatise, "an irresistible movement all over the world to raise tariffs and to erect other trade barriers, including quotas, began. Protectionism ran wild over the world. Markets were cut off. Trade lines were narrowed. Unemployment in the export industries all over the world grew with great rapidity."33 But this was not all. The Revenue Act of 1932 doubled the income tax. It ordered the sharpest increase in federal tax burden in American history. Exemptions were lowered, "earned income credit" was eliminated. Normal tax rates were raised from a range of 1½$ - 5$ to 4 - 8$, surtax rates from 20$ to a maximum of 55$. Corporation tax rates were boosted from 12$ to 13¾$ and 14½$. Estate taxes were raised and gift taxes imposed with rates from ¾$ to 33½$. When state and local governments faced shrinking tax collections they, too, joined the federal government in imposing new levies. Murray Rothbard, in his authoritative work on America's Great Depression estimates the enormous increase in the fiscal burden of government during the depression as follows: The federal costs rose from approximately 5$ to 8$ of Gross Private Product, and from 6$ to 10$ of Net Private Product. The state and local government burden rose from 9$ to 16$ of Gross Product, and from 10$ to 19$ of Net Product. Total government burden rose from 14.3$ to 24.8$ of Gross Product, and from 15.7$ to 28.9$ of Net Product.34 In short, the burden of government nearly doubled during the depression, which alone would bring any economy to its knees.

During the Roosevelt New Deal internal regimentation triumphed over freedom. Like Hoover before him, Roosevelt wanted the federal government in the driver's seat. He was not content with clearing away the economic barriers which his predecessor had erected. Instead, he untiringly built his own, such as, a sweeping industrial reorganization by the National Industrial Recovery Act, higher income taxes, estate taxes, business taxes, the Wagner Act that revolutionized American labor relations, the Wages and Hours Act that greatly reduced labor productivity and raised labor costs, plus countless regulations and restrictions. The American economy thus would not recover from the abyss of depression into which it was first cast by the radical intervention of Republican administrations and then kept lingering by the Democratic New Deal. Individual enterprise, this mainspring of economic improvement, just did not have a chance.

In historical understanding as well as scientific method, theory, and policy the Chicago and Austrian Schools are worlds apart. To the Chicagoans money is a product of government, created and managed according to some rule of the game arrived at by political process. To Austrian economists money is a marketable commodity, such as gold or silver, that has become a widely accepted medium of exchange. It is a product of trade voluntarily entered upon by individuals. Banknotes and demand deposits are merely substitutes that receive their value from the money proper. These economists deplore the seizure of commodity money by government and its replacement by fiat money which is characterized by rapid inflation and depreciation. They advocate the orthodox gold standard because it makes the value of money independent of government as the quantity of gold in existence is independent of the wishes and manipulations of government officials and politicians, parties and pressure groups.

The monetarists are unanimous in their condemnation of the gold standard. But while they argue for government fiat "on purely scientific grounds," they pay lip service to monetary freedom. Prof. Friedman would not deny us the freedom to buy, hold, and use gold in all economic exchanges, but paradoxically he would also impose a fiat standard. He seems to be unaware that monetary freedom would soon give birth to a "parallel standard" that permits individuals to make "gold contracts" and "gold clauses" calling for payment of measures of gold. Thus individual freedom alone, needing no reform law, no conversion or parity, no rule of the game, would lead us back to the gold standard as free individuals would prefer gold over government paper.[35]

Under the steadily growing influence of Chicagoan monetary thought the U.S. government may some day soon remove the last vestiges of the gold-exchange standard. Both the fiscalists and monetarists would rejoice about this triumph of fiat money over gold. But to Austrian economists such a step would merely divide the free world into currency blocs and invite more inflation and depreciation. It would merely be another chapter in the age-old struggle between monetary freedom and governmental control.

NOTES

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Hubris And Environmental Variance
Joseph J. Spengler

"Ancient Arrogance loves to bring forth A young Arrogance among the evils of men."

Aesch?lus, Agamemnon.

Arrogance, C. M. Bowra has written in his The Greek Experience, "was regarded as the worst of evils," in part because "it scorned the social obligations on which the city-state depended." And F. A. Hayek has observed that "never will man penetrate deeper into error than when he is continuing on a road which has led him to great success." One may ask, therefore, if the conjoining of these two observations has implication for the practitioners of social science, above all the economists.

Not until the second third of this century did confidence in the economist and his findings promote him into the hierarchy of policy formulators. Theretofore his role was predominantly advisory in nature and confined to the realm of microeconomics. Moreover, he did not find himself pressed to postulate a degree of fixity in economic relationships, corresponding in some measure to those on which an engineer counts when developing and executing plans in the world of structures.

I. Problem And Trends

Policy recommendations, together with suggestions for policy implementation, need to be in keeping with the degree of variance characteristic of the environment to which they are applied. The scientist finds himself in a sea of facts, always reducible in some degree to categories within which relations of varying degrees of exactness and stability are to be found. But this degree varies with category and science, ranging from marked to limited exactitude and stability. The policy maker finds himself constrained accordingly.

Among the conditions that distinguish social science from natural science, especially inorganic science, is the fact that the environment to which social science relates is subject to much more variance than that to which natural science, especially inorganic science, relates. It is much more difficult, therefore, to map models upon selected segments of the social environment than upon selected segments of the physical environment. The behavioral regularities which social scientists have "discovered" are less stable than those revealed by physical science. The capacity of the so-called "social engineer" to formulate and execute policy, be it economic or otherwise, is much more limited, therefore, than that of the engineer operating in the field of inorganic science or even in that of life science.

It is paradoxical that over the past several centuries the weight allotted to contingency by scientists and policy makers has not varied in the same degree in the realms of social and non-social science. This paradox is all the more striking in that today, more than ever before, man is alert to the stochastic aspects of his universe.

Consider the physical world. The universe to which Newtonian physics related and in fact ruled for two centuries was conceived of as a universe in which, as Wiener noted, “everything happened precisely according to law, a compact, tightly organized universe in which the whole future depends strictly upon the whole past.” Those accepting the Newtonian view had therefore to proceed as if physics were subject to precise laws susceptible of discovery and formulation even though the physical measurements of which man is capable are never absolutely precise. Of import here is the corollary that the engineer operating in a strictly Newtonian world can rule out the possibility of variance, together with the implications of variance.

The present century has witnessed a change in this vision of the physical world, a change inspired in part by questions raised in the preceding century and prompted by the spread of inquiry into neglected components of man's universe. For, after its reign of two centuries, the Newtonian view gave way to a view in which scope was allowed to probability, an element introduced by Willard Gibbs. Of some significance in the present connection is the emerging recognition of the role of chance even though physics as such relates largely to that which is sufficiently probable to be treated as certain. Of greater significance is the change produced in the scientist's image of his universe and of means appropriate to his accommodation to diverse components of this universe.

Given an invariant universe, subordination of this universe to man's purposes entails action based upon this invariance. But, given a universe subject to variance, subordination of it to man's goals entails compensatory adjustment to this variance. Such adjustment must be sought through servo-mechanisms. In most instances, however, the degree of variance encountered in the physical world is much less than that found in the social world; and when this variance is pronounced, it is essentially orderly in pattern, even though subject to the drift of time. What Lotka called “parameters of state” function as parameters whereas corresponding parameters in the social universe seldom stay entirely put and stable.

Turning now to the realm of social science as represented by economics, we find that in the work of Smith and his classical successors, the economy was viewed as a self-adjusting organization, an organization made up of small behaving units bound together by mechanisms which enabled men to adjust to each other and achieve a kind of state which, though essentially stable, did undergo change with the passage of time. Smith was writing at a time, of course, when Leibniz, Euler, and others were describing the world at large as under the empire of optimizing mechanisms.

Of concern here is the fact that Smith's view of the economic world was not Newtonian and mechanical. Smith's world was subject to variance and men supposedly adjusted their behavior accordingly. This world tended to function well so long as coalitions and monopolies were not allowed to develop, often with the connivance of the state. There was very limited scope in Smith's world, therefore, for salutory intervention by the state in economic life. Moreover, the state was viewed as the agent and servant of society, and not as its hortator and taskmaster.

Smith's image of the social world not only persisted in the works of his classical successors. It was also given new dimensions by the Austrians, most prominent and influential of the schools which paralled what might be called the neo-classical school of Marshall, direct continuator of the classical tradition. Indeed, Menger, founder of the Austrian school, emphasized the evolutionary adaptability of man's institutional structure to emerging needs and problems. For, while, as Louis Schneider summarises Menger's view, "functional institutions can be the product of deliberate reflection and planning," they are more likely to be "spontaneous developments" rather than the creations of "human intention." Illustrative was the institution of money.

The image of the economy as a homeostatic organization shot through with automatically responsive mechanisms did not undergo serious modification until in the 1930's. Then the vision of Smith, Menger, and Marshall began to give place to that of J. M. Keynes. Macroeconomics began to coexist with microeconomics and even partially to displace it as long regnant assumptions gave way to those undergirding the new vision. Objectives changed as well. It apparently came to be believed above all that, despite the variance-ridden character of man's economic environment, the economy could be kept within the conduit of "full employment" by economist-policy-makers, and at little or no cost to any elements in the population. In sum, whereas the natural scientists turned to cybernetics in the sense of servomechanisms, economists turned to cybernetics in the ancient meaning of Plato who had in mind both the art of steermanship and the art of government.

II. Caveats

Were Aristotle alive he would enter a caveat against the ascendancy of Plato's conception of cybernetics. Not only did he warn against looking for more precision than "the nature of the subject permits" (N.Eth., 1094^{b}). He also distinguished "scientific knowledge" from "practical wisdom" which underlay the art of government or politics. Of "scientific knowledge" he wrote: "We suppose ourselves to possess unqualified scientific knowledge of a thing, as opposed to knowing it in the accidental way in which a sophist knows, when we think we know the cause on which the fact depends, as the cause of that fact and of no other, and, further, that the fact could not be other than it is" (An. Post. 71^{b}). "Practical wisdom" to which "political wisdom" and the "art of politics" corresponded, Aristotle then pointed out, did not have to do with the invariable; rather it resembled "opinion" in being "about the variable," about what "is capable of being otherwise." Moreover, policy as expressed in law needed to reflect experience and judgment, ingredients of practical wisdom, rather than mere content of text-books and comparison of laws (N.Eth., 1140^{a}-1142^{b}, 1180^{b}-1181^{b}). And even then they could prove highly effective only if the political structure were adequate, that is, if the middle class held sway (Pol., 1295^{a}-1297^{a}) and (presumably) weight was attached to equity (Rhet. 1374^{a}-1374^{b}).

Success on the part of economists as of other social scientists eventually reduced their sensibility to dangers implicit in the reorientation of the role of the state and economic policy. Not much attention was paid to economists or other social scientists by policy-makers until in the 1930's. By then the number of economists had become much greater than before 1920 and governmental employment opportunities for them had begun to increase appreciably, at a rate that subsequently rose with the coming of World War II. Moreover, as noted above, the ascendancy of macroeconomics removed old constraints on the economic role of the state, theretofore largely restricted in times of peace to financing the polity and preserving an economic structure conducive to effective competition. Accordingly, despite continuation of variance in the economy and of imprecision in the measures obtained of macroeconomic relations and mechanisms, belief on the part of economists in their power to intervene salutarily at the macro-level increased greatly.

In the wake of this confidence there came into being an attitude, new to economics and never associated with microeconomics, an attitude reflecting confidence, perhaps overweening confidence remindful of hubris—in the capacity of economist-policy-makers to guide the economy costlessly along the path of full employment. One is reminded of the unprecedented enthusiasm for natural sciences in late-eighteenth and early-nineteenth century France, enthusiasm that, as Hayek points out, found expression in the Ecole polytechnique, source of "scientistic hubris" and contributor to the then emerging belief that technological education could provide the key to societal problems.

As has been suggested earlier, the effectiveness of interventionist macroeconomic policy turns on the degree to which the economy is subject to instable or relatively unknown variance, together with the degree to which account is taken of the constraints imposed on the behavior of variables by the current state of the parameters entering into economic equations or bearing upon economic policy. Firm and generally accepted knowledge regarding the quantitative values of temporal and other relations between macroeconomic components of the macroeconomy are not yet available, or when available, are not yet known to be stable or to vary in quite orderly and easily foreseeable ways. Information has not yet been acquired in adequate amount and under conditions enabling one to rule out the spurious and the specious and gain sufficient understanding of the relevant dynamics of the economy—perhaps because students of economic phenomena tend to be too involved in that which they are studying.

In the absence of the conditions requisite for establishing a basis for macroeconomic policy, one may inquire if there exists a sufficient consensus regarding sets of relations to permit the formulation of policy on the basis of consensus instead of upon a firm grasp of variance and its behavior. Such a consensus does not exist. Among economists there is not to be found a consensus comparable to that found among inorganic and (even) organic scientists—a lack associated with varying interpretation of the variance existing in the social and economic environment.

Absence of consensus has been well described by Peter Bauer in his essay in Roads to Freedom, the Festschrift honoring F. A. von Hayek. There Bauer shows how "a whole range of mutually interacting political and intellectual forces has promoted the spurious consensus in development economics, a consensus the conclusions of which are unrelated to reality." Any extensive review of the literature will bear out Bauer's finding. He goes on to point out that "by acquiescing in the belief that development economics can appreciably promote the material progress of underdeveloped countries we have come to some extent to live beyond our intellectual incomes, and perhaps have even come to live on false pretences.... But the cost of the continued promotion of unwarranted expectations is certain to be very high." Indeed, he adds, "the soul of a profession, as well as that of persons, can be lost in attempts to gain the world."

An examination of the literature on monetary behavior and on the areas of policy of concern to the President's Council of Economic Advisers would reveal a similar lack of consensus. It should provoke inquiry into the degree to which policies endorsed by the Council have contributed to maintenance of employment and economic stability, given the structure of conditions within which policy recommendations have had to be carried out. A cursory comparison of the period 1904-29 with that of 1946-71 does not generate great confidence in the macroeconomic policies pursued in this country, or in the disposition of policy-makers to allow for conditions that might make for policy failure.

Given the absence both of invariance in the relevant economic environment and of consensus regarding what constitutes appropriate and administrable policy under changing existing conditions, one might expect that formulators and administrators of economic policy would be modest respecting what they can do. One is left with the impression, however, that such modesty is in limited supply, that progress in the realm of technical economic theory has generated a spirit of hubris that has infused the realm of administrative practice and made it insensible of the costs resulting.

III. Conclusion

It is to be inferred that a spirit of modesty better becomes the social scientist, especially the economist, than the spirit underlying what the Greeks called hubris. Otherwise, as Greek mythology had it, Nemesis could intervene and depress the degree of confidence men have in social science, especially economics, below the level warranted by the capacity of its practitioners to perform. Accordingly, given the large amount of instable variance in the economic environment and the impossibility of mapping macro-models and policy closely upon this economic environment, a dynamic rather than essentially fixed approach is indicated—one in keeping with the spirit of Smith's Wealth of Nations. When controls are indicated because of defects in the performance of the economy, it is desirable that these controls be as servo-mechanistic in character as it is economically feasible to make them. Then the controls put into effect will be responsive to variance in the economic environment. Under these circumstances so-called economic policy will not operate, as it often does today, to impose heavy and uncompensated costs on large segments of the population—witness the heavy burden placed upon fixed-income receivers by a policy of inflation pursued in the name of "growth" and the optimizing of a politically oriented employment statistic. Moreover, continuing observation of the response of the economy to policy expressed in servo-mechanistic terms will evoke the information essential to shaping policy in relatively costless and equitable form.

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An Application Of Economics In Biology
Gordon Tullock

(It may seem odd to place an article originally designed for publication in a biological journal in a collection of articles dedicated to Ludwig von Mises. Among his other distinctions, however, Professor von Mises was among the first to point out that economics can be expanded to deal with many areas outside of its traditional scope. In my own case, my work in expanding economics into new areas was, in a real sense, begun by my reading of Human Action. The article below, then, represents my most extreme application of economics outside its pre-von Mises boundaries.)

The recent rise of interest in problems of pollution and similar matters has led to considerable contact between those biologists interested in ecology and economists interested in the special economic field of "externalities."[1] It is the point of this essay to indicate that there are certain interrelations between the economics of externality and the problems of ecology, which are different from those ordinarily studied. Specifically, I propose to use the economics of externality as an analytical tool in dealing with natural ecological systems. Plants and animals have effects on other plants and animals, and the effects of these externalities are very much the same as the externalities which human beings impose on each other or upon the natural environment.

The results of this investigation will be, I think, somewhat startling to the biologist. I think I can demonstrate that the climax state of any ecological system is inferior. That, substantially, regardless of what value we put upon the individual species within the ecological system and/or their usefulness to man, it is nevertheless possible always to improve upon the system produced by "nature." In order to make such a judgment which will fit any one of a vast number of different sets of values, I will be compelled to make use of an economic concept, known as Pareto optimality, albeit in a radically reformed manner. Pareto optimality was first suggested as a way of avoiding making certain types of value judgments, and it can be used in evaluating biological systems in a similar way.

For the purpose of this article, I propose to use a very simple system. This simple system will not exist anywhere in the real world—it is too simple for that—but it closely approximates a situation which we do find very commonly in the real world.[2] The system is composed of two species: grass and some herbivore. One may consider it to be an approximation of the situation in the Old West in which cattle grazed upon grasslands.[3] For the time being, we will assume that these are the only two species. This simplification is introduced in order to make the line of reasoning easier; it can be demonstrated that the same principles apply even if we have many species and the ecology is quite a complex one. This demonstration, however, will not be included in this article, since it is quite complicated and the outcome seems intuitively obvious.

Under these circumstances, we may feel fairly confident that what is known as "over-grazing" would occur. The cattle would multiply until such time as there were enough cattle exactly to consume the maximum amount of grass produced by the plot. This grass, however, in part would be produced by mature plants; in other words, it would be possible for the number of cattle temporarily to rise to a larger number than could be permanently maintained by the process of eating the existing plants back down to the point where they no longer are fully efficient. In a sense, this is consumption of capital in the form of grass to support additional cattle.

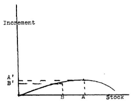


FIGURE 1

In order to make the matter clear, let us turn to Figure 1. On the horizontal axis, I have shown varying amounts of grass that could be on our plot of land. The vertical axis then shows the increment that one could expect in a short period of time, let us say one day, granted that you have that amount of grass shown on the horizontal axis at the beginning of the time period. If you have very little grass already in existence and, hence, are on the left end of the horizontal axis, there will be relatively little growth in any given short period. Similarly, if the grass is already up to the maximum that the land can hold, there will be no increment; hence the line once again hits the horizontal axis.

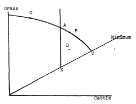
Between these two points, the increment rises as the amount of grass increases, and eventually falls off. If we propose to harvest the maximum amount of grass that we can from this plot, we should choose to maintain the stock of grass at amount A and harvest, during this period, A' of grass. Assume that our method of harvesting the grass is to let cattle graze upon it. You should also assume that the line drawn represents the amount of grass which the cattle can take in each day, although in practice this line would probably be somewhat below the physical increment in our diagram, because the cattle are not perfectly efficient in removing grass in such a way as to inflict the least possible damage on the remaining grass.

Suppose, then, that we attempt to graze more cattle on the land than can be supported by eating the grass A'. Under these circumstances, they would eat not only the increment in any given period, but some additional grass, let us say the amount A-B on the horizontal axis. As a result, in the next period the total amount of grass available to produce more grass would be smaller, hence only B' amount of grass would be produced. Under these circumstances, the cattle would once again cut into the existing stock and move us farther to the left. Eventually, we would reach a situation in which grass was scarce, and the few scrawny cattle which grazed upon it would find the energy involved in chasing down their grass enough so that they could not increase in population. Under these circumstances, a new equilibrium would be reached somewhere to the left of A.

Hereditary selection of the “fit” makes this outcome inevitable. If some of the cattle had a relatively low rate of reproduction and others a rather high rate of reproduction, and the cattle with the low rate of reproduction had a rate of reproduction such that they remain in exact balance with the grass supply, the only effect of this would be that in each generation there would be more cattle of the high reproduction strain and a lower percentage of cattle in the low production types. The death rate from overgrazing would be spread across both types, independently of these reproductive capacities; hence the end product would be the gradual disappearance of the low reproduction strain.

Note the situation, however. By artificially restricting the number of cattle, we can increase the amount of grass produced each year and, thus, in the long run produce more cattle. It is possible by intelligent management to produce a situation in which both more grass and more cattle (or both elements of our simple ecology) exist than would exist under natural climax conditions. Suppose that point B in Figure 1 is the natural climax with the amount of cattle which consume exactly B' grass. Under these circumstances, by reducing the number of cattle temporarily, one could increase the amount of grass and make it possible to maintain a larger number of cattle on the same land in the future.

