The Review of Austrian Economics

Volume 6,
Numbers 1 and 2, 1992

Murray N. Rothbard

THE REVIEW OF AUSTRIAN ECONOMICS

Volume 6, Number 1

The Review of Austrian Economics

Murray N. Rothbard, Editor
University of Nevada, Las Vegas

Walter Block, Co-Editor
College of the Holy Cross

Steve H. Hanke, Associate Editor
The Johns Hopkins University

Judith F. Thommesen, Managing Editor

Editorial Board

Martin Anderson
Hoover Institution
Stanford University

Dominick T. Armentano
University of Hartford

Roger Arnold
California State University, San Marcos

Charles W. Baird
California State University, Hayward

Don Bellante
University of South Florida

James T. Bennett
George Mason University

Olufur Bjornsson
University of Iceland

Samuel Bostaph
University of Dallas

J. B. Bracewell-Milnes
Surrey, England

Yale Brozen
University of Chicago

Alfred G. Cuzan
University of West Florida

Thomas J. DiLorenzo
University of Tennessee Chattanooga

Richard Ebeling
Hillsdale College

Robert B. Ekelund, Jr.
Auburn University

Joseph Fuhrig
Golden Gate University

Lowell Gallaway
Ohio University

Fred R. Glahe
University of Colorado

David Gordon
Ludwig von Mises Institute

F. A. Hayek†
University of Freiburg Germany

Henry Hazlitt
Fairfield, Connecticut

Robert F. Hébert
Auburn University

Robert Higgs
Seattle University

Ole-Jacob Hoff
Tjøme, Norway

Randall G. Holcombe
Florida State University

Hans-Hermann Hoppe
University of Nevada Las Vegas

Edward Kaplan
Western Washington University

Lord Harris of High Cross
Institute of Economic Affairs London, England

Kurt Leube
California State University, Hayward

Stephen O. Littlechild
University of Birmingham England

Naomi Moldofsky
University of Melbourne Australia

Thomas Gale Moore
Hoover Institution
Stanford University

John C. Moorhouse
Wake Forest University

David O'Mahony
University College Cork, Ireland

David Osterfeld
St. Joseph's College

E. C. Pasour, Jr.
North Carolina State University

William H. Peterson
Campbell University

W. Duncan Reekie
University of the Witwatersrand, So. Africa

Morgan O. Reynolds
Texas A&M University

Charles K. Rowley
George Mason University

Joseph T. Salerno
Pace University

Arthur Seldon
Institute of Economic Affairs London, England

Sudha Shenoy
University of Newcastle Australia

Mark Skousen
Rollins College

Gene Smiley
Marquette University

Jack Sommer
National Science Foundation

T. Alexander Smith
University of Tennessee

Thomas C. Taylor
Wake Forest University

Richard K. Vedder
Ohio University

Leland B. Yeager
Auburn University

Albert H. Zlabinger
Carl Menger Institute Vienna, Austria

THE REVIEW OF AUSTRIAN ECONOMICS

Volume 6, Number 1

Edited by
Murray N. Rothbard
University of Nevada, Las Vegas

Co-edited by
Walter Block
College of the Holy Cross

LUDWIG VON MISES INSTITUTE

Auburn University

Kluwer Academic Publishers
Boston/Dordrecht/London

The Review of Austrian Economics

SUBSCRIPTION RATES

The subscription price for 1992, Volume 6 (2 issues) is:
For institutions Dfl. 213.00/US $108.50 including postage and handling.

ORDERING INFORMATION / SAMPLE COPIES

Subscription orders and requests for sample copies should be sent to:

Kluwer Academic Publishers Group
P.O. Box 322
3300 AH Dordrecht
The Netherlands

or

Kluwer Academic Publishers
101 Philip Drive
Assinippi Park
Norwell, MA 02061, USA

or to any subscription agent

All requests for further information concerning *The Review of Austrian Economics* should be sent to:

Kluwer Academic Publishers
101 Philip Drive
Assinippi Park
Norwell, MA 02061, USA

or

Kluwer Academic Publishers
P.O. Box 163
3300 AD Dordrecht
The Netherlands

Photocopying. *In the U.S.A.:* This journal is registered at the Copyright Clearance Center, Inc., 27 Congress Street, Salem, MA 01970. Authorization to photocopy items for internal or personal use, or the internal or personal use of specific clients, is granted by Kluwer Academic Publishers for users registered with the Copyright Clearance Center (CCC) Transactional Reporting Service, provided that the base fee of $5.00 per copy per article is paid directly to CCC. For those organizations that have been granted a photocopying license by CCC, a separate system of payment has been arranged. The fee code for users of the Transactional Reporting Service is 0889-3047/92/$5.00.