Intelligent range managers do exactly this. A well-functioning cattle ranch supports more poundage of beef animals than it could support if the manager did not artificially keep the grass and the beef in balance. This balance is essentially an artificial structure which could not occur in a state of nature, and the natural balance would involve less of both grass and cattle. The movement from the cattleman's organized ecology to natural balance would involve a natural (and temporary) increase in the number of cattle, which would then graze back the grass supply. Similarly, a movement from the natural ecological balance to the cattleman's superior ecology would involve a temporary restriction of the number of cattle in order to permit the grass to grow up to a higher level of productive efficiency.



Ranch managers, in dealing with this kind of problem, have a fairly simple and straightforward objective: they want to maximize the production of beef or whatever else it is they are raising. Our system, however, has no such obvious maximum. Consider Figure 2. On the vertical axis, I have put the total amount of grass on some particular plot of land, and on the horizontal axis, the total number of cattle. Since there is some minimum amount of grass necessary to sustain each head of cattle, I have drawn in a line representing this minimum, starting at the origin. In actual fact, the line would probably be slightly concave downward and not quite hit the origin, due to the fact that the cattle must use more energy to seek out grass when it is scarce, but we can ignore this minor correction. All of the points in the area above the minimum line and below the curving line GABC, are feasible, i.e., it is possible to reach any combination of grass and cattle shown in this area.

The line, GABC, is the maximum amount of our two species which can be supported by the land in varying combinations. It corresponds to the production frontier of standard economic theory. The maximum amount of cattle which can be raised or the cattleman's maximum is shown at C. Similarly, the maximum amount of grass which can be raised is shown at G. Note that G is not drawn at the vertical axis, because I assume that the fertilizer produced by the cattle has at least some effect in stimulating grass production. This might not be so in some circumstances, in which event the maximum grass production would be obtained without any cattle at all. The other points on the line GABC represent other combinations of production of cattle and grass, and in each case they are maxima, i.e., you cannot produce more with the same ratio. The area within the production frontier and above the minimum, which after all is simply part of the production frontier, represents those combinations of cattle and grass which are achievable, but are less productive than the areas on the frontier.

Let us suppose that N is the natural climax or equilibrium of the system. It is the point to which the system will proceed if there is not regulation on the number of cattle. Any point in the triangle—bounded on the bottom by the minimum line, on the left by the vertical line drawn through N, and on the upper right by the curved line ABC—is superior to N in production of grass and cattle. Any point in this area will be better from the standpoint of both increasing grass production and increasing cattle production than is N.4

Note, however, that there is a good portion of the production frontier—that running between the vertical axis and the vertical line running through A—which we cannot say is clearly dominant over the natural climax. In order to make any judgment here, we would have to have some way of evaluating grass against cattle. If we did feel that grass was much more important than cattle, we would probably aim at point G, even though this would reduce the number of cattle. But this requires a value judgment; movement up and to the right from N requires no judgment as to the relative merits of grass or cattle, it merely requires a feeling it is desirable to have more. Hence, if movement into this triangle is movement into a permanently sustainable system, it seems hard to argue against the view that we would have as much of the natural product as possible. Certainly, the ecology buffs cannot complain about it.

It is very hard, however, to decide what specific movement from N would be optimal without some kind of value system putting cattle against grass. Movement out to point D and then on, let us say, to point B clearly involves two improvements from the standpoint of both cattle and grass. From the standpoint of the grass, however, A would be better and from the standpoint of the cattle, C would be better. Here we are confronted with a situation which frequently confronts economists, and we shall follow the economist in refusing to solve the problem. With an external value system, we could decide which point was the best. Without such an external value system, however, all we can say is that our diagram shows a number of points which are superior to the natural equilibrium point, but gives us no way of choosing among these points. Since any one of them is superior to the natural equilibrium, on the whole movement to any one of them would be desirable. The decision as to which point on the frontier is optimal is equivalent to the distribution problem in economics, and, as in economics, can only be solved by bringing in external value judgments. I have no objection to the reader bringing in such a value judgment, but I suspect that the readers have different judgments. We can all agree, however, that movement up and to the right would be desirable, even though we might disagree as to which of the various directions within the pieshaped space would be optimal.

So much for our simple two-species ecology. Let us now engage in a somewhat more rigorous investigation of the tools which have been used in this example, and then indicate how a more general version of these tools can be applied to a more realistic ecology. First, note that we have had only two species on Figure 1. Economists have discovered that a simple two-item diagram like this can be a great help in analyzing many-dimensional situations. The real ecology could be placed in a multidimensional space with each species, or indeed each subspecies, on a separate dimension. This hyperdimensional diagram would then have a hypersurface, its equivalent of the curved line, and there would again be an area inside this which was achievable but not fully efficient.

A simple two-dimensional diagram which can, after all, be drawn on a piece of paper can be thought of as a cross-section of that much more complex diagram. Alternatively, it can be considered to be a special two-dimensional space in which one of the axes is a particular species and the other is a composite bundle of all of the other species. By this method, each species can be taken out by and of itself and its interrelation with the whole ecology (minus itself) analyzed. This latter technique is perhaps less convenient for ecological problems than it is in economics, because in economics we have a rather simple measure of the purchasing power. We can consider the baskets of goods which are being contrasted to the single good as having whatever their monetary value is.

The most elegant way of dealing with a manydimensional space with many species, each represented by one dimension, would of course make use of the Cartesian algebra in its many-dimensional version. Although this is the most elegant method, it is generally speaking much too tedious and, in any event, we seldom have enough empirical knowledge to make it sensible to move to such a complicated representation. Nevertheless, it should always be kept in mind that this many-dimensional Cartesian system is the true model, and the twodimensional subset of that model is a simplification.

A second special problem has to do with values. It is good Catholic doctrine that the natural world exists solely for the benefit of man, and that man, therefore, is the measure of the ecology. This would, needless to say, raise the question of which man; hence, we would be back to the distribution problem of economics. There is, however, an even more fundamental difficulty here. A great many people are now saying that they do not think that man should be the measure of all ecological problems, and that we should take into account the well-being of other species. In part, these people are simply expressing themselves badly. Many of them do in fact hold the well-being of mankind as their major goal, but feel that long term calculations of the well-being of mankind require some temporary sacrifices of human well-being in the aid of the well-being of certain other species.

In this sense, there is no particular problem with our diagrams. The point on the efficiency frontier would be the long-run sustainable output; hence we could still retain the desire to maximize the return for human beings. In Figure 1, since human beings do not eat grass and do eat cattle, we would choose point C. Some of the members of the Sierra Club, however, apparently do believe that it is worth sacrificing some long-run human goals for long-run growth of other species. For them, the value system is not quite so straightforward.

Fortunately, the Paretian apparatus makes it possible for us to deal with this matter without much difficulty.5 The Paretian apparatus was first designed for the specific purpose of dealing with some change which might injure one person and benefit another. It was pointed out by Pareto that we had no positive reason for believing that the injury and the benefit were commensurable. It might well be that what we thought was a rather minor injury to Mr. A actually hurt him more than the benefit received by what to us appeared to be a very significant improvement for Mr. B. Pareto, therefore, suggested that we accept a very modest criterion: any change which benefits at least one person and injures no one must be an improvement. It is clear that this rule gives guidance only in a general way. Returning to Figure 2, it indicates that we should move up and to the right from point N, but does not tell us the exact location. It is an astonishing fact that this very simple rule has permitted a very large amount of calculation on improvement in the economic system. I hope to demonstrate that it will be of almost equal use in the biological system.

For people who have strong personal feelings on the evaluation of different species, the rule will not be ideal. They might feel very strongly that some particular point on the frontier shown in Figure 1 is superior to all others. There is no reason why they should not feel this way and they can, of course, make calculations very similar to the ones I have made; thus, they get results which are in essence a specialization of the very general results I get. The advantage of the very general results, however, is that they are not dependent upon the particular value system of the investigator. We do not have to choose between grass and cattle to accept a movement up and to the right from point N. If I am interested in the well-being of either human beings or of these particular species or any one of them, such a move is an improvement, even though it may not be a movement toward the point which exactly maximizes my particular goal. If, for example, I was pro-grass, I would regard movement from N to D to be an improvement; but I would regard any point between A and C as inferior to G. Such a move, however, would be a marked improvement over N.

The system, thus, is relatively value-neutral simply because it is consistent with a tremendous range of possible values, not because it imposes any value system of its own. Individuals are likely to regard their own personal value system as better than this criteria which, instead of aiming wholeheartedly at fulfilling their value, aims at giving at least some benefit under a very large range of values. The principal argument for the Paretian rule is that it does avoid most of the controversies which any more specific rule would entail. Actual decision in any specific case must involve putting in more in the way of a preference function than the Paretian rule. The Paretian rule demonstrates in Figure 1 that improvements are in fact possible; it does not specify which of the many improvements should be undertaken.

Let us now discuss the concept of externality. Externalities were originally developed in economics to analyze certain areas where the market economy worked badly. They are probably more familiar to biologists than most other tools of economics simply because the problems of pollution are very good examples of externalities in the pure economic sense. We, however, are not talking about externalities generated by human beings, but externalities generated by plants and animals.

Externalities are rather easily understood. Any given species will have some effects upon the development of some other species. The grass, for example, provided a food for the herbivores and the cattle reduced the total amount of grass by eating it. In the first case, we have a positive externality, that is, a species providing something of benefit to other species; and in the second case, we have a negative externality, that is, a species doing something to injure another species.

We need not, however, confine ourselves to these very direct relationships of eating and being eaten. Most plants release into the soil and into the atmosphere various chemicals. The obvious case, of course, is free oxygen into the atmosphere, but there are many others. Confining ourselves to chemicals found in the soil, we find that these chemicals have an effect upon the soil which makes it more or less suitable for the growth of other plants. This is an example of an externality. There are innumerable other similar examples. Indeed, in a real sense, the whole science of ecology is devoted solely to the study of such externalities. The existence of one plant or animal has significant effects on many other parts of the ecological community, and the study of this chain of effects from each plant or animal to all the other plants and animals is the subject matter of ecology. I will not, however, make an effort to develop the collection of interactions in any existing ecology, but to discuss the theoretical consequences of the mere existence of such interaction.

Let us begin our discussion with a very simple example. We assume two plants which customarily live in close proximity and we assume that each produces, as a byproduct to its life processes, a chemical which is of benefit to the other. Thus, each plant will grow somewhat better in the presence of the other.[6] Here we have an externality. Naturally the plants, having no minds, do not take this externality into account; but evolution will select the plants for efficiency in generation of these byproducts as well as for efficiency in other matters. We can, therefore, discuss what is the most efficient rate of generation of the byproduct for the plants and, as we shall see, the rate of generation of the byproduct which would be selected by natural selection is inferior to another rate. The details of this argument are quite complex, but we may begin by simply assuming that each of the plants is available in two strains, as shown on Figure 3. Species A is available in variant A_1 and A_2. A_2 produces the byproduct only insofar as that byproduct is essential for the maximization of the growth of the strain in and of itself. In other words, it spends no energy at all on producing additional amounts of that byproduct. A_1, on the other hand, sacrifices some of its own growth in order to produce more of the byproduct. With species B, the same situation obtains, with B_2 being the strain which produces only enough of the byproduct as is consistent with maximum growth of itself, and B_1 being the one which produces more of the byproduct and which tends to get somewhat less growth itself.

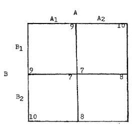


FIGURE 3

In the figure, the weight of each of these plants which, given a space of land (granted there is a mixture of the two), can be expected to support is shown with A in the upper right hand corner and B in the lower left of each cell. Since each species byproduct benefits the other species and since, in this case, the benefit is “Pareto relevant,”7 the weight of each plant is higher in the upper left hand corner where each of the plants is using some of its energy to provide “fertilizer” for the other than in the lower right, where each of the plants is composed of the “2” strain, which simply attempts to maximize its own development while ignoring the development of the other. Both types of plant have a higher net weight in this upper left square than in the lower right; hence, the upper left can be regarded as being superior from the standpoint of either plant.

Note, however, that the structure of this diagram is that of the prisoner's dilemma. It is clear that the strains which would be selected by natural selection are not A_1 and B_1, but A_2 and B_2. We can see this very easily by observing that if a mixture of A_1 and A_2 were placed in a field with either B_1 or B_2 (or a mixture of them), the A_2 would grow more rapidly than A_1, as shown by the matrix. Over a number of generations, A_2 would completely replace A_1. For example, if the strain of B which happened to be in the field was B_1, then a given amount of plant seed for A_2 would produce ten-ninths as much as the same amount of plant seed would for A_1. Similarly, if the field was planted in B_2, the ratio would be eight-sevenths. Since the diagram is symmetric, the same line of reasoning applies to B. Thus, natural selection would select strains which produce a lower quantity of these plants than other strains. With selective breeding, it would be possible to produce strains which produced more of both of the two plants.

Needless to say, positive externalities of the sort shown in Figure 3 are not the only ones we find in nature. Plants may also cause great injury to or exterminate other plants, and the same is, of course, true of animals. We could make up an example similar to Figure 3 to deal with such cases, and we would find once again that the natural selection optima would not be that which maximizes the output of the two strains. Further, the use of two strains is dictated only by a desire for simplicity. We could have a very large number of strains and, for that matter, mixtures of different strains. The end product would be the same. Further, the use of two species instead of the many-species of the average ecology is dictated solely by the fact that I am using a two-dimensional piece of paper. The argument is, in fact, much stronger if there are many species than if there are only two. Thus, nature unaided does not reach an optimum.

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What Mises Did For Me
John V. Van Sickle

I first met Professor Mises some 51 years ago. I had crossed over the Ringstrasse from my office in the Austrian Kriegsministerium with a letter of introduction from Professor Charles Rist of Paris, determined to use the ample time at my disposal as Assistant Secretary to the American Unofficial Delegation to the Austrian Section of the Reparations Commission to write the doctoral thesis that had been twice interrupted—first by President Wilson's call to the young to make the world safe for democracy, and then, following discharge from the armed services, by a 14 months tour of duty at the American Embassy in Paris where I prepared daily summaries of the press for an Ambassador who could neither speak nor read the language of the country to which he was accredited, and where, in my spare time, I had worked on a study of Franco-American commercial relations.

Professor Mises was seated behind an uncluttered desk in a room even larger than the one I had left. I told him how far I had gotten along at Harvard with a study of direct taxation in Massachusetts. He suggested that there was need for a similar study of direct taxation in Austria. So I went to work and before I left Vienna in late 1923, I had completed an acceptable thesis on Direct Taxation in Austria which eventually appeared under the same title in the Harvard Economic Series (Volume XXXV, 1931), with a dedication to Professor Mises.

I remember very vividly my then vision of the Good Society, and the stages by which I had come to it. I was, in effect, a Fabian socialist.

Capitalism, I admitted, could build an impressive International House, with tall walls, graceful columns, majestic stairways and marvelous central heating, but it could not put a roof over the structure. And the social and material inequalities within the house made life uncomfortable for most of the inhabitants most of the time, even in the fairest weather. Socialism, on the other hand, could build a livable International House. It would be low and rambling, with a thatched roof, wide-open fireplaces in its many rooms, and friendly people moving freely from room to room.

This pretty picture had taken place very gradually. I had left college a confirmed free trader, convinced that if governments would let goods, services and people move freely into and out of their territories, if they would but specialize in doing what they could do best, the divisive spirit of nationalism would subside and men everywhere would live in peace and harmony with one another.

Like many, perhaps most of my generation, I took it for granted that wars were a thing of the past. Consequently, World War I had come as a great shock. It seemed clear to me that this war, like the Revolutionary War and the War between the States, as the people in the South still insisted on calling our Civil War, was the result of selfish tariff protectionism, and the world's businessmen, despite their lip-service to private enterprise, were largely responsible. The working man and his spokesmen, the union leaders, and socialists generally were pacifists, internationalists and free traders.

My stay in Paris had strengthened my attachment to the socialist dream. Day-in, day-out I had reported in my press summaries the hymns of hate coming from the journals of the Right and the calls for reconciliation with their late enemies coming from those of the Left. The short sharp economic collapse at the end of the war appeared to confirm the socialist thesis that capitalism was inherently unstable, that a high and continuous level of employment required planning which, wisely conceived, would reduce social and economic inequalities and promote harmony within, as well as between nations. Admittedly, there would be some blunting of incentives, but the socialist performance over reasonable spans of time would be better than that of its rival.

Such was my vision when I started and in a single night finished Mises' classic dissection of the socialist dream.[1] I had gone to bed a Fabian socialist; I rose the next morning a free enterpriser, or at least something like the 19th century liberal of my college days when Woodrow Wilson was my hero. From that day on it was clear to me that the burden of proof was on those advocating coercive interferences with the market's allocative functions and that interventions frustrating its adjustment mechanism would miss their marks.

Yet I realize, on rereading my reactions to Die Gemeinwirtschaft as they appeared in La Revue d'Economie Politique (Paris: 1923, vol. 37) and in the September 1923 issue of The American Economic Review, that my conversion was not complete. There was (and there still is) a bit of the Fabian socialist in me. I would like to see a somewhat more equal distribution of incomes than can be expected even if we could eliminate all the remediable deficiencies in the capitalistic performance.

In both reviews I recommended Mises' re-examination of the theory of socialism as “deserving careful reading by friend and foe alike,” and characterized his defense of capitalism as “a clear, vigorous and convincing restatement of the case for individualism, much in the tone of a Manchester Liberal of the ‘60s.... Whoever accepts the Austrian theory of value even in part,” I concluded, “can hardly refuse to follow the reasoning of Professor Mises as to the impossibility of complete socialism. More open to criticism, however, is his conclusion that complete laissez-faire is the solution.”

And then, in a final paragraph, I gently chided Professor Mises. After noting with approval his admission that the socialist ideology could only be destroyed by persuasion, by “right reasoning,” I assured him that “he need not fear the trade unions, or the presence of laborers in the councils of industry. Trade unionism had proved an educational force as well as at times a destructive one. Industrial democracy will prove as great an education in the intricate problems of production as political democracy has proved in that of citizenship.”

To date, Professor Mises' glimpses into the future have proved far more accurate than those inspired by my wishful thinking. Nonetheless, though with far less confidence than 50 years ago, I continue to believe[2] that the State, through taxing and spending (not through the manipulation of prices or the building up of the power of occupational groups) can provide a guaranteed income for all, as suggested by Professor Hayek toward the close of World War II,[3] or by Professor Friedman in Capitalism and Freedom,[4] originally presented in a lecture series at Wabash College in 1956; and could do it in a way that might actually improve the capitalistic performance and thus increase the prospects that the "right reasoning" that has flowed from Professor Mises' tireless pen in the years since the appearance of Die Gemeinwirtschaft will yet bear out his faith that "once the thinkers of the Socialist movement cease to believe in their doctrine, the movement itself is doomed to extinction."

At this writing it looks as though something approximating Friedman's negative income tax may be enacted. I must confess, however, that the political supporters of such a daring innovation show no realization of the need, as Friedman insisted, to repeal "the rag bag of measures" that now fetter the free enterprise system and discredit it in the eyes of those who stand to benefit most from the full deployment of its incredible productive powers. If these measures remain on the statute books, we may well discover that "we have jumped from the frying pan into the fire, ... supporting in demoralizing idleness even more people than at present, and most of them would belong to the ethnic groups that now bear the brunt of the majority's misplaced benevolence."[5]

Thus, if I survive to the ripe age of Professor Mises, I may well be forced to admit that his predictions of the consequences of political interventions with the market's allocative functions have again proved far more accurate than my wishful thinking.

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Economics In A Changing World
G. C. Wiegand

As the emphasis in economics has shifted during the past fifty years from a search for knowledge of the forces which govern the economic life to an attempt to plan and regulate the economy, a schism has developed within the discipline between the 'pure theorists' and the 'practical policy-makers' which may have serious consequences for the discipline and for the country as a whole, because it reflects a fundamental misunderstanding of the nature of economics in modern life.

The general public has never fully understood the basic nature of economics, and even economists occasionally admit that "they have not yet agreed what it is (they) are talking about."1 After attending a recent meeting of the American Economic Association, a reporter complained about the "impotence and irrelevance" of economics, and the tendency of economists "to operate in a vacuum."2 And many people agree with this view regarding the work of the 'pure theorist.'

No doubt, the general public has always been inclined to criticize economists. The Physiocrats were ridiculed, and 19th century humanists and humanitarians deplored the 'iron law' pessimism of the classical school. "No Englishman in his secret soul" according to Bagehot, "would ever be sorry for the death of a political economist." Today's criticism, however, is of a different nature by being largely pragmatic. What use is there, the people wonder, in spending time and money on abstract models which even members of the profession often do not fully understand, and which have no apparent bearing on the problems of the day? And why don't the practical policy-makers, who claim that they can "fine-tune" the economy, get on with finding a solution for the pressing problems of inflation and unemployment?

The public is told that we live in the "Age of the Economist," and that thanks to "the internal advances in recent decades ... in economic knowledge ... modern economics can deliver the goods."3 Yet the country and the world seem to be drifting deeper and deeper into what the Germans have come to call "stagflation," the unhappy combination of economic stagnation and inflation. Is there something fundamentally wrong with economics as we know it today? Is the discipline as a whole in need of a basic reconstruction?

Few modern economists feel as Robert Torrens did 150 years ago, that within a few decades "there will scarcely exist any doubt respecting any of [the] fundamental principles"4 of political economy, or as Schumpeter wrote just before the First World War that "the theory of the socio-economic process [had been] unfolded for the first time as an organic whole."5 But while most modern economists admit that we have made little progress in understanding the inner workings of the "great machine," there is a widespread feeling that even though we do not really understand what makes the economy work, we can probably improve it "by tinkering with it."

“Pragmatism” wrote Time some years ago, in describing the attitude of President Kennedy's economic advisors, “is the vogue word among economists today.... When economists call themselves pragmatists, they mean that they are the opposite of dogmatists, that they are wary of broad theories, that they lean to the cut-and-try approach to public problems, and that they believe it is possible to improve the functioning of the economy by tinkering with it.”6

In short, the pure theorists claim that they are not concerned—or certainly not immediately concerned—with the problems of the day, and the practitioners are wary of theories and try to solve the problems of the nation and the world by day-today ad hoc measures. All in all, not a picture which should reassure mankind, yet characteristic of the critical stage in which economics as a discipline finds itself at present.

The Changing Nature Of Economics

“Model building” according to Gunnar Myrdal, “is a universal method of scientific research. But to construct models in the air, out of uncritically conceived concepts that are inadequate to reality and not logically consistent, and so pretend to knowledge when none had been established, does not represent scientific progress; it comes near to being an intellectual fraud.”7 Unfortunately, only too many economic theories, both of ‘scientific’ and popularized variety, reflect the tendency described by Myrdal, and the public is being misled into believing that the theories proclaimed by the experts actually explain reality, and that the remedies proposed are both consistent and feasible.

The Employment Act of 1946, which has had a profound effect on American economic life, is a case in point. It places upon the President the responsibility of achieving and maintaining ‘maximum employment,’ implying (1) that the President and the Council of Economic Advisors can predict months in advance the probable level of economic activities; (2) that the government has the tools to “fine-tune” the economy in order to achieve maximum employment and growth without inflation and a balance of payments deficit; and (3) that the President and his advisors can have the insight to foresee the repercussions which the full employment measures will, or may, have on other aspects of the socio-economic system.

After 25 years of “planning”—with chronic inflation and regular ups and downs in economic activities—we know today that the full employment scheme which Congress adopted in 1946 does not work as expected. And the reason should be obvious. No group of economists can at present predict sufficiently closely the level of economic activities to keep the economy on the extremely narrow path between inflation and unemployment, and there are no precision tools to correct deviations from the expected norm.

Conditions have changed little since Neumann and Morgenstern wrote a generation ago that “there exists at present no universal system of economic theory, and ... if one should ever be developed, it will probably not be in our lifetime.”8 Neumann and Morgenstern saw the problem chiefly as a methodological one, “the creation of new mathematical disciplines" to handle the functional relationships of the multitude of economic variables in a system of probabilities. Actually, the problem may be far more deep-seated.

As in all fields of human knowledge, economic theories are based, consciously or subconsciously, on the one hand upon the personal experiences and value-judgments of the individual scholar, and, on the other hand upon a variety of explicit or implicit premises which in turn reflect the prevailing intellectual climate. As Frank Knight once put it, the ultimate reality of economics is the 'zeitgeist.' And during the past 50 years, the physical surroundings and the intellectual climate of western civilization have undergone fundamental changes, which have weakened, if not destroyed, the philosophic premises upon which economics was built during the past 200 years.

We are not interested here in the outward technological-social changes which have occurred: urbanization; rapid transportation and communication; the population explosion in developing countries; the end of the "European age"; the development of mass democracy with its Procrustean inclinations toward 'equality'; the growth of the new 'Leviathan'; and the modern emphasis on social security at the expense of individual freedom;—all of which have obviously created a new 'social reality' which calls for new theoretical explanations.

Far more important, however, than the changes in the world in which we live, are the fundamental changes in the way in which we think about this world;—our ethical, metaphysical and socio-psychological premises.

The Premises Of Economic Analysis

Much of analytical economics is based on at least four major premises, namely, the assumption that economics can be treated as a value-free, purely quantitative discipline; that there exists a social order governed by innate, universal and eternal forces; that these forces are mechanistic in nature; and that they can be 'discovered' by the economist in his capacity as an objective, 'value-free', outside observer.

To these major premises, which developed during the Renaissance and especially during the 17th century—actually before economics as a discipline was born—the 18th century Enlightenment added four minor premises: (1) 'Der wirtschaftende Mensch' is inherently rational, i.e. a pleasure-profit-maximizing creature, whose 'egoism', however, is balanced by 'altruism' which assures the preservation of the social fabric. (2) The social order is atomistic, and can hence be interpreted in micro-economic terms. (3) Private property is the inherent right of the individual which cannot be impaired by government fiat. Its role in the socio-economic process can thus be treated as a constant. And (4), man and his material existence will infinitely progress, without bounds and without major ill effects.

The Abandonment Of The Minor Premises

For better or for worse, western civilization has lost faith in these premises. They are part of an era which is no more. Yet most students of economics fail to see that the rejection of these premises weakens, if it does not destroy, the basis of traditional economic reasoning.

The Age Of Irrationalism

Micro- and to a large extent macroeconomic theories assume that men, in the aggregate, act rationally, that they respond in a more or less uniform fashion to a given set of situations. Without this assumption, economic forecasts are all but impossible. Obviously, given two products (which provide the identical degree of satisfaction) the great majority of the people will purchase the cheaper of the two. But this 'Robinson Crusoe' situation does not necessarily apply to the more complex decisions, which are actually far more characteristic of modern society. Can we actually assume, as Adam Smith did, that man will choose what is best for him and society? Workers demand wage increases far in excess of the rise in productivity, even though 'logic' should tell them that excessive wage increases will result either in inflation or fewer jobs. Politicians and bureaucrats keep on raising taxes and public spending, and operate on huge deficits, even though 'logic' should tell them that these policies must produce inflation, weaken the currency, and in the end 'kill the goose.' How much rationality is there really in either the private or the public sector? Probably not much less than there was at the time of Adam Smith—although, the more all-inclusive the vote, the more difficult it becomes for political leaders to appeal to reason; but in the past, western man claimed to be rational, and economic theory assumed that he was. And economic theory, certainly microeconomic theory, still pictures the market place as a reflection of the rational actions of buyers and sellers, even though we have come to doubt the rationality of consumer behavior in an 'affluent society,' and western thought in general tends to challenge the traditional notion of man's rationality. "Reason, although dead, holds us with an embrace that ... turns out to be rigor mortis."

From the Age of Rationalism, in which western civilization lived for the past 300 years, we are passing into a new Age of Irrationalism, whether it be modern art or poetry, the Freudian emphasis on the subconscious, the various shades of existentialism, the drug cult, or the growing popularity of the occult. "The whole world has become a surrealistic picture." One of the highest-paid modern American painters, Willem de Kooning, is praised by Time as "an artist who boldly dares over and over again to capture the essence of chaos."[9] "Man now realizes that he is an accident, a completely futile being that he has to play out the game without reason."[10]

Ours is at the same time, a world of science and technology, and a world of anti-intellectualism. "Muera la inteligencia!" was the battle cry of the Falange. "I want to make the people feel ... They can think afterwards," wrote John Osborn, the author of Look Back in Anger. Like Tertulian's dictum: "Credo, quia absurdum," modern man rejects the rational and reaches for the irrational. "I detest the Renaissance" wrote the French painter Pierre Soulages, and President Johnson was praised for being "a pragmatic man and not a theorist, an actionist and not a philosophic thinker."[11]

Since we no longer believe that man as an individual, and hence men in the aggregate, are rational and can comprehend the world in which they live, it may seem justified for economists to assume that there is no sense in their trying to communicate with the public at large. This is obviously a complete reversal of the attitude which prevailed during the past 200 years since the days of the Physiocrats.

The 18th and 19th centuries assumed that man must understand the mechanism of the self-equilibrating economic forces in order to be able to adjust to them. Today, we reject the very notion of self-equilibrating forces, and we deny that the public can grasp the complexities of the economic process. Yet we assume that the experts can not only understand the economic system, but can manage it for the benefit of—but without much help from—the great mass of the people.

There is danger is this 'professionalism.' Every time a person, be he an economic expert or not, makes a major purchase or sale, or votes for a political candidate, he makes economic decisions, and unless he understands what he is doing or voting for in the end, he surrenders his right of self-determination to politicians and behind-the-scene 'experts,' who are only too willing to take over. The German Chancellor Kiesinger, for instance, is quoted as having said that "in complex questions, I do not consider the mass of the people competent."12 Economic problems "are intricate ... and [according to one of America's leading economists] cannot be fully understood even by the intelligent minority ... On these technical matters [including "the functioning of the monetary system"] the American people will have to accept the word of the experts."13 Or, as another leader of the profession put it: "Economists, ... much to the detriment of their field, have attached unreasonable importance to be understood by the general public ..."14

From The Atomistic To The Organic Picture Of Society

The shift in emphasis since the 1930's from an almost exclusively micro-to an increasingly macroeconomic approach in economics reflects the basic change from an atomistic to a predominantly organic15 concept of society.

As late as the 1920's, it was fashionable to proclaim that "there is no America—there are 120 million Americans." Few would argue today that "America" is merely a verbal abstraction. The state, society, or whatever we wish to call it, has become an overpowering reality.

"The democratic idea of freedom ... must lose its nineteenth-century meaning of individual liberty in the economic sphere, and become adjusted to new conceptions of social duties and responsibilities.... Individualism in the laissez-faire sense is a false abstraction which has lost any concrete relevance it once possessed ... like the Divine Right of Kings, or the theological view of the State.... Our old order contains two principles which ... have now combined to deadlock progress. One is the liberal principle of economic individualism ...; the other is the conservative principle of class privilege based on property and social positions."16 Keynesian economics, and the whole macroeconomic approach, lacks inner logic, unless we are prepared to abandon the spirit and premises of 19th century liberalism and individualism.

The Changing Notion Of Private Property

One of the logical concomitants of the trend away from 19th century individualism has been the changing attitude toward private property. Disregarding Proudhon's slogan that “property is theft,” there are two basic views of the nature of private property. It can be regarded either as a social institution created by society for the benefit of society,—this is the traditional view; or, in the Lockian sense, as an inherent right of the individual, ranking equally in importance with life and liberty.[17] During the 19th century, and in the United States until the Great Depression, the Lockian individualistic philosophy of private property predominated, supported in Europe by a one-sided interpretation of Roman Law and in this country by an equally one-sided interpretation of the 5th and 14th Amendments.

Modern thought represents a return to the pre-Lockian view; and modern economic policy, based on centralized planning by government authorities, calls for an increasing curtailment of private property rights. In the end, there is no way of reconciling Keynes and Locke. Literally hundreds of Supreme Court decisions and administrative rulings reflect the new spirit;—and so does the change in attitude in the Papal Encyclicals.[18] An extreme view was recently expressed by Buckminster Fuller, whom many regard as “the Leonardo da Vinci of the 20th century.” “Property” Fuller proclaimed, “is the invention of an illiterate man who was hungry and tough and scared that he wouldn't survive. So how was he going to act? That's mine! That's mine! But there's not going to be any property much longer.”[19]

The Idea Of Progress

Finally, the notion of progress, one of the most important driving forces in western civilization since the days of Bodin, More, Bacon and Campanella, has given way to a widespread apathetic pessimism. At the end of World War I, Spengler tried to prove that the progressive “decline of the West” was the result of inexorable laws of nature and society. At the end of World War II, Toynbee, dealing with the same topic as Spengler, agreed that western civilization was in a “time of troubles,” but he rejected Spengler's notion of inevitable laws of decay, and postulated instead that western man was free to overcome the difficulties of the time.

Millions of Americans, especially among the young, no longer share Toynbee's qualified optimism of thirty years ago. Instead, a deep gloom has settled over America and large parts of Europe. Surrounded by ever greater material affluence, the world lives in an “age of impatience,” “an age of anxiety,” “an age of terror,” or in “den letzten Tagen der Menschheit,” depending upon the degree of pessimism of the author. Modern physicists have calculated when all life on this earth will end; according to Karl Jaspers “we regard it as possible that man may be doomed, or that he may turn into a different animal, disconnected from all that we are, seek, love and have made;”[20] and Boulding speaks of the “inexorable and irreversable movement toward the equilibrium of death.”[21] The faith in science, technology and progress, which dominated western life for the past 2–300 years, is being replaced by the fear of an atomic cataclysm or the slow death through pollution. Progress means change, and change means insecurity; and man seems no longer willing to sacrifice security to progress. In the early 1960's President Kennedy could fire popular enthusiasm, and Congress voted billions to put the first American on the moon. Ten years later, the majority of the American people and Congress voted against the Supersonic Transport.

Progress need not be a steady increase in material affluence, of course. Instead of a bigger and bigger G.N.P., man can strive for a more meaningful life. But such a goal could not easily be explained by profit-directed micro- or growth directed macro-economic theories. Our merchandising methods, our technology, our industrial and economic planning, our whole life would change, if the American people no longer believed that the latest must be the best.

Yet, while the faith in progress has been seriously weakened, most economic theory has made no allowance for this basic change in the popular outlook.

The Changing Metaphysical Basis

In the preceding pages we have shown how western man has largely abandoned four of the important assumptions, which for the past 200 years formed an integral part of economic reasoning.

It is not a question whether these changes represent progress or decay, we merely claim that the nature of economic reasoning must change, as we abandon the traditional premises.

Less obvious, but probably more fundamental, is the fact that modern philosophy and modern science no longer accept the picture of reality which crystallized during the 17th century, and which provides the four basic premises of analytical economics.

During the 19th century, when economics was largely an analytical discipline, searching for an insight into the mechanism of the 'great machine,' the question whether economic models truly reflected empirical reality, was largely academic. In fact, some economists, and among them especially Ludwig von Mises, always held that "economic theorems are not open to any verification or falsification on the ground of experience.... The ultimate yardstick of an economic theorem's correctness or incorrectness is solely reason unaided by experience."22

Economic Assumptions And Economic Planning

The situation is different today, as economics is becoming an increasingly operational discipline. Like all applied sciences, modern economics is expected to provide 'practical knowledge,' which will permit quantitative economic planning.

Can economics meet these requirements of the time? The premise that economics is—or is gradually developing into—an exact science is based on three assumptions: (1) that the economic life is governed by inherent 'laws;'—or to put it less emphatically: that there are, in the aggregate, certain predictable tendencies in economic behavior, which determined the main stream of economic events; (2) that these ‘laws’ are of such a nature that they can be understood by man; and (3) that man can develop the proper tools to control the essential features of economic life.

In order to prove the rationality of modern economic planning, it is thus necessary to show that there is a ‘reality’ about which man can know enough to permit forecasts within a fairly narrow range of probability. This is not merely a question of the accurateness of the statistical data and the effectiveness of economic tools—both of which leave much to be desired—, it is above all a question of the justification of metaphysical assumptions. Man is free to build models, but unless these models closely resemble ‘reality’—whatever ‘reality’ may be—he cannot hope to land on the moon. Do economic models resemble ancient maps or modern astro-physical calculations? Can they ever be made to resemble the latter?

A thousand or more years ago, Christian mapmakers pictured the world on basis of a ‘divine plan’ which they had gleaned from the Bible and other authorities;—the equivalent of modern economic models based on non-verifiable assumptions. If a country did not fit into the design, it was simply omitted;—which was really not more ‘unscientific’ than the practice of modern economists of turning important variables into constants, because they cannot readily be quantified. The early medieval maps served their purpose in illustrating the ‘divine plan,’ but the ‘geography’ of the Venerable Bede, Isidor of Sevilla and Scotus Erigina—all very learned men—was of no use in guiding ships and caravans. A choice had to be made between designing a map which was ‘logical’ according to the revealed divine plan—and hence of obvious value in its own right—, and a map which was ‘practical’ in guiding the traveler.

The problem of the 20th century economist is far more difficult than was that of the 8th century map-maker, because the economist's task does not consist simply in picturing what he can see, the various phases of the economy in action, but in presenting a model of the economic forces which he cannot see. In fact, the economist does not know whether the economic forces which he strives to ‘discover’ actually exist, or whether they are only constructs of his mind. The 19th century assumed that the economist could know reality; the modern economist is far less certain, since the 19th century concept of reality is fading away as a result of the experiences of modern science.

The Nature Of Reality

There are at least three ways in which ‘reality’ can be conceived. One can look upon reality as being composed of three closely interrelated elements: God, man, and the physical universe. According to the Christian cosmology of the Middle Ages, God had created the world as a stage setting for the great cosmic drama of man's struggle for salvation. Nothing existed that was not related to man and his ultimate destiny, and an all-powerful, all-wise and all-kind God was free at all times to intervene directly in the material world to reward or punish man.

On the other hand, reality can be conceived as consisting of the material world only; the Cartesian view. God has created man and the universe, but no longer directly intervenes in the world of time and space, which exists in its own right, independent from the human observer, who looks upon the world, as it were, from the outside. This is the view of the world on which science has been based for the past 300 years, and it is also the picture of reality which the analytical economist assumes.

Finally, it is possible to conceive the physical world and man as an inseparable entity. The physical world no longer exists in its own right independent from the human observer, and man, being now an integral part of the reality he attempts to observe, can no longer claim the ‘objectivity’ which the 19th century postulated. You cannot study a wave, of which you are a part. To a Hindu, this is the only possible way in which reality can be conceived—man as an integral part, rather than a special feature, of creation;—and modern western science leans in the same direction.

As the picture of reality changes—from that of the world of Descartes which can be viewed by man as an outside, and hence objective observer, to one in which the physical world and the human observer are inextricably interrelated—the very nature of our knowledge changes. Where does reality which we observe and measure cease to be objective reality, and begin to be a reflection of the subconscious of the observer?

Most economists still believe that they are dealing with a Cartesian reality. Yet the very notion of an objective economic reality, analyzed by an objective economist may have been foolish from the outset, and this misconception may well be at the root of many of our ills.

For the medieval mind, truth, as it concerned the material world, consisted in reconciling material observations with the ‘revealed’ truth, all of which was contained in the Bible and the teachings of the Church. The world reflected an Aristotelian hierarchy of innate qualities: bitterness, heaviness, hardness; and only very gradually, as clocks and measuring devices improved,—Lewis Mumford spoke of the transition from the “eternity of the religious man” to the “time of the secular man”— did western thought gradually change from ‘qualitative’ to ‘quantitative’ reasoning.[23]

During the 17th century, a new concept of the material world gradually emerged. However, “this fascinating new world of matter was not being discovered, but literally created by the new scientific mode of thinking. This is the new world that we feel so sure ‘exists’ around us today—the plain commonsense world of hard facts ... [Actually] the form we give to this world is a construction of our brains. Only in that sense does it exist ... Our favorite ‘real’ world was only invented in the seventeenth century, and [at that time] seemed very far from commonsensical to the average man.”[24]

Newton's great synthesis, at the end of the 17th century, finally seemed to confirm on the one hand the concept of an absolute material reality existing in time and space, subject to innate laws; and on the other, the Baconian-Cartesian dream that man's intellect could ultimately decipher God's most secret blueprints.

The Dawn Of A New Reality

But this Cartesian-Newtonian world of observable ‘facts’ and discoverable ‘laws’ is now fading. “The old framework of classical physics [and may we add: of analytical economics] ... the conception of a material world in time and space comparable to a machine, which, once set in motion, continues to run, governed by immutable laws has proven inadequate to explain reality.... This machine as well as the whole world of science were themselves only products of the human mind.”25

“The mid-nineteenth century scientists thought they were looking upon a real external substantial world of material bodies whose content could be measured by its mass and weight.... The information thus provided gave clues ... to the external and changing principles that were firmly believed to underlie the behavior of the world.... Our view is very different.... We can no longer say the world is like this or like that. We can only say our experience up to the present is best represented by a world of this character.”26

The beginnings of this new concept of reality date back more than a century. When Darwin's Origin of the Species appeared in 1859, few people realized that it challenged not only the beliefs of traditional religion, but also the then prevaling basic premises of science. Yet, the theory of evolution made man himself “a natural member of the universe under discovery rather than a superior being endowed with ‘faculties’ from above and beyond.... While enterprises of pre-Darwinian type require certainties, and require these to be achieved with perfection, absoluteness and finality, the post-Darwinian logic is content to hold its results within present human reach, and not strive to grasp too far beyond.”27

Half a century later, Einstein's theory of relativity and Heisenberg's principle of uncertainty showed that the system of causality of Newtonian physics is apparently not universal, and that the nature of physical reality is thus that man can probably never attain full knowledge of a ‘reality’—which may or may not exist.