Authorization does not extend to other kinds of copying, such as that for general distribution, for advertising or promotional purposes, for creating new collective works, or for resale.

In the rest of the world: Permission to photocopy must be obtained from the copyright owner.

Copyright © 1992 by The Ludwig von Mises Institute.

ISSN 0889–3047

Printed on acid-free paper.

The Review of Austrian Economics has two broadly conceived objectives: (1) to promote the development and extension of Austrian economics and (2) to promote the analysis of contemporary issues in the mainstream of economics from an Austrian perspective.

Correspondence relating to submissions, articles, book reviews, permission to quote, and back issues through volume 3 should be addressed to: *Review of Austrian Economics*, Ludwig von Mises Institute, Auburn University, Auburn, Alabama 36849.

Papers submitted for consideration should be double-spaced, include three copies of the manuscript, and an abstract of not more than 250 words to assist the referees. There is no submission fee. Articles that are accepted will be requested on an IBM format diskette, when possible.

The opinions expressed in this volume by the authors in their respective articles are their own and *The Review of Austrian Economics* assumes no responsibility for these views.

Dedication

Volume 6, number 1, of the *Review of Austrian Economics* is dedicated to the Members of the Ludwig von Mises Institute, whose generosity makes such projects possible, and in particular to O. P. Alford, III, Thomas K. Armstrong and the Armstrong Foundation, Brenda Bretan, Christopher P. Condon, Guy Curtis and the Alta Hier Estate, Robert T. Dofflemyer, Thomas Happ, Michael L. Keiser, Robert D. Kephart, Atlee Kohl and the Ralph and Marian Falk Foundation, The Lawrence Fertig Foundation, Hugh E. Ledbetter, Forrest E. Mars, Sr., The Millard Family Foundation, James M. Rodney, Sheldon Rose, Mr. and Mrs. Chris Saari, Leland W. Schubert and the AHS Foundation, Abe Siemens, Mrs. Somers von Behren, and Dallas R. Wolf.

THE REVIEW OF AUSTRIAN ECONOMICS

Articles

Joseph T. Salerno
The Development Of Keynes's Economics: From Marshall To Millennialism 3

Murray N. Rothbard
How and How Not To Desocialize 65

Jeffrey M. Herbener
The Role of Entrepreneurship in Desocialization 79

Review Essay

Murray N. Rothbard
Aurophobia: or, Free Banking on What Standard?
A Review of *Gold, Greenbacks, and the Constitution*, by Richard H. Timberlake 97

Book Reviews

Bruce L. Benson, *The Enterprise of Law*
Reviewed by *David Gordon* 111

Paul Edward Gottfried, *Carl Schmitt: Politics and Theory*
Reviewed by *David Gordon* 117

Donald R. Hoke, *Ingenious Yankees: The Rise of the American System of Manufactures in the Private Sector*
Reviewed by *Murray N. Rothbard* 121

David Schmidtz, *The Limits of Government*
Reviewed by *David Gordon* 125

VOLUME 6, NUMBER 1 **1992**

Articles

The Development of Keynes's Economics: From Marshall to Millennialism

Joseph T. Salerno*

One long-standing interpretation of the *General Theory*, which has been growing in influence recently, emphasizes that Keynes's sociopolitical vision was formulated long before and, in fact, inspired the heterodox economic analysis and policy prescriptions that were served up in his most influential work. One of the earliest proponents of this interpretation, Joseph Schumpeter ([1951] 1965, p. 268) writes that "In those pages of the *Economic Consequences of the Peace* [published in 1919] we find nothing of the theoretical apparatus of the *General Theory*. But we find the whole of the vision of things social and economic of which that apparatus is the technical complement. The *General Theory* is the final result of a long struggle *to make the vision of our age analytically operative*."