If this is true in physics, it is even more obviously the case in economics, where we are confronted with not one but actually three factors of uncertainty: (1) The natural laws which we postulate as a basis of our economic model building are largely reflections of the changing ‘zeitgeist’ which affect the conscious and subconscious of the economic model builder. The four ‘minor premises,’ discussed earlier, are typical examples of time-conditioned assumptions which became part of abstract reasoning. All theories are historically conditioned. All methodologies ultimately teleological.

(2) The economic ‘reality,’ largely statistical aggregates, are the result of far from perfect measurements conditioned by strictly subjective criteria of selection.28

(3) the economic standards by which economic performances are measured, and which thus become guidelines for policy—the definition of full employment, or of the ‘normal’ rate of economic growth, or the ‘poverty’ level—are essentially non-economic, but socio-political and teleological in nature, and thus in conflict with the

mechanistic-automatic notions of economics. They are definitely ‘subjective’ rather than ‘scientifically objective.’

In short, we can almost be certain that there is no ‘objective’ economic reality existing in time and space which can be ‘observed’ and ‘measured’ by a ‘value-free’ economist. Instead, the economic ‘reality’ which the economic planner tries to manipulate is actually a construct of the human mind, i.e. of the ‘trained imagination’ of the economist. But this imagination, in turn, is subconsciously conditioned not only by the ‘zeitgeist,’ e.g. by the notion of ‘progress,’ but also by the subconsious ‘values’ or prejudices of the economic ‘reality builder.’

“It is absolutely useless to study a mountain of facts without knowing first of all, and very precisely and clearly, what one is looking for.”29 If we look for affluence, we shall find the statistics to prove it; if we look for poverty, statistics likewise will provide the evidence;—as two bestsellers, Galbraith's Affluent Society and Harrington's The Other America—Poverty in the United States indicate.

The Mechanistic Notions Of Economics

The mechanistic elements in economic reasoning have disturbed economists almost from the outset. But the dangers of the mechanistic mode of thinking are becoming apparent only now.

It may seem foolish to us that the 18th century simply assumed that since mechanistic laws apparently governed the physical universe, similar laws must apply to society as well. Yet, considering the spirit of the time, the idea probably seemed as plausible, as did the Keynesian theory to the depression-conscious economists of the 1930's. “It would be very singular” wrote Voltaire, “that all nature, all the planets, should obey eternal laws, and there should be a little animal, five feet high, who in contempt of these laws, could act as he pleased, solely according to his caprice.”

Thus was born the picture of the economy as a great, self-equilibrating machine, similar to the solar system. “In this immense machine” Galiani wrote in 1770, “everything hangs together, is connected and linked. Nothing must disturb the equilibrium lest the whole mechanism overturn.”30 And two generations later, Bastiat wrote in the preface of his Harmonies Economiques: “I believe that He who has arranged the material universe has not withheld His regard for the arrangements of the social world. I believe that He has combined and caused to move in harmony free agents as well as inert molecules.”

Whether we think of the “ordre naturel et essentiel des sociétiés politiques” of the Physiocrats, the “invisible hand” and “iron laws” of the classical school, Walras' general equilibrium, or even Friedman's idea that the economy can be kept on a steady keel by increasing the supply of ‘money’ at a fixed rate;—we meet everywhere the same implied philosophic premise of an economy existing in time and space, functioning like a machine according to innate laws, which the economist can discover;—and (this is the assumption which developed during the past 40 years) can successfully manipulate. In the introduction to his Foundations of Economic Analysis, Paul Samuelson quotes, as a quasi-preamble, a passage from the American mathematician E. H. Moore: “The existence of analogies between central features of various theories implies the existence of a general theory which underlies the particular theories and unifies them with respect to those central features.”

For the past 200 years, this notion of a ‘general theory,’ a universal principle, which unifies all aspects of reality has been deeply rooted in western thought, so that it is not surprising that the ideas of Newtonian physics, which seemed the ultimate truth at the time when economics was born as an independent discipline, should have pervaded—and still pervades—economic thinking, unfortunate as this might be.

After showing, in his younger years, that the cosmic worlds could not be explained in terms of Newtonian physics,—and the same applies, of course, to nuclear physics—Einstein, in his later years, devoted a great deal of time to the search for a ‘principle’ which would unite Newton's world of causality and the modern world of relativity and probability. Werner Heisenberg and many others do not share Einstein's optimism: “The extension of scientific investigation to new fields of experience does not mean the application of previously known laws to new subjects. The belief of the 19th century that the principles of classical physics are ‘absolute,’ i.e., valid for all times, and could never be modified as a result of new experiences, is no longer accepted by modern physicists.”31

Yet economists cling to the traditional mechanistic pattern of thought even though many of them—e.g. Jevons and Marshall, both of whom had been raised in the mechanistic tradition—have long been aware of the potential dangers. The failure of economics to provide what Veblen called a “generic account of an unfolding process” has become a particularly problematic aspect of economic thought, as the emphasis has shifted from micro- to macroeconomics. Growth and decay cannot be explained in mechanistic terms. While economists list numerous, largely non-economic, factors which apparently make for development and growth, no integrated theory has yet been developed. Even more serious is the absence of a ‘theory of decay,’ because there is an obvious danger that Britain, and possibly even the United States, mistake symptoms of long-range decay for the reflections of temporary cyclical downswings.

Conclusion

Despite the promise that we live in the “Age of the Economist,” economics as a discipline finds itself in a fundamental crisis of transition. We may well have reached the end of a two-hundred year epoch which began with the Physiocrats, and which, in recent decades, produced among the general public the—probably false—feeling that “economics can deliver the goods.”

Our political and social atmosphere would be quite different, if the American people realized that the Employment Act of 1946, for instance, and many other political promises are the result of a basic misunderstanding of the nature of economics, and of man's ability to shape socio-economic reality. The American people do not expect the President to be able to assure adequate rainfall throughout the country, even if Congress were to pass an “Adequate Rain Act” and set up a Council of

Meteorological Advisors;—yet meteorologists, as a rule, have been more successful with their short- and long-range forecasts than economists.

The people have been told that Washington can produce full employment, stable prices, and rising incomes, that it can abolish poverty, and since government after government has failed to achieve the promised goals, the people are beginning to conclude that there must be something wrong with the 'system.'

Actually, the fault does not lie with the 'system' which has failed to 'deliver the goods,' but with the false expectations raised by politicians and experts, and the naive ignorance of the public as to the nature of economics and its capacity to meliorate the world's ills.

Man has obtained a great deal of insight during the past 200 years into the economic forces which shape his life, but many of the explanations are based on premises which modern man no longer accepts. A new approach—a new philosophy of economics—is needed, and in this respect, the situation is not unlike that which existed in the mid-18th century when the 'science of economics' was born.

But new ideas do not develop overnight. The Physiocrats and Adam Smith did not prevent the revolutionary upheavals of the 1790's, nor the Napoleonic wars. Decades may elapse before social philosophers have developed a new ideological basis. In the meantime, the future of western civilization may well depend upon the ability of the economist to convince the general public not of his skills and wisdom, but of the obvious limitations of both his insight and skills, so that the people can begin to realize the narrow limits within which government economic policy operates;—limits set by inadequate knowledge, and, more importantly, by the very nature of economics as we understand it today.

Footnotes

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Can A Liberal Be An Equalitarian?
Leland B. Yeager

An answer to the question posed by my title depends obviously, on how its terms are defined.1

I shall deny that a liberal can consistently advocate government action to chop down high incomes or especially favorable opportunities out of zeal for a closer approach to material equality as a goal in its own right.2

Instead of using the term "liberal" as it is used in modern American politics, I use it, as Professor Mises and the "Austrian" and "Chicago" economists do, in the traditional sense. Liberalism is a doctrine that rejects any supposed social or national purpose transcending the purposes of individuals. Instead, it seeks to assure each individual a wide range of free choice among purposes and pursuits. (While emphasizing the goals of each individual, it in no way denies the healthy fact that he may largely relate his own interests and satisfactions to those of many people beyond himself.) Liberalism calls for preserving, adopting, and devising the social, political, and economic institutions likeliest to minimize the frictions that inevitably arise to some extent among the pursuits and the specific freedoms of different individuals. Yet it cannot give an equal blessing to whatever goals individuals might have. Malicious enjoyment of the misfortunes of other people, or envy, or a sheer delight in meddling—all are hard to square with liberalism. This judgment holds even when such tastes are gratified through voluntary transactions among all persons concerned. More about this later.

As for equalitarianism, instead of defining it explicitly, I want to distinguish between leveling up and leveling down. Consider a minority of people whose wealth or income or opportunities are distressingly inferior to those of most people. Redistribution to help them, perhaps through the government budget, is leveling up. With that I have no quarrel in principle. Such relief of actual poverty—of definitely sub-modal circumstances—is not meddlesomeness. Rather, it is an effort to remedy a situation almost universally recognized as bad. (This is not to say that monks and nuns and other ascetics should be barred from choosing a life of poverty.) Involuntary but eradicable poverty is a blemish, making a society less attractive for practically everyone who comes in contact with or even is keenly aware of it. Its elimination would be in the recognized interest of almost everyone.

Redistribution to level down unusually great wealth or incomes or unusually favorable opportunities is quite a different thing. Great wealth is the opposite of something that almost everyone would consider bad for himself. It, or the opportunity to choose it, broadens the range of alternatives open to people, as we can recognize without supposing that material abundance must form the very core of the good life. Ideally, a liberal would like each person to have the opportunity for it if that is what he wants. A policy aimed at leveling down the exceptionally wealthy few would deprive some people of their good fortune—a good fortune that a liberal would welcome for everyone-because other people are less fortunate. If everyone cannot be very lucky, no one shall be. This attitude may be a very human one; but it is an unlovely one, unworthy of being sanctified in public policy.

But do any people who consider themselves traditional liberals really advocate leveling down as distinguished from leveling up? Does any liberal really favor tax progression of such a degree that direct benefits to poor people are doubtful or trivial? It is true that this idea seldom appears unequivocally in print. But it crops up often in discussions. And it seems to underlie the ubiquitous slogan that “Equality is an end in its own right.” Henry Simons, who deservedly ranks as one of the saints of the Chicago School, has expressed his preference

for rather steep progression. The tax system should be used systematically to correct excessive economic inequality and to preclude inordinate, enduring differences among families or economic strata in wealth, power, and opportunities.3

According to Simons,

Sound meliorative measures must yield not mere leveling of incomes but leveling accretions of capacity, capital, and possessed power. Equality of opportunity is an ideal that free societies should constantly pursue, even at much cost in terms of other ends.4

According to Allan T. Peacock,

Liberal support for such measures as progressive taxation does not rest on the utilitarian belief that an extra pound is more “valuable” or will “afford a greater utility” to a poor man than to a rich man. It rests on a positive dislike of gross inequality.5

Frank H. Knight has repeatedly likened social life to a “game” or “contest”, has talked about the “distribution of prizes”, has mused on what arrangements tend to make the contest “interesting to participants and spectators”, and has considered the imposition of “handicaps”.6 His thought is so rich and complex that a reader cannot be sure whether Knight really favors some degree of leveling down for the sake of equality as an end in its own right. Qualifications can also be found in Simons's writings. But whatever the correct interpretations may be, Knight and Simons have furnished intellectual stimulation for some of their more forthrightly equalitarian Chicago School disciples. Ideas of the kind under consideration abound, of course, in the works of writers who do not even claim to be traditional liberals.

I wonder whether liberals who speak of equality as an end in its own right have really examined their values thoroughly. Why is equality an end? Perhaps some people honestly have no idea of how to answer this question because they consider equality as an ultimate desideratum that they cannot describe as a means of serving any more basic values. But this position must be rare. Most equalitarians presumably consider equality a means to more basic values with which the connection is obvious.

What might these still more basic values be?7 One might be the avoidance of concentrated power. But great wealth is not great power. Being wealthy does not enable a person to coerce others or to restrict the opportunities open to them. His ability to offer them financially attractive deals is not the same as power to deprive them of alternatives they would have had anyway. The situation would be different if one person or group, or a very few of these, accounted for a large enough fraction of national income or wealth to possess monopoly power in dealing with other people. Then, however, the unsatisfactory condition would be precisely this monopoly power; and it would confuse the issue to talk about inequality instead. When a country has several thousand separate individuals or families of great wealth, it is almost a contradiction in terms to speak of concentration of wealth or power in their hands. On the contrary, the existence of several thousand pillars of economic strength, many of them able and some of them willing to support causes and persons that may be unpopular with the general public and with the government, may be of great value in preserving a free society.

Another motive for equalitarianism might be the belief that a marginal dollar adds less to the utility of a rich person than of someone else and that redistribution might accordingly increase total social utility. Besides taking some old-fashioned strands of economic theory too seriously, this argument blinks the ethical question whether an involuntary transfer can be justified by the mere fact or conjecture that the gainers gain more than the losers lose. A more plausible version of the argument is that the surplus of the rich can be taken for such socially important purposes as building and running schools and hospitals. In considering this argument, we must distinguish between two cases, though the analysis does not hinge on any exact dividing line between them. First, suppose that those who benefit from the schools and hospitals8 are so poor that they could not pay for them without trenching painfully on consumption of still more urgent necessities: they could not pay by ordinary private purchase of schooling and hospitalization, through premiums on private or governmental insurance, by taxes, or in any other way. The problem is then one of their actual poverty, and rhetoric about schools and hospitals in particular beclouds the issue. Most liberals would favor measures to relieve actual poverty; but precisely because it is in almost everyone's interest to live in a society free of actual poverty, it is not clear—at least, not without further argument—why the cost should be concentrated on a rich minority. Secondly, suppose that the beneficiaries of the schools and hospitals are not especially poor and could afford to pay for their services in one of the ways mentioned. Why, then, should a rich minority have to pay a share of the costs out of proportion to their share of the benefits? So far as the beneficiaries of the schools and hospitals escape the cost, they have money left over to spend on other things. Redistributive taxation may thus in effect make the rich help pay for the clothing, automobiles, entertainment, and liquor of people who are not poor. Perhaps this is defensible; but what, then, becomes of the special emotional aura of schools and hospitals?

Perhaps equalitarianism is an extension of the liberal case for relief of actual poverty. For (redistributionists might argue) the dividing line between poverty and adequate income is vague. Even persons in the modal or typical income brackets may suffer relative poverty: they may be uncomfortable about not being able to live on the same material plane as the wealthy minority. If relieving the discomfort of actual poverty is urgent, then relieving the mental discomfort of relative poverty may be advantageous.9 In reply, it may be pointed out that while a line between poverty and material comfort cannot be drawn precisely, a general basis for the distinction exists. In the United States, the persons to be considered actually poor are a fairly small minority in material circumstances well below what is typical. Redistribution to benefit this poor minority is different in principle from leveling down a rich minority in the supposed interest of a modal majority. Principle, not definite tax schedules, is what is at issue here. A further aspect of the issue is whether public policy should recognize the notion of relative poverty and should dignify whatever uneasiness some people may feel about the better fortune of others by basing tax legislation upon it. It is not enough to consider what attitudes may in fact prevail, causing mental pain or pleasure; social philosophers also have the job of considering what sorts of attitudes should or should not be encouraged because they do or do not tend to promote a good society, coherently conceived.

Perhaps the redistributionist case rests less on any of the foregoing arguments than on inchoate notions about what makes for a healthy tone of society—notions about avoiding social distinctions and feelings of inferiority and about promoting solidarity and brotherhood. Slogans about equality as part of the democratic ideal support this conjecture. I admittedly would consider it a good thing (though I would be hard pressed to explain just why) if the distributions of physical and mental talent and energy, personal ambition and inclination, inherited property, advantageous family backgrounds, and so forth meshed with the derived demands for material and human factors of production in such a way that the personal incomes distributed on the free market were not conspicuously unequal. Spontaneous equality of this sort could perhaps be furthered by measures to break down any contrived restrictions on economic opportunity.

Spontaneous equality would still contrast sharply with deliberately leveling down the rich. Deliberate leveling would be likely to do the reverse of overcoming incentives to envy, embarrassments to social intercourse, and obstacles to brotherhood and mutual respect. The degree of envy and so forth would probably not correlate at all closely with the size of inequalities remaining under an avowed program of equalization; sometimes the smallest distinctions are the most keenly resented. More important, the idea of deliberate leveling seems dangerously akin to ideas that all men are not equal in those respects which concern the State, that men with different incomes are different in intolerable ways, and that differences in people's material wealth and life style—differences going beyond the discomforts of actual poverty—are conditions to emphasize, to be suspicious of, and to take action about. To work against poverty is admirable, but to be concerned about other people's exceptional good fortune and to want to interfere strikes me as hardly compatible with a coherent liberalism. People are all too ready, anyway, to pass judgment on their fellows. They are all too ready to display intolerence, bitterness, Puritanism, a busybody spirit, and suspicion of other people and their personalities and life styles. Many redistributionists, it is true, are moved by humanitarian motives; they do not want to promote suspiciousness or pander to resentment. But "good intentions are not enough." The spirit of live-and-let-live, so crucial to a free society, is fragile. Any policy that dignifies and reinforces the less lovely traits of human nature, however unintentionally, deserves bad marks on this score.

The leveler philosophy may rest in part on the feeling that extremely high incomes are undeserved. Of course not all large incomes derive from hard work, ingenuity, or alertness in meeting consumer tastes. Large incomes obtained by force, fraud, restraint on competition, or dishonest advertising and salesmanship are indeed open to question. More precisely, it is the illegal or immoral activities themselves that deserve attention; to focus on the sheer size of the resulting incomes beclouds the issue. Large incomes due to inheritance of talent or energy or beauty or connections or wealth, or to sheer luck, pose a trickier question: why should some not particularly virtuous people enjoy luxury while millions of harder-working and worthier people must scrape to make ends meet? In partial reply, one may ask another question: If the processes of allocating the services of persons and property into the lines of most intense consumer demand yield very large incomes for some not especially deserving persons and for their heirs, who is actually hurt and entitled to complain? In an innovating, enterprising society, total real income is not a rigidly fixed pie; larger slices for some do not necessarily mean smaller slices for others. Perhaps people with lower incomes are harmed in the sense that their taxes would be lower if the rich paid still higher taxes. But this "harm" is different from harm positively inflicted by the rich. As for rich persons innocent of illegal or immoral activities, the demand that they justify or forgo their exceptional incomes raises fundamental questions about what prerogatives of organized society are compatible with liberalism. Like busybodiness, it is perhaps a human trait to begrudge one's fellows whatever exceptional good luck may come their way—I say "perhaps" because the general public does not seem to bear grudges against lottery winners and against the exceptionally glamorous rich—but grudges about good luck are unworthy of being dignified as the basis of public policy.

Note that I am not accepting—instead, I explicitly reject—the "marginal productivity ethics" of John Bates Clark and his followers, a doctrine rightly dissected by Frank Knight and other liberal economists. The mere fact that a man's own work or the services of his property happen to have an exceptionally high market value does not mean that he is especially deserving, in any ethical sense, of an exceptionally large income. Market value is not a measure of ethical merit, and people in general would be happier if this fact were explicitly recognized.10 My concern is with what sort of a politico-economic system would replace capitalism if productivity and market-value considerations were set aside as a basis of income distribution. More specifically, in this paper, I am concerned about the implicit redistributionist conception of the State as an agency that, while not allotting individuals their fates outright, at least takes a decisive hand in readjusting that allotment. I am rather horrified at the idea of the State as a dispenser of "justice" in the concrete, material sense, and as a God that passes judgment on what people deserve and steps in not merely to allay the unfortunate consequences of bad luck but also to strip people of the fruits of what it considers too much good luck.

Before returning to the question of equality of opportunity, I shall now shift from examining possible strands in a rationale of leveling down to expressing some actual doubts. A much-discussed problem in political ethics arises when people who expect material or psychological gain from redistributionary taxation act as judges in their own cause. By imposing higher tax rates than they themselves are willing to pay, the majority of voters ask a a rich minority to “work more days out of the year for the government” than they themselves are willing to do. As Hayek has said, “That a majority, merely because it is a majority, should be entitled to apply to a minority a rule which does not apply to itself is an infringement of a principle much more fundamental than democracy itself, a principle on which the justification of democracy rests.11

This “discrimination” argument infuriates redistributionists, who suspect that its user's heart is bleeding for people who will have more income and wealth per head, even after taxes, than their alleged despoilers. The critic has a hard time proving that his real worry is over the attitude that might makes right—the sheer might of numerous votes.

The “discrimination” argument would lose much of its force if leveling down were enacted not merely by an overall majority but also by a majority of even those persons who would have to pay the exceptionally high tax rates. But then why not rely on voluntary redistribution? One reason, apparently, is the “public-good” character of redistribution: the typical rich person might be willing to redistribute only if all other rich persons did the same; only compulsion could achieve the general redistribution assumed to be desired by the rich themselves. But if this coerced action would be noble and praiseworthy, would it not be still more so for each rich person to redistribute independently? A generous act is tarnished by being made compulsory and by satisfaction in seeing other persons coerced along with oneself. Those who failed to respond to an educational campaign for voluntary redistribution—I am setting aside, for the sake of argument, doubts about the desirability of even such a campaign—could be left unmolested as monuments to the toleration of eccentricity so essential in a free society. Apart from the matter of voluntary action versus coercion, much can be said for distribution from numerous individual sources and in favor of a great variety of independent purposes rather than through the monolithic agency of the State.

The doctrine of coercive redistribution has a subtle affinity with materialism. Why should it disturb us that some people are very wealthy? If we are unwilling to tolerate great superiorities in income and wealth, how do we feel about superiorities in talent, physical and mental strength and health, influence through family connections and personal friendships, ability and time to appreciate conversation and art and music and sports, amount of formal education, experience gained through travel, and so forth? People's circumstances can be different in innumerable ways. Why do redistributionists single out material inequality unless they think that money is—and should be—the prime measure of a man's capacity to enjoy life and of his worth to himself and other people, his social status, and his personal dignity? The reason cannot be that material inequality is the only kind susceptible of being leveled down. We could partially level out advantages of early training by requiring all children to attend democratically standardized public schools. (Even some self-styled liberals are perverse enough to recommend compulsory military training for similar reasons.) We could level down physical attractiveness by requiring everybody to wear masks and shapeless uniforms, or we could put especially heavy taxes on beauty as well as on brains.

Aurèle Kolnai has perceptively said:

... the true Christian is inclined to feel a certain disdain for the wealthy inasmuch as he disdains wealth, more or less factitious goods of which the rich man is a slave, while the believer in the “social gospel” will call for the elimination of the wealthy for the gain of all because wealth seems to him to be the sole good that counts. In the old liberal-democratic conception, a poor man seemed invested with human dignity, had a claim to honour and was entitled to freedom no less than a prosperous one; the refurbished ideology denies him the capacity for freedom unless or until he is also made wealthy.12

In doubting whether the pursuit of material equality will achieve any of the more decent motives of its proponents, I can quote Frank Knight on my side:

... the significance of consumption itself is largely symbolic; the inequality which really “hurts” is the unequal distribution of dignity, prestige, and power. Neither abstract reasoning nor the evidence of experience affords ground for belief that, given the moral drive toward such values as the dominant motive in society, democratic political process could fail to distribute them even more unequally still than does competitive business.13

Furthermore, pursuit of an unattainable material equality will foster attitudes and political behavior incompatible with a quasi-equality of a more human and more nearly attainable type. Ideally, people should not have to be ranked above or below each other according to the fields in which their accomplishments lie. Each person should have a chance to excel in something, with the different types of excellence regarded as incommensurable. Adventure, scholarship, conviviality, self-effacing service to mankind—all should be as respectable as the amassing of fortunes. People of modest talents or ambitions who do routine work and content themselves with inexpensive pleasures should be regarded as contributing to a desirable diversity in personalities, modes of thinking, and styles and goals of life. A teacher could continue associating without embarrassment with congenial former colleagues or students who had become business tycoons not because progressive taxation had lopped off their larger monetary incomes but because scholarly values and monetary values were regarded as incommensurate but of equal dignity. As Herbert W. Schneider has noted, the equality of the equalitarians implies measurement; he emphasizes, instead, what he calls “the incommensurability of human beings”.14

“All men are created equal” and statements like that are obviously not meant literally. They use poetic language legitimate in their contexts. They are meant as normative prescriptions for social actions and attitudes. They express disapproval of trying to classify individuals as more or less worthy, more or less entitled to pursue happiness in their own ways, and more or less entitled to have their views or interests considered in the forming of public policy.

We should not exalt materialism, but neither should we despise it. Just as a healthy society needs statesmen, humanitarians, esthetes, and eggheads, so it also needs money-minded Philistines. It takes all kinds of people to make a world. Each person's freedom to choose the niche in life that best accords with his own talents and inclinations gains from the willingness of other people to fill other niches.

Erosion of monetary incentives unleashes pressures toward conformity. One of the individual's best protections against the arbitrary whims of the business firm employing him is the fact that his employer and other employers are seeking profit in a competitive market. Policy that weakens the profit motive or the competitiveness of markets is likely to reduce the cost to employers of tyrannizing over employees. (This fact, in the academic world, leads teachers to demand other forms of protection.) Furthermore, to the extent that the tax structure leads companies to compensate their executives in kind rather than in freely spendable money—stock options, club memberships, pleasure travel in the guise of business travel, use of company cars, planes, apartments, vacation lodges, and expense accounts—to this extent business and private lives become intermingled. We see the rise of the Organization Man. From the liberal point of view, this state of affairs seems questionable not only or not even especially for the Organization Men themselves but also for members of society in general.

I offer as a mere conjecture one more doubt about equalitarianism. Especially if it is dignified by serving as a basis for public policy, the philosophy that encourages people to brood about whether wealthier people “deserve” their material abundance, and whether they themselves are not “entitled” to a larger share, may well have something to do with crime. Even relatively poor people are likely to suffer in the long run from the far-reaching consequences of a philosophy that undermines respect for personal safety and property rights.

The postponed topic of equality of opportunity will now serve as a transition to the concluding sections of this paper. Ideally, everyone should have a decent start in life, free from the cumulative disadvantages of initial poverty. But should the State go so far as to try to deprive fortunate young people of whatever advantages they might enjoy from bodily or mental or financial inheritance or from family background and contacts? Much could be done, after all, towards offsetting even the nonfinancial aspects of exceptionally favorable opportunity. Any really close approach to equality of opportunity is, however, impossible. Liberals should shun a slogan—“equality of opportunity”—whose implementation is impossible, especially since even an attempt to implement it approximately would entail extreme totalitarianism. Furthermore, it is logically difficult to establish equality of opportunity as a desideratum distinct from equality of income or status, since unequal attainments in income or status must be due either to unequal luck or to unequal endowments of the abilities and inclinations conducive to achieving income or status. From an equalitarian standpoint, inequality of results would show that unequal luck had not been properly compensated for or that opportunities had not been properly equalized.

From the liberal standpoint, the whole discussion would be simplified by calling for adequacy rather than equality of opportunity. Removal of actual poverty and of caste and race restrictions that arbitrarily hamper people in the pursuit of their own goals is quite different from chopping down advantages.

Why, incidentally, might anyone want to chop down advantages rather than merely remove disadvantages? I wonder whether one of the objectives of equalitarians who consider themselves liberals might not be to make the outcome of the market process a more nearly plausible indicator of personal worth. Their likening of life to a “game” or “race” and their talk of imposing “handicaps” to make the game “interesting” certainly suggests so. Everyone is to have the same purpose in life, overriding the diverse purposes that individuals might otherwise have; and this common purpose is to be success in the game. Everyone is to engage in—if necessary, be drafted into—the game. The score will be kept, especially in terms of money and status. No one will have an excuse for not taking this rivalry seriously, for proper handicaps will have been imposed. By persuading themselves that the “game” has been made “fair”, the self-styled liberal equalitarians will have more supposed basis than ever for indulging their propensity to pass judgment on their fellows, smugly dispensing praise and scorn.

This view of society as an organized activity, with the government as a busybody game-master or social director imposing handicaps and otherwise trying to drum up “interesting” rivalry, strikes me as profoundly anti-liberal. It is putting things backwards to regard the game—or the market of the textbooks—as a supreme value in its own right, with the diverse values of individuals taking second place.

Here I have admittedly drifted into considering the possible motives of the equalitarians. Questioning motives is often bad form. It is rank anti-intellectualism, in particular, to dismiss purportedly factual or logical propositions by a mere sneer at the alleged motives of their propounders. But when policy goals and conceptions of the good society are at issue, motives are at the core of the discussion. If we ask why a certain person advocates certain policies, the reason is that we are trying to understand his conception of the good society. The tastes gratified by leveling policies—the taste for making a goal out of the social and economic game itself, the taste for smugly passing judgment on other persons, the taste for sheer meddling-clash with the spirit of liberalism.

Am I denying that liberalism accords equal esteem to all tastes of individuals, regardless of what they are? Should liberalism discriminate between worthy and unworthy tastes, ones that “ought” and others that “ought not” to count in a liberal social order? Yes. As a conception of the good society, liberalism cannot, with consistency, give its blessing to all kinds of taste, indifferent to the kind of society that emerges in response. If social philosophy has any role at all, it is to investigate and promote consensus about what social institutions and policies and attitudes are conducive to human happiness. Its job is to paint a coherent picture of the good society. It cannot just offer a ticket instead of a picture, a ticket reading that the good society looks like whatever a substantially unanimous opinion thinks it looks like. There may be no substantially unanimous opinion. Prevalent opinion may be unenlightened. Social philosophy shirks its job whn it offers no positive guidance. Quite properly, de Tocqueville and John Stuart Mill inveighed in the name of liberalism not only against governmental tyranny but also against the conformist pressures of public opinion.

Suppose one man were to buy the fawning submissiveness of another, or even the other's submission to torture to gratify the sadism of the first. Can liberalism bless such transactions in the name of the free market? Of course not. Voluntary though they may be, they gratify and encourage attitudes subversive of an enduring liberal social order. A number of practical reasons, to be sure, tell against making them illegal. On the other hand, public policy should not provide examples that sanctify tyrannical and meddlesome private tastes. Policymakers should recognize that State actions today may well influence what private attitudes will prevail tomorrow.

Does liberalism sanctify illiberal practices freely agreed upon? Does tolerance imply toleration of intolerance? Does democracy imply the right of the people to vote democracy out and dictatorship in? Such questions are reminiscent of certain logical paradoxes discussed by Bertrand Russell and untangled by his distinction between levels of discourse. We have to be clear whether we are talking "in" or "about" language, "within" or "about" democracy, "within" or "about" liberalism. An action or policy that embodies or sanctifies meddlesomness cannot properly be called liberal merely by postulating that it is freely agreed to, perhaps in some market transaction or by some democratic procedure. Liberalism is defined, instead, in terms of the nature and motivation and probable consequences of policies and institutions. For the word to have any content, we must recognize the possibility that people may freely choose the negation of liberalism. To define liberal policies in terms of negotiating procedures or of degree of agreement is to empty the word of meaning. The choices that emerge from political or market processes may quite conceivably not be coherent; they may not fit in with a coherent picture of the good society. One reason among many is that the choices may not be sufficiently enlightened.15 A decision-making process is no substitute for a social philosophy. If totalitarianism were adopted by unanimous consent, would this decision be a liberal one? Of course not; for liberalism values arrangements that enable individuals to pursue their own diverse ends with a minimum of interference with each other.

In conclusion, I recognize that some would-be levelers of income and wealth and opportunity are honorable men. They do not believe that numerical might makes right; they do not want to aggrandize the power of the State; they do not pander to envy; they do not make money the measure of all things; they do not savor the prospect of feeling superior to the losers in a suitably handicapped contest. But in appraising a line of policy, it is not enough to satisfy oneself about the motives of the more honorable among its proponents; one must also consider the type of society that it tends to promote. One must consider that a policy may exert some of its effects over a long period of time through its influence on what attitudes prevail. If I am a good judge of my own motives, I oppose fiscal leveling because I want the kind of society that respects but puts no special emphasis on material values, one that allows niches for people with diverse drives and goals in life, one characterized by tolerant attitudes, and one whose institutions facilitate voluntary cooperation while minimizing the scope for clashes among the freedoms of its members.

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The Political Economy Of Nostalgia
Ramon Diaz

Travaillons donc a bien penser: voila le principe de la morale.

Pascal

I

Regret is often voiced for the loss to Western civilization of a world-view, prevalent in the Middle Ages, according to which, in the words of R.H. Tawney, human society was "a spiritual organism, not an economic machine".1/ The steed of self-interest, or of covetousness, or of avarice, all terms that you might apply to it, was held in check, as this sentiment would have it, by the use of moral bridles and ethical fetters. And if it was not quite held in check, as in fact it often was not, an effort was made in that direction "that had in it something of the heroic".2/ Later the steed was let loose and the results are there for all to see.

Sometimes this sense of loss is coupled with the notion that the West could recapture the world-view in question, if it so wished, and thereby achieve a "moral rebirth"3/ and further that this "re-insertion of the economic world in the moral order"4/ affords the only hope for our civilization to overcome its current predicament. This idea enhances the feelings of regret and then they assume the distinct nostalgic tinge to which the title of this essay refers.

Among those who share this nostalgia, some speak of a system that will transcend capitalism,5/ but few attack private property, including private ownership of the means of production,6/ and their writings contain numerous condemnations of socialism.7/ The "moralizing of economic life" which they propose would imply only slight institutional change;8/ after all, they implicitly argue, there was little production in public hands in the course of the Middle Ages, and certainly no central planning.

We intend to show, against such arguments, that central planning and socialism is precisely where an attempt to restore the mediaeval rule of moral law over economic activity would lead, under contemporary conditions. It will also become manifest, in the course of our demonstration, that some of the principal reasons invoked in favour of the proposal break down completely when extracted from the atmosphere of a closed, stagnant economy with which the system was originally associated.

II

Before that, however, we should try to determine as far as possible what the doctrine in question is and what it implies.

In the first place, it is a theory about what society is; it concerns human activity as it appears when looked at from the outside, as seen by students of society, by social scientists, as we should say to-day. It therefore contains a system of political economy. When held by our contemporaries, it is proper to call it the Political Economy of Nostalgia.

What are its characteristic elements? Let us be reminded that, from the vantage-point in which Nostalgic economists place themselves, society is seen as "a spiritual organism, not an economic machine". If one stands before a machine, the question naturally comes up - how does it work? On the other hand, if one is instead confronted with a spiritual being, a more pertinent question seems to be - how ought it to behave? These political economists consequently tell us, not what people do while they go about their economic affairs but what they ought to do when so employed; they are concerned, not with the sein, but with the sollen of human action.

To illustrate the difference between the Orthodox and the Nostalgic schools of economic thought, let us take the theory of value as an example. The members of the former school examine exchange transactions under given conditions, say under "free market" conditions. By analysing the behaviour of economic units, i. e. of households (sellers of factor services and buyers of consumer goods) and producers or entrepreneurs (buyers of factor services from households, sellers of consumer goods to households, buyers and sellers of intermediate goods among themselves) in terms of their respective goals and the means whereby these can be achieved, the economists of orthodox inclinations can explain how decisions are reached separately by the vast multiplicity of units about the purchase and sale of factor services and goods in such a way that each market tends to reach equilibrium (i.e., to be cleared) at a certain price level. Since this approach comprises the totality of markets, the analysis shows, apart from the laws of competitive pricing, how the economy (i. e. the whole of the consuming and producing units, acting independently, each in the pursuit of its own interests) decides, as Paul Samuelson puts it, what goods to produce and how and for whom to produce them. In other words, this single theoretical block simultaneously accounts for (a) the determination of an equilibrium quantity in each market for goods, which in its turn implies a solution to the problem of what to produce; (b) an equilibrium quantity in each market for factor services, and its break-down at the level of the purchasers, which implies the determination of the factor mix and hence the solution of the problem of how to produce each good and, finally, (c) an equilibrium price in each market for goods and for factor services, all of which, in addition to the quantities resulting from (a) and (b), implies the determination of profits, wages and other factor incomes, i.e. the distribution of national income, or the answer to the question concerning to whom production goes.

Let us next watch their colleagues of the Nostalgic persuasion at work. Their method also comprises the analysis of methods with a view to the attainment of certain goals; but there, in the common use of what has been called "teleological reason",9/ the similarity ends. With the former political economists, the objectives in question are those of individuals or minute social aggregates, the atom-like economic units, and such as, to the best of the economists' beliefs, the units in fact do hold. With the latter, the goals belong to the community taken as a whole, they make up what one might designate the moral purpose of society, and are not part of what the political economist finds given but rather the first question for which he must supply an answer. Whether or not the moral purpose of society is something real and whether or not it can be known, and, if so, how it can be known, involve problems far too vast to be dealt with here. For the sake of argument, we shall assume that reality contains such a thing and that the Nostalgic economists can attain knowledge of it. The next question with which they are confronted is—how ought the economic units to behave so that the common purpose of society is achieved?

Rather than try to show how this question could be answered in the abstract, let us see how the method worked in the historical period when it was at the zenith of its prestige. The words of Henry of Langenstein, a mediaeval writer, contain the doctrine in a nutshell—prices may be such as will enable each man "to have the necessaries of life suitable for his station".10/ This is the most typical formulation of the doctrine of the just price, and from it is transparent that, like the modern theory of fair profits, it aims at preserving a certain social status quo. The unchallenged sway this doctrine has held for something like four centuries shows what exceptional degree of self-contentment with its social arrangements the culture of the West generated at the time, and the fact that the intellectuals of the period—the clerics—enjoyed a position of exceptional social eminence does make one reflect about man's tendency to rationalize his own interests as a form of the common good. It should give the Nostalgic economists food for thought, but, of their difficulties, the present one lies somewhat beside our line of argument. We shall therefore grant that the obvious ideological features of the just price doctrine are accidental to the whole approach and that this could eventually lead to a system capable of realising the true moral purpose of society. What we now have to be concerned with relates to the different contents and implications of the Orthodox and the Nostalgic schools in the realm of value.

The latter's theory is far less comprehensive than the former's—this is the contrast we should like to bring out. The Nostalgic economists perhaps can turn out a set of rules for the pricing of goods and factors relative to each conception of the common end of society that they may happen to embrace, but their theory of value will certainly fail to tell us more than one thing—that the resulting prices will be just in the sense that they are adequate for the chosen end. Seeing that society's moral purpose could never be anything so prosaic as keeping markets cleared, their pricing rules will not even guarantee that. In fact, their theory of value entirely fails to account for flows of goods and services and therefore to throw any light on the subjects of what ought to be produced and how. In the Middle Ages these problems seem to have been solved implicitly by tradition. This could hardly be expected to happen under present conditions and, in fact, Nostalgic writers do deal with such matters quite often. Their way of handling them, however, is unsatisfactory, mainly because they seem to be unable to cope with the pertinent quantitative aspects. As long as they limit themselves to the critique of liberal capitalism, this shortcoming is not very noticeable; as, for instance, when they express their moral reprobation at self-interest providing the sole dictation at which entrepreneurs choose to produce guns or butter, marihuana or milk. But they seem to be seriously handicapped when called upon to pass judgment on how much of each good should be turned out. One can understand that it may be considered immoral to produce guns and marihuana, but hardly that it would be unethical to go beyond a certain annual output of either good. Qualitative questions involving an either-or alternative seem to be all they can answer. The real problem that every economy faces, on the other hand, concerns the mix of goods to be produced, a problem containing a myriad of unknowns. What it all boils down to is that the Nostalgic writers can only provide answers to a few of them—those for which the solution is nought.

But more about this later. Our purpose now was merely to illustrate the differences between the two schools of thought, and let us trust that it has been achieved. We must inquire next about the main implications of the system of Nostalgic economics.

III

Or rather, let us first ask what the system does not imply. It does not imply, contrary to what might appear, the contention that a high level of moral life would follow from its adoption. It is not affirmed by Nostalgic economists, or even hinted, that people at large became moral cynics when, in the sixteenth century, the system they propound was put in abeyance. Nor do they hold that observance of the rules of the system was satisfactory throughout the Middle Ages and everywhere in the mediaeval Western world. What is more, the kindred literature of that period was often cast in a mood that has been described as "the jealous and cynical suspicion of economic egotism".11/ It is not, therefore, the facts of economic life from the Renaissance onwards that the Nostalgic economists particularly find fault with; it is the tone that the discussion began to assume—that matter-of-fact, utilitarian approach—that they abhor. It was tantamount to treating society as an economic machine, instead of the spiritual organism that they know it to be. It implies raising the lamentable workings of avarice to the rank of an object of science, coming to terms with sin. This attitude, which condemns the pursuit of knowledge in a given field as morally tainted, is indeed a strange one. It implies that, after having discerned a level of coherence in human action, man should deliberately stay away from it, that some peaks should remain for ever unconquered, some lands untrodden, certain challenges unanswered. It can be seen that the Nostalgic school holds claims in this field that are quite unrealistic and smack of intolerance.

So much about their attitude towards economic studies; let us return to their views on economic life. These certainly do not include any illusions about the moral conduct of men in the course of their business. On the contrary, as pointed out above, authors of this persuasion have always shown signs of being obsessed by human weakness before the temptations of covetousness. They have never entertained the hope that knowledge of the rules of the good conduct would in itself guarantee their observance; on the contrary, they have always preferred to rely on the authority of government to enforce those rules. Nevertheless, the possibility of spontaneous, uncoerced compliance is certainly implicit in the system. Moreover, among the reasons that commend it most, according to its supporters, stands precisely the possibilities it opens for man's self-realisation through his free observance of the moral law. To state that, ceteris paribus, if demand goes up, prices will go up too is like saying "if you propel that shaft, this wheel will be put in motion". But human beings can transcend the realm of natural laws and be free. And to be free is to act in accordance with the rules of ethics for the sake of justice and truth. Finally, to achieve freedom (man is not born free, according to Maritain, but can become free) is to attain full human status, to realise oneself as a man.12/ Between a system that opens this sort of avenue for man's improvement and another that treats human beings as though they were inanimate things, how can anyone hesitate?

This is the sort of argument one comes across. It is not our intention to discuss it here; merely to point to one thing it implies—that the rules that should govern each man's economic life are intelligible for him. This was clearly the case with the doctrine of the just price. Schoolmen often advised that prices should be fixed by public authority, but this was only because they did not trust men to act ethically. In absence of official pricing each individual must fix prices for himself in conformity with the rules of the system.13/ As a matter of historical fact, most of the mediaeval literature on economic subjects developed as the Schoolmen attempted to provide guidelines for confessors, who in turn were assailed by penitents troubled about what their behaviour ought to be.14/ Sometimes the penitents were rulers, sometimes they were subjects. The system undoubtedly contained rules addressed to one and the other rank. This was so under the economic circumstances prevalent in the Middle Ages. Let us now inquire how the change into contemporary Western conditions would affect the issue.

IV

It has been stated above that, in the Middle Ages, the what, the how and the for whom of production was solved implicitly by tradition. The same can be said about all stationary economies, in which, as Octave Gélinier has pointed out, the role of producers consists of supplying a constant volume of production of an unchanging set of goods according to an invariable technique.15/ The entrepreneur has no place in such an economy; neither have profits.

The situation is radically different in a contemporary Western society. The flow of production varies all the time. Not only does the rate at which each product is turned out constantly change but, what is even more characteristic, new goods are permanently being poured into the stream. Methods of production are hardly more stable. Techniques are in a state of flux and so is the factor mix. The main determinants of change can be grouped under two headings—alteration of consumer preferences and technical development; but, however determined, change always occurs by the decision of an entrepreneur—that character, once superfluous, not long ago unknown, so often still mistaken for somebody else; that character whom profit moves and, even more significantly, guides; whose business it is precisely to supply the flow of decisions that keep a modern economy on the move.

The mediaeval producer was no entrepreneur. The latter is surrounded by problems; the former was immersed in tradition; and tradition had answers for all the questions that could ever arise in his life. Not that many did. Occasionally, the mediaeval farmer or craftsman was confronted with doubt. The disease of a cow, the command of an excentric patron, a friend's offer to lend or request to borrow, a poor harvest or a shortage of certain materials made him ponder. But he would normally find a way out of his perplexity by seeking advice from someone older or wiser. The answer was somewhere out there, to be looked for among the rules of which the fabric of tradition was largely made up.

Some of these rules were seen as possessing ethical nature; others, as the standards of an art or husbandry. When proving elusive, some posed technical difficulties; others, cases of conscience. All, however, were interwoven in the same texture, formed part of the same system.

When the Nostalgic political economists believe they contemplate the mediaeval economic system they suffer from a sort of historical mirage. What they actually see is part of a system, a part that would not be, by itself, viable. When they wish to revive the system they love, they are in fact trying to resuscitate an incomplete body, a fraction that would be quite incapable of independent life.

Or could it be that the Nostalgic school are proposing to do away with all material progress and bring back the economies of the West to a stagnant condition, when traditional technique could again govern the what and the how of production, and ethics could see to the for whom of it? The idea must be dismissed forthwith. Nostalgic economists as a rule entertain nothing but gentle, humane feelings, whereas such a project would involve the curtailment of the population growth by the sheer starvation of millions, before a stationary equilibrium, in the midst of destitution and despair, again became possible.16/

Nor can one hope that a market economy might afford the Nostalgic system the second leg it needs to stand on. Under the conditions they wish to impose upon it, the mechanism simply would not work. We are sorry if the members of the Nostalgic school dislike the metaphor; it is nevertheless a pertinent one. Spiritual beings one can expect to be amenable to argument; machines certainly are not. Try to substitute water for gasoline and your engine, whatever your eloquence, will refuse to start. Social phenomena often exhibit that very kind of intractability. Take, for instance, the notion that profits are deserved, and therefore legitimate, only if the result of the firm's efficiency, the high productivity of its resources or some similar reason. This is undoubtedly among the mildest propositions on record to interfere with market forces. And yet, if adhered to strictly, it would be lethal to a free economy. “Deserved” profits are of no avail when you want to re-direct resources. You need “undeserved” profits for that—i. e. firms ought to make them in the fields of production to which demand requires that resources should be channeled. As Enoch Powell so aptly puts it, “Profit will only serve the consumer and the common good if high profits can be made from time to time with less effort, less efficiency, less of all the deserving virtues than lower profits. Profits are the index of what people want.”17/

Offer the possibility of “deserved” profits only and entrepreneurs will do the necessary to make them. If it is low costs that will bring them, they will see that productivity is high. But their decisions will have lost one of the essential virtues they would have possessed in a free market—the ability to direct resources to where they are most needed. Tamper further with market forces and entrepreneurs will perform their task with ever decreasing efficiency. They will continue to set the course of their action guided by profits but these will no longer be a true guide. The index of what people want will have been lost. Their decisions will no longer tend to clear the markets. Consumers will start forming queues in some of them while in others unsold stocks begin to pile up. Frustration will accompany all policy measures. New wage rates, new prices for grain, all fixed with the best of intentions, so sincerely aimed at doing justice—at long last!—to the worker and farmer, will fail to enthuse their beneficiaries. Unemployment and bursting silos will have spoilt their appreciation of social justice. The authorities will begin to fear that, before long, all those they are trying to help will address them in the spirit in which young Andrés spoke to Don Quixote: “By the love of God”, the poor boy begged of his protector, “should you run across me again, though I am being hacked to bits, do not come to my rescue: leave me to mine evil fate ...”18/

V

There is nothing moral or immoral about the production of so many tons of pig iron or so many barrels of oil more or less, the mix of thermic, nuclear and hydraulic generation of power seems quite indifferent to ethics and the blend of wool and synthetics in a fabric is likely to leave most moralists quite undisturbed, while hardly one of them will turn a hair if the issue relates to the launching of the latest model of a desk computer. The Nostalgic school would gladly leave such trivial matters to be determined by market forces while they would have government concentrate on the really important ones concerning the pricing of goods and factors, from which distributive justice depends. But, as we have just pointed out, things will not work out that way. To a number of the unknowns that the market economy used to solve they now wish to give certain values, aimed at realising certain moral ends; and they expect the rest to be solved by the old procedure. But the new inputs render the machine (the inescapable metaphor!) erratically wrong. Its answers no longer make sense. The use of new methods becomes imperative. The market economy must be scrapped.

We trust we shall not be misunderstood. We do not hold that a market economy is a delicate flower, likely to wither away at the slightest tampering. There is ample evidence to the contrary. The pertinent question, however, is not whether a minute dose of the medicine prescribed by the Nostalgic economists would prove lethal to a market economy, but whether this would survive the whole treatment that this school propounds.

We have therefore to assume that the economic authority has decided to model society after some ethical blueprint, leaving the morally indifferent trimmings of the good society to market forces, and ask ourselves whether this is a viable proposition. And to this question it is we suggest the answer should be negative.

We further submit that such an attempt would inevitably lead to central planning. One can see it happen in a gradual way, every failure of the ethically-oriented policy being taken as proof of the shortcomings of a market economy, calling for further state intervention in the economy, now even in morally neutral fields. Experience will show that the unco-ordinated operation of firms and households does not lead to market equilibrium (under the conditions created by the new policies this conclusion would become increasingly evident); more and more of the choices the entrepreneur used to face will have to be made on his behalf by a central authority; while rationing will be instituted to cope with the disorderly behaviour that scarcity would have brought out among consumers.

Finally, when no choices are left for the economic units to be made for themselves, the process will have been completed. The result will be undistinguishable from socialism; even if private property were maintained as a legal institution, its economic substance would have dried up; even if some people continued to be referred to as entrepreneurs, they would be so only in name.

The process would have been accompanied by growing inefficiency in the use of productive resources. Its consumation into a centrally planned regime, far from offering any hope of recovery, would simply crystalize inefficiency into a permanent feature of society. Von Mises's thesis to that effect stands unrefuted.19/ Thanks to him there is, in this connection, a large “lasciate ogni speranza” sign inscribed in large characters at the entrance of every system involving central planning. The Nostalgic economists would be quite wrong to ignore it.

They could, on the other hand, understandably disregard the advice. They could hold that people would derive spiritual satisfaction from living in a good society and this would outweigh any material loss coming from the lower degree of efficiency. But if the choice in itself is not debatable, the alternatives should be clearly defined. To this end, we trust we have shown that the Nostalgic school adorn theirs with a number of features that are illusory, beginning with the notion that their system is compatible with private property and the institutional arrangements of a substantially free economy. But more of prime importance is implicit in this; it brings us back to the starting point of our essay.

“Society is a spiritual being”, the Nostalgic economist argues, “not an economic machine. Man can only attain freedom and full human status by recognising himself as part of that spiritual being and accordingly accepting the common good, not self-interest, as his goal in life”. But this theory was evolved in the context of a stationary, extremely simple economy. In the infinitely complex, highly dynamic conditions of the contemporary West, no set of rules capable of realising some ethical ideal would be intelligible to the ordinary economic units, to the firm or the household. Only a centrally placed unit, possessing an intelligence of the entire system, could possibly discern such rules. Only to the central authority in control of the flow of goods and of the factor combinations throughout the economy could prices be meaningful in terms of relative factor incomes, of relative costs and profits. The behaviour of that authority could be seen as ethically significant, but no-one else's. It is transparent that the system aims at the freedom and the selfrealization ... of the central planners. To the common run of men and women would be reserved the sole freedom of obeying their self-realised masters and the single spiritual satisfaction of being told that they had been ushered into an incorruptible brave new world.

NOTES

[?]This essay is a revision of a contribution (for which I had permission to republish) which appeared in Japanese in Toyo Keizai, Tokyo, in 1966.

[1]Hutt, Keynesian Revisions, South African Journal of Economics, June, 1965.

[2]I do not, of course, accept mere disparagement and misrepresentation (of which there has been plenty) as reply or criticism. Subsequent to the publication of my book, J. H. Botha published a courteous criticism of an earlier contribution of mine—to Hazlitt's symposium, The Critics of Keynesian Economics. This created the only opportunity I have yet had of hearing and answering explicit Keynesian objections to my argument. Botha's article was published in the S.A.J.E., 1963, and my reply in the S.A.J.E., 1964.

[1]On Keynesian Economics ..., O.U.P. (1968).

[2]Other causes of the phenomenon are discussed in my recently published book, Politically Impossible ...? (Institute of Economic Affairs, London, 1971).

[3]Hutt, Economists and the Public (1936), pp. 245-7.

[1]A similar judgment has been passed by Haberler, who suggests that "the General Theory would have been much less influential ... had it built on existing foundations and had it done justice to earlier writers; had its author refrained from setting up a caricature of the 'classical economists' as a strawman to be knocked down; in other words, had Keynes written a scholarly, well-balanced treatise instead of providing an ad hoc, makeshift theory serving as underpinning for a combination of policy tract, a passionate call for economic reforms, and an impassioned indictment of orthodoxy." (Haberler, in Lekachman (Ed.) Keynes' General Theory, Reports of Three Decades, p. 294).

[2]This discussion was based on work done very much earlier.

[1]Robinson, in Lekachman, op. cit., p. 93.

[2]Harrod, Life of J. M. Keynes, p. 462.

[3]Robinson, Economic Journal, 1947, p. 41.

[1]As early as his 24th year he was gambling for large stakes in the casinos of Europe. He was keen on poker. His financial speculations began in 1919. In his private financial dealings and in his role of trustee of institutions, he was persistently taking risks—gambles which would never have come off if he had not correctly judged that governments would, in fact, follow the policies he was advocating.

[2]In referring to his lack of profundity, I am according full weight to the rare insight and critical power which eminent reviewers reported in his Treatise on Probability.

[3]Harrod (op. cit., p. 453) confesses that it seemed to him that Keynes was "in some confusion about what the classical position really was; that he had not fully thought it through."

[4]Perhaps the most indefensible misrepresentation was his quotation of J. S. Mill in his attempt to refute Say's Law, where (as B. M. Anderson, Emil Korner, Patinkin and others have pointed out), he ended the quotation just where its continuance would have led to a wholly different view of Mill's contention. (See Hutt, Keynesianism, p. 390.)

[1]See Hutt, Keynesianism, pp. 19, 36, 344n.

[2]Robinson, Economic Journal, 1947, p. 45.

[3]Harrod, op. cit., p. 467.

[1]Harrod, op. cit., pp. 350–1.

[1]Austin Robinson refers to the remark of a momentary opponent: "Keynes can persuade me of anything, however wrong-headed I believe it to be." (Robinson, op. cit., p. 67).

[1]Samuelson, Econometrica, 1946, p. 190.

[2]Wilson, Fluctuations in Income and Employment, p. 19.

[3]Knight, Canadian Journal of Economics and Political Science, 1937, pp. 101, 119.

[4]For clear instances, see my article, Keynesian Revisions (referred to on p. 13, and pp. 18–20, above.

[1]Harrod, op. cit., p. 467.

[2]The most strongly worded attack I can remember on this issue came from Pigou.

[3]Harris, The New Economics, p. 3.

[4]Ibid., p. 7.

[5]Robinson, in Lekachman, op. cit., p. 87.

[1]Harrod, op. cit., p. 88.

[2]Ibid., p. 367.

[3]Ibid., p. 451.

[4]To illustrate by my own case. As I have said above, I devoted more time to Keynes Treatise on Money than to any other book I ever studied prior to The General Theory.

I felt compelled to do so because of the extraordinary respect and attention which this work seemed to be receiving from economists whose opinions I respected. What other economist has ever had his writings subjected—during the decade in which he had written—to such detailed and painstaking analysis as is found in Marget's Theory of Prices?

[5]E.g., those of Machlup, Haberler, Viner, McCord Wright and Modigliani. I do not think that Pigou's angry article (Economica, 1936) or Knight's hard-hitting review (Canadian Journal of Economics and Political Science, 1937) can be regarded as exceptions. Every harsh word of the latter was justifiable.

[1]Robinson, in Lekachman, op. cit., p. 94.

[2]Tarshis, A Consideration of the Economic and Monetary Theories of J. M. Keynes, A.E.R., P. & P., 1948, p. 261.

[3]Hicks, Mr. Keynes and the Classics Econometrica, 1937, p. 147.

[4]Williams, An Appraisal of Keynesian Economics, A.E.R., P. & P. 1948, p. 289.

[5]Harrod, op. cit., p. 88.

[6]Ibid., p. 451.

[7]Williams, op. cit., p. 276.

[1]E.g., to the effect that Cambridge “was the only place where they knew anything about economics. The London School of Economics ... was pushed aside ... They knew nothing at all of economics on the Continent.” (Harrod's words (op.cit., p. 319) Harrod confesses that Keynes' whole exposition “was so drenched in friendly feeling” towards himself “that it was impossible to be critical” (op. cit., p. 319).

[2]Ibid., p. 373.

[3]Ibid., p. 460.

[4]See p. 16, above.

[5]The typical student of today seems to have been indoctrinated with the belief that the classical school somehow relied upon divinely-enacted guidance—“mythical automatic stabilizers” as one Keynesian has put it—to produce order out of laissez-faire chaos.

[6]Lekachaman, op. cit., p. 10.

[1]The retreat, which I have discussed in my Keynesianism, is indeed continued in the book which Lekachman has edited. The reader will find several passages in his Introduction which illustrate this, particularly on pp. 2, 4 and 9.

[2]Keynes seems himself to have been warning, in the largely contradictory last chapter of the General Theory, of the dangers of his own policy recommendations. The same fears appear to be reflected in references, in his last E. J. article, to the “wholesome long-run doctrine” and “classical medicine” (the latter no fewer than four times). (Keynes, Economic Journal, 1946, p. 172).

[1]In 1958, reminding the American people of the warnings issued by “experienced monetary economists” at the time, Spahr asked: “Do the Keynesians shout from the housetops that F.D.R. has been proved wrong and that we should therefore change our course? Not at all.... “(Quoted from Spahr, Monetary Notes, Economists National Committee on Monetary Policy, December, 1964).

[2]McCracken, Unemployment in an Expanding Economy—The Long View, p. 8 (reprinted from the Michigan Business Review, July 1964). In respect of unemployment, the “bad old days” were by no means as black as they have been painted. For instance, in the United States, in two-thirds of the identifiable recessions from the 1890's to the 1930's, real income was higher in the recession year than it had been in the previous peak. (Ibid., p. 8) Moreover, in two of the recessions in which this was not the position (1894 and 1921) drastic co-ordinative price adjustments were laying the foundations for prolonged prosperity (in the 1921 recession, following an unprecedented but remarkably effective deflation to re-establish the integrity of the dollar); and of the other two cases, in 1908 and 1914, the first was the consequence of a financial panic and the second was due to disturbances of world trade caused by the outbreak of World War I.

[3]Lekachman, op. cit., p. 2.

[1]T. Wilson, Professor Robertson on Effective Demand, E.J., 1953, p. 570.

[2]E.g., H. G. Johnson, The General Theory after Twenty-five Years, A.E.R., P. and P, May 1961, p. 26.

[1]This is the main theme of my recently published book, Politically Impossible ...?, op. cit.

[2]Johnson, op. cit., p. 3.

[1]See Hutt, Politically Impossible ...?, Part V.

[1]In my judgment, however, the political obstacles were not insurmountable in Britain in 1931. If Lord Passfield (Sidney Webb) had had the courage that year to state in the House of Lords what he and Beatrice Webb privately believed about the British trade unions, he may have brought down the government of which he was a member, but his action could well have saved the pound sterling. (See my article, Critics of the “Classical Tradition,” S.A. Jour. of Econ., June, 1964, p. 84).

[1]In my Plan for Reconstruction (1943), I envisaged the establishment of an expanded statistical service to collect, analyze and disseminate data required for purposeful planning and co-ordination (whether by collective or entrepreneurial

initiative). This suggestion was discussed further in my article, Plan for Economic Research in the Union (S.A.J.E., June 1944, reprinted as a pamphlet by the Association of Scientific Workers of S.A., 1944).

[1]Hutt, Critics of the Classical Tradition, S.A.J.E., 1964. There may well have been occasional discriminations of a similar kind (equally difficult to substantiate) against the Keynesian type thinking during the days when classical thinking was dominant. (See p. 36, below, footnote 1).

[1]See Hutt, Keynesianism, pp. 6–7, 25–29, 89, 166–7, 391–3.

[1]In 1947, Seymour Harris (The New Economics, p. 3) contended that academic opposition to Keynes originated from “the vested interests of scholars in the older theory.” There is no doubt at all that the sheer burden of the readjustment of thought and the recasting of teachings hindered the more rapid adoption of an economics which now employs Keynesian concepts and models. But when economists cling, as they do today, to Keynesian apparatus (with its policy implications) when the manifest untenability of its central tenet (unemployment equilibrium) has been demonstrated, Harris' charge is reversed.

[2]In my Politically Impossible ...?, I suggest that the remedy is for economists' assumptions about the vote-acquisition process always to be explicitly announced and evaluated.

[1]In order to prevent possible misunderstanding, I must explicitly disclaim any suggestion that the teaching of the economic doctrines which I have tried to show are untenable should be suppressed! When I maintained for instance, in my Keynesianism, that the Multiplier and the Accelerator theorems should be expunged from the text books, I was not recommending any expurgation or censorship. I merely assumed that authors would soon be forced to abandon such notions if criticisms of them were fairly presented, side by side.

[1]“Human Action”, 1949, p.352.

[1)]“Theoretische Sozialökonomie”, Leipzig 1918, I.Kapitel, para. 6.

[2)]R.M. Solow “Growth Theory. An Exposition”, Oxford 1970, p.2.

[1]“These years, during which Böhm-Bawerk, Wieser and Philippovich were teaching at Vienna, were the period of the school's greatest fame.” F.A. von Hayek, “Economic Thought: The Austrian School.” International Encyclopedia of the Social Sciences, vol. 4, p.461.

[?]This book was not available to English language readers until 1950, when it was translated from the German by James Dingwall and Bert F. Hoselitz and published under the title, Principles of Economics (Free Press of Glencoe, a subsidiary of Macmillan).

[?]I am indebted to my colleagues, Charles Goetz and Gordon Tullock for helpful discussions on this paper.

[1]See Knut Wicksell, Finanztheoretische Unter-suchungen (Jena: Gustav Fischer, 1896), major portions of which are translated as “A New Principle of Just Taxation,” and included in Classics in the Theory of Public Finance, edited by R. A. Musgrave and A. T. Peacock (London: Macmillan, 1958), pp. 72-118.

[2]This assumes that no member of the community considers beach maintenance a “bad”; that is, no members place a negative evaluation on the proposed change. In this case, ti might, of course, be less than zero; that is, negative taxes might be required.

[3]For a generalized discussion, see James M. Buchanan and Gordon Tullock, The Calculus of Consent (Ann Arbor: University of Michigan Press, 1962).

[4]For a complete discussion of the relationship between tax institutions and decision rules, see, my, Demand and Supply of Public Goods (Chicago: Rand McNally, 1968).

[5]See Gary Becker, “A Theory of the Allocation of Time,” Economic Journal, LXXV (September 1965), 493-517.

[6]The possibilities of “voting with their feet” through outmigration effectively shifts collective-decision processes in the direction of a unanimity rule.

[7]This conclusion is in the Wicksellian tradition. Although his proposals for introducing a unanimity rule or a relative unanimity rule in fiscal choice making has often been interpreted as restricting the scope of approved projects, Wicksell himself interpreted his proposals as means of securing political approval of public projects that could not otherwise secure support. Wicksell's emphasis was on introducing greater variability in tax-sharing arrangements.

[1]Human Action (New Haven: Yale University Press, 1949), p. 696.

[2]Socialism (New Haven, Yale University Press, 1951), p. 136.

[3]Businessmen are also utilized by the government agencies, presumably for their expert knowledge. Von Mises in a small volume entitled Bureaucracy (New Haven and London: Yale University Press, 1944) p. 70 pointed out that even in nineteenth century Europe, it was necessary for corporation management to live on good terms with those in power. The reverse is also frequently true. Government officials often treat with special favor firms in which they plan to seek employment.

[4]Aircraft, Engine, and Propeller Production, 1940-1945 (Washington: U.S. Department of Commerce, Civil Aeronautics Administration, 1946).

[5]Several Yugoslavian economists in recent years have stated privately that little attention is actually paid to the central plan by firms in that country.

[6]Details on subsidies and other aspects of the government program described in the present paper are included in the writer's unpublished Ph. D. dissertation, Federal Control of Construction Following World War II (University of Michigan, 1950).

[1]Human Action (3rd ed.), p.335.

[2]Planning for Freedom, p.119.

[3]Greaves' Glossary for "Human Action."

[4]Human Action (3rd ed.), p. 337.

[5]Op. cit., p. 327.

[6]Ibid., p. 331.

[7]Planning for Freedom, p. 114.

[8]Human Action (3rd ed.), p. 334.

[9]Op. cit., p. 338.

[10]Ibid., p. 394.

[11]Op. cit., p. 396.

[12]The Distribution of Wealth, p. 411.

[?]Views expressed are the author's and not necessarily those of any organization with which he is associated.

[[1]]F. A. Hayek, "Socialist Calculation I: The Nature and History of the Problem," in Individualism and Economic Order (London, 1949), p. 143.

[[2]]To study the literature, the best starting point is F. A. Hayek, ed., Collectivist Economic Planning, op. cit., which contains the Mises article, introductory and concluding essays by Hayek as well as many other pertinent contributions published prior to 1935. In Individualism and Economic Order, op. cit., pp. 119–208, the two Hayek essays of 1935 are reprinted plus a third, "Socialist Calculation III: The Competitive Solution," which originally appeared in Economica (May, 1940). The content of these articles, together with the citations, are indispensable to any serious study of the literature. Mention should also be made of Trygve J. B. Hoff, Economic Calculation in the Socialist Society (London, 1949), the original publication of which, in Norwegian, is dated 1938. The bibliographical footnotes in Wilhelm Roepke, Economics of the Free Society (Chicago, 1963), p. 204, will also prove very helpful, as will M. Rothbard, Man, Economy, and State, II, p. 901, n. 59 (New York, 1962), and the paper submitted by M. F. Ayau, "Commentary on the Relevance of the Problem of Economic Calculation to Present Turmoil," at the 1970 meeting of The Mont Pelerin Society.

[[3]]For example, George N. Halm, Economic Systems, rev. ed. (New York, 1960), pp. 183–192; Morris Bornstein, ed., Comparative Economic Systems (Homewood, Illinois, 1965), pp. 159–170; Marshall I. Goldman, ed., Comparative Economic Systems, 2d. ed. (New York, 1971), pp. 9–71.

[[4]]See Fritz Machlup, Essays on Economic Semantics (Englewood Cliffs, New Jersey, 1963), pp. 97–103; George J. Stigler, The Theory of Price, 3d. ed. (Chicago, 1966); Milton Friedman, Price Theory (Chicago, 1962).

[[5]]Armen Alchian, Pricing and Society (Occasional Paper #17, Institute of Economic Affairs, London, 1967), p. 6.

[[6]]Robert Dorfman's description of "What the Price System Does," in the widely used paperback, The Price System (New York, 1964), pp. 4–10, is clearly not decriptive of the U.S.S.R.

[[7]]Naum Jasny, The Soviet Price System (Stanford, 1951), p. 19. The feature may be less noticeable than it formerly was, but the general characteristic is still valid.

[[8]]For an extensive description of the collective farm, see Lazar Volin, "The Collective Farm," in Inkeles and Geiger, eds., Soviet Society, pp. 329–349.

[[9]]Nicholas Spulber, The Soviet Economy, p. 83.

[[10]]Liberman's famous article, "The Plan, Profits and Bonuses," appeared in Pravda, September 9, 1962.

[[11]]For a more detailed summary of Nemchinov's position, see Margaret Miller, Rise of the Russian Consumer (London, 1965), pp. 45–60; also the political and economic assessment made by Ole-Jacob Hoff in "The Decline of Dogma," a paper presented at the meeting of The Mont Pelerin Society, Stresa, September, 1965. See also Eugene Zaleski, "Les tendances réformistes dans la planification sovietique," II Politico, Vol XXX, No. 4 (December, 1965), pp. 657–689.

[[12]]Feliksas Palubinskas, "The Growing Importance of Marketing in Soviet Russia," Western Economic Journal, Vol. III, No. 3 (Summer, 1965), p. 282.

[[13]]"Free Market and Planned Economy—Are They Beginning to Resemble Each Other?" (November, 1964). See also George N. Halm, "Will Market Economies and Planned Economies Converge?" in Erich Streissler, ed., Roads to Freedom: Essays in Honor of F. A. Hayek (London, 1969), pp. 75–88; Jan S. Prybyla, Comparative Economic Systems (New York, 1969), Part V, "The Convergence of Market-Oriented and Command Oriented Systems," pp. 449–483.

[[14]]"The decline and rise of Soviet economic science," Foreign Affairs (January, 1960), reprinted in Essays in Economics (New York, 1966), p. 228.

[[15]]For those who are particularly interested, I strongly recommend reading in tandem, Aleksander Bajt, "Property in Capital and in the Means of Production in

Socialist Economies,” Journal of Law and Economics, Vol. XI (April, 1968), pp. 1–4; and Bela Csikos-Nagy, Pricing in Hungary (Occasional Paper #19, Institute of Economic Affairs, London, 1968). Of special interest also is Svetozar Pejovich, “Liberman's Reforms and Property Rights in the Soviet Union,” Journal of Law and Economics, Vol. XII, No. 1 (April, 1969), pp. 155–162 and, by the same author, “The Firm, Monetary Policy and Property Rights in a Planned Economy,” Western Economic Journal, Vol. VII, No. 3 (September, 1969), pp. 193–200.

[1]W.J. Baumol, “Entreprensurship in Economic Theory”, American Economic Review (May, 1968)p.64.

[2]H. Leibenstein, “Entrepreneurship and Development”, American Economic Review (May, 1968), p. 72.

[3]For a survey see F.H. Hahn and R.C.O. Matthews, “The Theory of Economic Growth: A Survey”, Economic Journal, (December, 1964).

[4]Even Hicks' Capital and Growth (Oxford, 1965), in which the price theoretic implications of formal growth theory are pursued, is not concerned at all with entrepreneurship.

[1]For a sampling of this literature see P. T. Bauer and B.S. Yamey, The Economics of Under-developed Countries, (Chicago, 1957), Chapter VIII: M. Abramovitz, “Economics of Growth”, in A Survey of Contemporary Economics, Vol. II, (Irwin, 1952), pp. 157-162; H.G. Aubrey, “Industrial Investment Decisions: A Comparative Analysis”, Journal of Economic History, (December, 1955); N. Rosenberg, “Capital Formation in Underdeveloped Countries”, American Economic Review, (September, 1960), pp. 713-714; G.F. Papanek, “The Development of Entrepreneurship,” American Economic Review, (May, 1962).

[2]See J.A. Schumpeter, The Theory of Economic Development, (Harvard, 1934).

[1]See I.M. Kirzner, “Methodological Individualism, Market Equilibrium, and Market Process”, Il Politico, 1967.

[1]Schumpeter, op.cit., p. 64.

[1]F.A. Hayek, The Pure Theory of Capital, pp. 22f; I.M. Kirzner, An Essay on Capital, p. 30; Market Theory and the Price System, pp. 311-320.

[1]Schumpeter, op. cit., p. 64.

[2]P.A. Samuelson, Economics, (7th Edition), p. 725.

[1)]See H. Leibenstein, “Allocative Efficiency vs. X-Efficiency”, American Economic Review, (June, 1966) “Entrepreneurship and Development”, American Economic Review. (May, 1968).

[2)]Schumpeter, op.cit., p. 154.

[1]See on this the masterful passage in Hayek, Individualism and Economic Order, pp. 201-203.

[1]Schumpeter, op.cit., pp. 138ff.

[1]Fritz Machlup, “Real Adjustment, Compensatory Correction, and Foreign Financing of Imbalances in International Payments,” in Richard E. Caves, Harry G. Johnson, and Peter B. Kenen, editors, Trade, Growth and the balance of Payments (Chicago and Amsterdam, 1965), pp. 185–213.

[1]“The Mysterious Numbers Game of Balance-of-Payments Statistics,” in Fritz Machlup, International Payments, Debts, and Gold (New York: 1964) and International Monetary Economics (London: 1966), pp. 140–166.

[1]“Real Adjustment, Compensatory Correction, and Foreign Financing,” op. cit., pp. 211 and 213.

[[1]]See Ludwig von Mises, Socialism (New Haven: Yale University Press, 1951); F.A.von Hayek, ed., Collectivist Economic Planning (London: George Routledge and Sons, 1935); and Oskar Lange and Fred M. Taylor, On the Economic Theory of Socialism (New York: McGraw-Hill, 1964). For a summary and critique of the controversy, see Trygve J.B. Hoff, Economic Calculation in the Socialist Society (London: William Hodge and Co., 1949).

[[2]]Lange and Taylor, pp. 57-58

[[3]]See particularly Ludwig von Mises, Human Action (New Haven: Yale University Press, 1949). For a discussion of Mises' praxeology and its relation to previous economic methodologies, see Israel M. Kirzner, The Economic Point of View (Princeton, N.J.: D. Van Nostrand, 1960).

[[4]]For Mises on Kotarbinski, see Ludwig von Mises, The Ultimate Foundation of Economic Science (Princeton, N.J.: D. Van Nostrand, 1962), pp. 42, 135. Most accessible of Kotarbinski's writings is his “Idée de la methodologie generale praxeologic,” Travaux du IXe Congres International de Philosophie (Paris, 1937), IV, 190-94.

[[5]]Oskar Lange, Political Economy (New York: Macmillan, 1963).

[[6]]Lange, p.148.

[[7]]Lange here explicitly accepts the modern concept that the ultimate end is not cardinal or quantifiable, but rather an ordered, ordinal set of preferences. Lange, pp. 167-68.

[[8]]Lange, p.176.

[[9]]Kotarbinski's early work was on praxeology as applied to the theory of hostile action. See Mises, Ultimate Foundation, pp.42, 135.

[[10]]In Espinas' article, "Les Origines de la technologie," Revue Philosophique, XVth year (July-December, 1890), pp. 114-15, and in his book with the same title, published in Paris in 1897. See Mises, Human Action, p. 3n.

[[11]]Eugen Slutsky, "Ein Betrag zür formalpraxeologischen Grundlegung der Oekonomik," in Annales de la classe des sciences sociales-economiques, Academie Oukranienne des Sciences, Vol. 4 (Kiev, 1926).

[[12]]On the economic vs. the technological principles, see Lionel Robbins, The Nature and Significance of Economic Science (London: Macmillan, 1935), a work heavily under the influence of Mises, Richard Strigl and others of the Austrian School; and Kirzner, pp. 108-45. Also see Rutledge Vining, Economics in the United States of America (Paris: UNESCO, 1956), pp. 1-37.

[[13]]Lange, p. 190n.

[[14]]Lange, pp. 229ff.

[[15]]Lange, p. 236.

[[16]]Croce's decidedly praxeological contributtion to economics may be found in his fascinating debate with the positivist Pareto on economic methodology, written in 1900 and 1901. See Benedetto Croce, "On the Economic Principle," in International Economic Papers, No. 3 (1953), pp. 172-79, 197-202. For an appreciation of Croce's work, see Giorgio Tagliacozzo, "Croce and the Nature of Economic Science," Quarterly Journal of Economics (May, 1945), and Kirzner, pp. 155ff.

Čuhel's great contribution was his Zür Lehre von der Bedurfnissen (Innsbruck, 1907). On Cuhel, see Eugen von Böhm-Bawerk, Capital and Interest (South Holland, Ill.: Libertarian Press, 1959), II, 191, 193-94, 423, 431-32; III, 124-36, 232-33. Mises' development of Cuhel is in his Theory of Money and Credit (New Haven: Yale University Press, 1953), pp. 38ff.

[[17]]In Max Weber, "Die Grenznutzlehre und das 'psychophysische Grundgesetz', "Gesammelte Aufsatze zür Wissenschaftslehre (2nd ed., Tubingen, 1951), pp. 364ff. On the Weber article, see Emil Kauder, A History of Marginal Utility Theory (Princeton, N.J.: Princeton University Press, 1965), pp. 116-17 136-37.

[[18]]Lange, p. 237

[[19]]Robbins, passim. On the relationship between Robbins' and Mises' views on the nature of economics, which however greatly understates their similarities, see Kirzner, pp. 108-86. Bracketing them more closely is Ludwig M. Lachmann. "The Science of Human Action," Economica (November, 1951), p. 413.

[[20]]Hans Mayer, "Untersuchungen zu dem Grundgesetz der wirtschaftlichen Wertrechnung," Zeitschrift für Volkwirtschaft und Sozialpolitik (Vienna, 1922), II, 5; Max Weber, The Theory of Social and Economic Organization (New York, 1947), pp. 162, 209. For a critique of Weber's views on economic methodology, see Ludwig von

Mises, Epistemological Problems of Economics (Princeton, N.J.: D. Van Nostrand, 1960), pp. 74-106. On Mayer, see Kauder, pp. 107 and passim.

[[21]]Kirzner falls into the same error. Kirzner, p. 134

[[22]]Lange, p. 242.

[[23]]For a slightly different translation of this passage, see Paul M. Sweezy, ed., Rudolf Hilferding, Böhm-Bawerk's Criticism of Marx (New York: Augustus M. Kelley, 1949), p. 196.

[[24]]Lange, p. 298.

[[25]]Lange, p. 298n.

[[26]]Lange, pp. 300ff. Lange himself is a bit dubious on this point, since capitalism in Austria was not as highly developed as in the other Western countries where the subjectivist, praxeological economics did not take hold.

[[27]]Lange, pp. 301-02.

[[28]]Lange, pp. 314ff.

[[29]]Ronald L. Meek, Economics and Ideology and Other Essays (London: Chapman and Hall, 1967), pp. 216ff.

[[30]]Meek, p. 216.

[[31]]Meedk, p. 218.

[[32]]B.B.(Ben Brewster), "Review of Ronald L. Meek, Economics and Ideology and Other Essays," New Left Review (November-December, 1967), p. 90.

[[1]]Lord Acton, Essays on Church and State, edited by Douglas Woodruff (London, 1952) p. 6.

[[2]]Gertrude Himmelfarb, Lord Acton (Chicago, 1952) p. 15. Besides the very thorough chapter on Acton's education in Miss Himmelfarb's biography, the interested reader may consult a chapter by the Cambridge historian Herbert Butterfield, entitled "Acton: His Training Methods and Intellectual System," in Studies in Diplomatic History Presented to G.P. Gooch, edited by A.O. Sarkissian (London, 1961).

[[3]]Wilfrid Ward, The Life and Times of Cardinal Wiseman (London, 1897), Vol. I, p. 348.

[[4]]Ibid., p. 343.

[[5]]Ibid., p. 349.

[[6]]Ibid., p. 353.

[[7]]Lord Acton, Selections from the Correspondence of the First Lord Acton, edited by J.N. Figgis and R.V. Laurence (London, 1917), pp. 1-2.

[[8]]Ibid., p. 1.

[[9]]Ibid., pp. 256-57. Acton, in 1890, thanked Gladstone for securing his appointment as a Fellow of All Souls. He added that King's College, Cambridge and "a famous college at Oxford" had offered him fellowships at the same time. "All of this has flattered me unduly," he noted "as both universities refused me as an Undergrad."

[[10]]M. Grant Duff, Cut of the Past (London, 1903), Vol. II, p. 190.

[[11]]Himmelfarb, Lord Acton, p. 19.

[[12]]Acton, Correspondence, p. 8.

[[13]]Ibid., p. 24.

[[14]]Acton, History of Freedom, p. xviii.

[[15]]Acton, Selections from the Correspondence, p. viii.

[[16]]Himmelfarb, p. 69.

[[17]]Ibid., p. 23. The reader interested in learning more about Dollinger may consult Acton's essay on his teacher in The English Historical Review, V, 1890, pp. 700-44.

[[18]]G.E. Fasnacht, Acton's Political Philosophy (London, 1952), p. 48.

[[19]]Duff, Out of the Past, Vol. II, p. 195. Acton is quoted as saying, "I am not conscious that I ever in my life held the slightest shadow of a doubt about any dogma of the Catholic Church."

[[20]]Lord Acton, Historical Essays and Studies, edited by J.N.Figgis and R.V. Laurence (London, 1908), p. 369.

[[21]]Lord Acton, "Inaugural Lecture on the Study of History," in Lectures on Modern History (London, 1926), p. 12.

[[22]]Home and Foreign Review, July 1863, p. 163.

[[23]]Himmelfarb, Lord Acton, p. 23.

[[24]]For more on Acton's early training consult E.L. Woodward, "The Place of Lord Acton in the Liberal Movement of the Nineteenth Century," Politica, IV, 1939, pp. 248-65, and Sarkissian, Studies in Diplomatic History.

[[25]]The Chronicle, 13 April 1867, p. 57.

[[1]]Investigations in Currency and Finance, (London, 1884) p. XXIV.

[[2]]Ibid., p. 104

[[3]]Cf. also "An Ideally Perfect System of Currency" in Investigations in Currency and Finance, pp. 297-302; "The Variation of Prices and the Value of the Currency Since 1782," ibid., pp. 120 ff.

[[4]]Official Papers (London: Macmillan & Co., 1926) for the Royal Economic Society, pp. 10-12; Also Money, Credit and Commerce (N.Y.: Augustus M. Kelley reprint, 1923) p. 36. According to Marshall, "An official index number, representing average movements of the prices of important commodities, might well afford the basis for a Unit of general purchasing power, in terms of which long-period obligations might be expressed: and in this matter the State might advantageously lead. The Unit would be derived from an official price list by adding together the prices of certain quantities of wheat, barley, oats, hops, beef, mutton, tea, coffee; together with staple timbers, minerals, textile materials and fabrics and so on. A new contract for interest on loans and other long-standing obligations might then be arranged by free consent of both parties to it in terms of the standard unit, instead of money."

[[5]]Money, Credit, and Commerce, p. 43 et seq. His theory was later put into the form of a quantitative equation by Prof. Pigou in Quarterly Journal of Economics, Vol. XXXII, Nov., 1917.

[[6]]The Gold Standard in Theory & Practice (London: Longmans, Green & Co., Ltd., 1939, 4th ed.) pp. 101, 102, 121, 122; cf. also Currency and Credit (London: Longmans, Green & Co., Ltd., 1927, 3rd ed.) pp. 156 et seq.; Monetary Reconstruction (London: Longmans, Green & Co., Ltd., 1926, 2nd ed.) p. 156; Trade and Credit, (London: Longmans, Green & Co., Ltd., 1928) p. 82 et seq.

[[7]]The Art of Central Banking (London: Longmans, Green & Co., Ltd., 1932) pp. 446 et seq.

[[8]]A Century of Bank Rate (New York: Augustus M. Kelley, 1962, 2nd ed.) p. xxi.

[[9]]Mastering the Crisis (London: George Allen & Unwin, Ltd., 1934) p. 21.

[[10]]Inflation (London: George Allen & Unwin, Ltd., 1934) p. 91.

[[11]]Mastering the Crisis, p. 37. Prof. Fisher apparently applied this version of trade cycle theory to his own financial transactions. He was caught unaware of the 1929 stock market crash and remained bullish throughout the decline. Although he enjoyed great reputation as an economic forecaster he failed to foresee the depression and therefore lost his sizeable fortune. Cf. Irving N. Fisher, My Father, Irving Fisher (N. Y.: Comet Press, 1956). According to his son, "the 1929 stock market crash caught him unawares. Placing his faith unreservedly in the 'new economic era' he did not foresee that it was destined to collapse like a house of cards." p. 242. Between 1929 and 1933 Fisher lost an eight to ten million dollar fortune which he had pyramided on his wife's blue-chip inheritance and was left with an ultimate debt of three-quarters of a million dollars to his aunt. A committee of a lawyer and two nephews finally handled his intricate debt relationship. pp. 264-267.

[[12]]Inflation, p. 80.

[[13]]Stabilized Money, ibid., pp. 259-262.

[[14]]100$ Money (N.Y.: Adelphi, 1935) pp. 8-9.

[[15]]According to Simons, "attempting mischievous and salutory irritation of his peers ... he (Keynes) may only succeed in becoming an academic idol of our worst cranks and charlatans—not to mention the possibilities of the book as the economic bible of a fascist movement." Cf. "Keynes' Comments on Money," Christian Century, July 22, 1936, pp. 1016, 1017.

[[16]]See Milton Friedman, "The Monetary Theory and Policy of Henry Simons," Journal of Law and Economics, Vol. X, Oct. 1967, pp. 1-13.

[[17]]Economic Policy for a Free Society (Chicago: The Univ. of Chicago Press, 1948) p. 168.

[[18]]Economic Policy, pp. 161, 162

[[19]]Ibid., p. 180.

[[20]]Ibid., p. 176.

[[21]]Milton Friedman and David Meiselman, "The Relative Stability of Monetary Velocity and the Investment Multiplier in the United States, 1897-1958," Stabilization Policies (The Commission on Money and Credit, Prentice-Hall, Inc., 1963). Also Milton Friedman, "A Monetary and Fiscal Framework for Monetary Stability," American Economic Review, June 1948, reprinted in Essays in Positive Economics (Chicago: Univ. of Chicago Press, 1953) pp. 133-156 and "Has Fiscal Policy Been Oversold?" Monetary vs. Fiscal Policy, A Dialogue between Milton Friedman and Walter W. Heller (New York: W. W. Norton & Co., 1969) pp. 43-62, 71-80

[[22]]Studies in the Quantity Theory of Money (Chicago: Univ. of Chicago Press, 1956) pp. 20-21

[[23]]A Program for Monetary Stability (Chicago: Univ. of Chicago Press, 1953) p. 91.

[[24]]Essays in Positive Economics (Chicago: Univ. of Chicago Press, 1953) p. 315.

[[25]]Monetary vs. Fiscal Policy, ibid., p. 76. For further details on his lags hypothesis of. Essays in Positive Economics, ibid., pp. 133-156

[[26]]The Optimum Quantity of Money and other Essays Chicago: Aldine Publishing Co., 1969) p. 222.

[[27]]Milton Friedman and Anna J. Schwartz. A Monetary History of the United States, 1867-1960 (Nat'l Bureau of Economic Research, Princeton University Press, 1963) p. 300.

[[28]]“The Case for Flexible Exchange Rates,” in Essays in Positive Economics, ibid., p. 157-203; also A Program for Monetary Stability, ibid., pp. 81-101.

[[29]]Milton Friedman, “The Methodology of Positive Economics,” in Positive Economics, ibid., pp. 3-43.

[[30]]Ludwig von Mises, Human Action (New Haven: Yale University Press, 1949) p. 30 et seq.; also his Theory and History (New Haven: Yale University Press, 1957) p. 240 et seq.; Epistemological Problems of Economics (Princeton, N. J.: D. Van Nostrand Co.1960); The Ultimate Foundation of Economic Science (Princeton, N.J.: D. Van Nostrand Co., 1962); Friedrich A. Hayek, The Counter-Revolution of Science (Glencoe, Ill.: Free Press, 1952).

[[31]]Cf. Ludwig von Mises, The Theory of Money and Credit (first German edition in 1912; English ed. New Haven: Yale University Press, 1953) p. 365 et seq.; also Human Action, ibid., p. 535 et seq.; also F.A. Hayek, Monetary Theory and the Trade Cycle (first German edition in 1929; English ed. A.M. Kelley, 1966); Profits, Interest and Investment (London: G. Routledge and Sons, 1939).

[[32]]Milton Friedman and Anne J. Schwartz, A Monetary History of the United States, 1867-1960, ibid., pp. 711, 712.

[[33]]Economics and the Public Welfare (Princeton, N.J.: D. Van Nostrand, 1949) p. 225.

[[34]]America's Great Depression (Princeton, N.J.: D. Van Nostrand, 1963) p. 303.

[[35]]Cf. Hans F. Sennholz, Inflation or Gold Standard (Lansing, Mich.: Constitutional Alliance, 1970)

[1]Otherwise referred to as neighborhood effects or public goods and bads. At this point, I shall not include a technical definition of externalities since the meaning of the term will become clear to the reader as he goes along. I should perhaps warn economists that the word, although within the normal scope, will have somewhat different applications than the one to which he is accustomed. For some recent literature showing the contact between biologists and economists, see Hardin (1968) and Tullock (1970, 1971).

[2]This situation has been considered a great deal by economists, particularly those concerned with the undeveloped areas, because of its relationship to meat production by pastoral activities. Economists, of course, have considered it solely in terms of its

long run effect on the human beings who engage in pastoral activities in the areas concerned. We will be considering it without this ethnocentric bias.

[3]Although I have chosen to illustrate this example with cattle and grass, the same system exists in many natural situations. One example is presented by J. P. Dempster (1968).

[4]This is, of course, the standard Pareto criteria and it should be noted that movement along the vertical line through N would increase grass production, but not cattle production. Thus, we would be increasing one and holding the other constant. This is what leads to the Paretian slogan: improve the welfare of one unit while injuring no one. In practice, of course, we seldom are able to move along the boundaries and, therefore, benefit both or all of the factors.

[5]Note that in strict terms, there is no way in which we can avoid maximizing the utility functions of human beings. The members of the Sierra Club are human beings; if they feel that it is better to have a smaller population of human beings and a larger population of redwoods, they are maximizing their own utility functions when they aim at or achieve this goal. Redwoods cannot vote. Thus, in a sense, any policy carried out by human beings will aim at the maximization of at least one human being's utility function, rather than at some other goal. The well-being of nonhuman species comes in only insofar as some or all human beings may have the well-being of such nonhuman species as arguments in their utility function.

[6]In many cases, the chemical persists in the soil so that the history of the area may be more important than its current use. This would, however, merely strengthen the relationships discussed.

[7]The concept of "Pareto relevance" is rather complex, but in this case it can be interpreted very simply. As long as the numbers in the upper left hand corner are larger than those in the lower right, the externality will be Pareto relevant. This is not, of course, a necessary condition in the real world. We would anticipate that sometimes we would find it and sometimes we would not.

[[1]]Ludwig Mises, Die Gemeinwirtschaft: Untersuchungen uber den Sozialismus (Jena: Gustav Fischer, 1922).

[[2]]Thus in lectures and later in Van Sickle and Rogge, Introduction to Economics (New York: Van Nostrand, 1954), I argued that "if our colleagues, the political scientists and the psychologists" could convince us "that such a program would not be abused, it would be quite easy to imagine a broad security program of admirable simplicity. The federal government might, for example, issue weekly or monthly checks to all families in the United States based on the requirements for a really Spartan existence. The only condition for eligibility would be the submission each year of a detailed family income declaration. The government would then levy a progressive income tax which, in the case of each family, would begin with the amount received over and above the government annuity. Thus each family would be assured of a tax-free income which would vary with the size of the family. The income tax admittedly would be heavy, but while we are allowing free play to our imaginations, we can also imagine some substantial savings: no more public works undertaken just for the sake of providing employment; no more minimum wage laws; no more restrictive union agreements; no more agricultural price supports and acreage restriction programs; no more special programs for the needy aged, for dependent children, for the blind and physically handicapped; no more tariffs to protect high-cost enterprises. In brief, one can imagine a highly competitive enterprise economy superimposed on a thin cushion of guaranteed income." (pp. 522-23)

Fifteen years later, in Freedom in Jeopardy: The Tyranny of Idealism (New York: World Publishing Company, 1969), I, suggested safeguards that would, in my judgment, warrant experimenting with a universal minimum. For the suggested safeguards, see pp. 176-180.

[[3]]F. A. Hayek, The Road to Serfdom (Chicago: The University of Chicago Press, 1944). Here Hayek stated as self-evident that the British economy, despite the damages suffered and still being suffered by the poundings of the German Luftwaffe, could easily provide a guaranteed income to all, if all the existing restrictions were swept away. "Let a uniform minimum be secured to everybody by all means, but let us admit at the same time that with the assurance of a basic minimum all claims for a privileged security for particular classes must lapse, that all excuses will disappear for allowing groups to exclude newcomers from sharing their relative prosperity in order to maintain a special standard of their own." (p. 210)

[[4]]Chicago: The University of Chicago Press, 1962. In his advocacy of a negative income tax, Friedman attached conditions similar to Hayek's. "If enacted as a substitute for the present rag bag of measures directed to the same end (i. e., the alleviation of poverty), the total administrative burden would surely be reduced," (p. 193) and while "reducing the incentives of those helped to help themselves, ... it does not eliminate the incentive entirely, as a system of supplementing incomes up to some fixed minimum would." (p. 192)

[[5]]Quoted from Freedom in Jeopardy, op. cit., p. 173.

[[1]]Lionel Robbins, An Essay on the Nature and Significance of Economic Science (London: Macmillan & Co., 1952), p. 1.

[[2]]"Job-Hunting Futile as Economists Meet" (N.Y. Times-Chicago Tribune Service, Dec. 27, 1970).

[[3]]Walter W. Heller, New Dimensions of Political Economy (New York: W. W. Norton & Co., Inc., 1966).

[[4]]R. Torrens, An Essay on the Production of Wealth (New York: A. M. Kelley, 1965), p. XIII.

[[5]]Joseph A. Schumpeter, "Eugen von Boehm-Bawerk" reprinted in Ten Great Economists from Marx to Keynes (London: George Allen & Unwin, 1952) pp. 157 and 189.

[[6]]Time, March 3, 1961, pp. 18–19.

[[7]]Gunnar Myrdal, The Challenge of World Poverty: A World Anti-Poverty Program in Outline (New York; Random House-Pantheon Books, 1970), p. 24.

[[8]]John von Neumann and Oskar Morgenstern, The Theory of Games and Economic Behavior (Princeton: Princeton University Press, 1944), p. 5.

[[9]]Time, November 17, 1967.

[[10]]Time, November 1, 1963. Quote from the well-known English painter Francis Bacon (ironically, not only the name-sake, but actually the descendent of the co-founder of modern empiricism).

[[11]]Time, February 28, 1964.

[[12]]The Economist, November 18, 1967, p. 751.

[[13]]Seymour E. Harris, National Debt and the New Economy (New York: McGraw-Hill Book Co., 1947), pp. 24–25.

[[14]]Joseph A. Schumpeter, History of Economic Analysis (New York: Oxford University Press, 1954), p. 10n.

[[15]]'Organic' is used here not as the opposite of mechanistic. According to the atomistic view, society resembles a sand dune, with each individual representing a grain of sand, the ultimate reality;—the individual producer and consumer studied in microeconomics. According to the organic concept, on the other hand, society is looked upon as an organism, with the individuals likened to cells which are dependent for their survival upon the organism as a whole. The emphasis thus shifts from the individual to the organism as the most important entity;—which, of course, is the philosophic premise of macroeconomics.

[[16]]Julian Huxley, On Living in a Revolution (New York: Harper Brothers, 1944), pp. 21–23.

[[17]]The original version of the Declaration of Independence, before it was changed at Jefferson's suggestion, called for "life, liberty and property," the original Lockian phrase.

[[18]]The Catholic Church never accepted the Lockian individualistic view of private property, but defended private property rights, in Aristotelian fashion, as a desirable social institution. In Mater et Magistra (1961), for instance, Pope John XXIII still stressed that private property "is a suitable means of safeguarding the dignity of the human person." Less than a decade later, however, Progressio Populorum placed new and important restrictions on private property rights by holding that "it is unacceptable that citizens should transfer part of their wealth abroad for their own advantage." Private property thus becomes a part of the national wealth, as Plato, Fichte and all modern totalitarian writers have held.

[[19]]Life, February 26, 1971. Interview with Buckminster Fuller.

[[20]]Karl Jaspers, Existentialism and Humanism, trans. E. B. Ashton (New York: R. F. Moore Co., 1952), p. 83.

[[21]]Kenneth E. Boulding, A Reconstruction of Economics (New York: Science Editions, 1950), p. 34.

[[22]]Ludwig von Mises, Human Action (New Haven: Yale University Press, 1949), p. 858.

[[23]]Well into the 19th century, value was regarded as an innate quality by those who held to the notion that it represented "congealed labor," and to this day most people think of beauty as an inherent quality, rather than a conditioned response of the observer.

[[24]]J. Z. Young, Doubt and Certainty in Space—A Biologist's Reflection on the Brain (Oxford; Clarendon Press, 1951), p. 101.

[[25]]Werner Heisenberg, Philosophic Problems of Nuclear Physics (New York: 1952), p. 22.

[[26]]Herbert Dingle, "The Scientific Outlook in 1851 and 1951," British Journal for the Philosophy of Science, 1951, pp. 89, 99.

[[27]]John Dewey and Arthur F. Bentley, Knowing and the Known (New York: 1949), pp. 205–206.

[[28]]The American G.N.P., for instance, makes no allowance for the work done by millions of housewives, because this work has 'no market value' (a purely subjective notion), while the Russian G.N.P. makes allowance for the work of housewives because it is 'labor' (a similarly subjective notion).

[[29]]J. R. Hicks, The Social Framework: An Introduction to Economics (Oxford: Clarendon Press, 1942), p. 8.

[[30]]Ferdinando Galiani, Dialogues sur le commerce des bles (Milano: G. G. Destefanis, 1803), p. 279.

[[31]]Werner Heisenberg, Philosophic Problems in Nuclear Physics (London: Faber, 1952), p. 22.

[1]I am indebted, in ways I could no longer trace in detail, to writings, lectures, and conversations not only of Professor Mises but also of F.A. Hayek, Walter J. Blum and

Harry Kalven, Jr., Bertrand de Jouvenel, Wilhelm Röpke, Milton Friedman, Peter Bauer, and James M. Buchanan, among others.

[2]I shall obviously be dealing in value judgments. While it is impossible to classify value judgments scientifically as right or wrong, it is possible to investigate relations among them, revealing compatibilities and clashes and striving for a consistent and economical articulation. Showing people that certain of their less fundamental value judgments clash demonstrates the need for a more careful ranking and articulation of their values.

[3]Federal Tax Reform (Chicago: University of Chicago Press, 1950), p. 144.

[4]Economic Policy for a Free Society (Chicago: University of Chicago Press, 1948), p. 6.

[5]Quoted in F. A. Hayek, The Constitution of Liberty (Chicago: University of Chicago Press, 1960), p. 518.

[6]For example, in The Ethics of Competition (2d ed.; New York: Harper, 1936), pp. 60-66, 292-293, 302-304.

[7]The ones to be considered here still are not absolutely basic. An absolute value would presumably be something comprehensive and vague such as "human happiness" or "human self-fulfillment". Not only economics but also political science, sociology, psychology, philosophy, and other disciplines presumably have much to contribute to investigation of which intermediate ends, or the policies and social and political and economic arrangements adopted in their pursuit, do and which do not conduce to the irreducibly basic end of human happiness.

[8]These beneficiaries are of course likely to include people beyond those who actually use the schools and hospitals—the "externalities" involved are familiar—, and I am not implying that the entire cost should be charged to the actual users alone.

[9]Admittedly I cannot cite a clear statement of this position. The grounds for equalitarianism or redistributionism are so generally regarded as self-evident that a critic must try to figure out for himself just how the redistributionist case might look if spelled out in detail in the strongest version he can conceive. This is what I am trying to do, rather than concocting and refuting flimsy arguments as a debating tactic.

[10]On this point, see Hayek, The Constitution of Liberty, chapter six.

[11]The Constitution of Liberty, p. 314.

I am aware that a case of sorts can be made out for redistributive taxation as a kind of mutual insurance arrangement: not knowing how rich or poor they will be in the future, individual voters agree to a scheme that will redistribute income away from them if they turn out to be rich but in their favor if they turn out to be poor. One trouble with this argument is that voters do in fact have a pretty good idea of their current and future positions in the national income distribution. Furthermore, the argument hardly applies to the philosophy of leveling down for its own sake, leveling carried to the point where additional tax revenue for redistribution to the poor is relatively insignificant.

[12]First passage from “Le culte de l'homme commun et la gloire des humbles”, Laval Théologique et Philosophique, II, no. 1, 1946, p. 78; second passage from “Privilege and Liberty”, same journal, V, no. 1, 1949, p. 82. (My quoting these passages is not meant as an endorsement of the attitude of “the true Christian”.)

[13]The Ethics of Competition, pp. 308–309.

[14]Three Dimensions of Public Morality (Bloomington: Indiana University Press, 1956), p. 97; cf. pp. 100, 118.

[15]This is one among many reasons for rejecting the currently fashionable concept of “Pareto optimality” as a touchstone for economic policy. There is no substitute for considering how the probable consequences of each contemplated policy will mesh or will clash with one's conception of a good society.

[[1]]Religion and the Rise of Capitalism, Penguin Books, 1948, p. 75.

[[2]]R. H. Tawney, ibid.

[[3]]Jacques Maritain, Scholasticism and Politics, p. 87.

[[4]]Pope John XXIII, Enciclical Mater et Magistra, No. 5.

[[5]]E. g.: Jacques Maritain, ibid.

[[6]]E. g.: Popes Leo XIII, Pius XI, John XXIII and Paul VI in their Enciclicals Rerum Novarum (No. 5), Quadragesimo Anno (No. 45), Mater et Magistra (No. 3) and Populorum Progressio (No. 61).

[[7]]E. g.: Rerum Novarum (No. 12); Quadragesimo Anno (No. 112).

[[8]]Cf. Pope Paul VI's formula: preserve competitive markets but keep them within limits so that they become fair and humane (Enciclical Populorum progressio) No. 61.

[[9]]See Williams T. Bluhm, Theories of the Political System, 1965, p. 10

[[10]]Quoted by R. H. Tawney, op. cit. pp. 53–54.

[[11]]R.H. Tawney, op. cit., p. 72.

[[12]]V. Jacques Maritain, Principes d'une Politique Humaniste, Paris, 1945, pp. 20–21

[[13]]R.H. Tawney, op. cit., pp. 53–54.

[[14]]V. Daniel Villey, Petite Histoire des Grandes Doctrines Economiques, Spanish Edition, Buenos Aires, 1960, p. 70.

[[15]]Morale de l'Entreprise et Destin de la Nation, Paris, 1965, pp. 38–39.

[[16]]V. Ludwig von Mises, Human Action, Chapter XXXV, Section2.

[[17]]Freedom and Reality, London, 1969, p. 28.

[[18]]Part. I, Chapter XXXI.

[[19]]V. Ludwig von Mises, Socialism.