More recently this interpretive thread has been taken up by scholars who can be classified mainly, though not exclusively, as opponents of textbook Keynesian economics. For example, in a recent article on "The Sociopolitical Vision of Keynes," the late Karl Brunner reaches a conclusion similar to Schumpeter's. According to Brunner (1987, p. 32), "The general direction of Keynes's sociopolitical thoughts had . . . already emerged many years before he wrote the *General Theory*. . . . [The latter work] provided the underlying vision of the socioeconomic process in an extensive analytic context. The sociopolitical program outlined over the prior decade naturally fitted with the *General Theory* into a coherent story of modern Western society."

In another recent contribution, Allan Meltzer (1988, p. 5) declares that "[i]t is nearer the truth to say that the *General Theory* provided

*Joesph T. Salerno is associate professor of economics at Pace University in New York City.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 3–64
ISSN 0889-3047

the analytic framework for Keynes's long-standing policy views than to conclude that the books' [sic] policy recommendations are the derived implications of his theory." Finally the post-Keynesian Hyman P. Minsky may be cited. Echoing Schumpeter, Minsky (1975, p. 145) writes:

> In an interpretation of Keynes's views on the implications of *The General Theory* for broader social issues and on the appropriate structure of policies designed to implement the new theory, his writings on politics and social policy prior to *The General Theory* are relevant. While *The General Theory* marks a sharp break in economic theory, the "social philosophy" implications he drew from the work are consistent with his earlier views. In fact, *The General Theory* can be viewed as giving an economic theoretic rationalization for views that Keynes's ethics and intuition had led him to, even as he was a practicing "classical" economist.

Textbook Keynesians, on the other hand, who generally are wont to emphasize the Great Depression as the main intellectual stimulus to the formulation of the "vision" underlying the *General Theory*, strongly demur from the Schumpeterian interpretation. For instance, in discussing Brunner's contribution cited above, Lester Thurow (Brunner 1987, p. 52) flatly states that "The *General Theory* would not have been written without the Great Depression." In his comment on Brunner, James Tobin (Brunner 1987, p. 53) expresses agreement with Thurow that the *General Theory* was presented as "a diagnosis of the world economic crisis of the Great Depression."

In this paper I shall argue that when the nature and evolution of Keynes's "vision" is fully grasped, the Schumpeterian and neo-Keynesian views of the *General Theory* are complementary rather than antithetical. It is indeed true that Keynes's ethical and sociopolitical views were formulated long before the writing of the *General Theory* and inspired and suffused the heterodox vision of the economic system presented in the book. But it is also true that prior to the onset of the Great Depression and up through 1931, in theorizing about the capitalist economy, Keynes proved to be a rigidly orthodox and parochial Marshallian economist, despite the idiosyncratic refinements and contrivances he introduced into Cambridge monetary theory in his *Treatise on Money*. It was not until 1932, at the earliest, that Keynes set himself to the task of overturning the Marshallian orthodoxy by undertaking the construction of a deliberately heretical economics explicitly based upon and embodying concepts and precepts derived from his ethical and social philosophy.

Keynes's social philosophy, the rudiments of which can already be found in *The Economic Consequences of the Peace* and which was

expounded in widely scattered articles, book reviews, and speeches throughout the 1920s and early 1930s, can be classified as "millennialist." Although there are numerous variants of social millennialism or chiliasm, including those based on Christian theology and Hegelian philosophy (Rothbard 1990), what is common to all is the view that social evolution is teleological and, from a specific starting point, progresses along a necessary and definite course to a pre-ordained end. All millennialist theories are therefore presented as theories of historical stages in which human history is foretold as coming to a close in a paradisiacal final stage or millennium.

The teleological aspect of social millennialism has been well-described by Ludwig von Mises ([1936] 1951, p. 287):

> The teleological view describes the course of [social] evolution in all its windings and deviations. Thus it is typically a theory of stages. It shows us the successive stages of civilization until one is reached which must necessarily be the last, because no other follows it. When this point has been reached it is impossible to foresee how history is to proceed.

As a consequence of their teleological orientation, millennialist theories are inherently esoteric, gnostic, and antirationalist, involving the explicit or implicit assumption that the theorist or prophet alone possesses gnosis or direct intuition of the truths of social evolution.

Before examining Keynes's specific theory of social evolution, it is useful to broadly contrast this general characterization of millennialist theories with the approach to social evolution that I have elsewhere designated as "social rationalism" (Salerno 1990). The rationalist approach is methodologically individualistic and seeks for the ultimate explanation of social evolution in the perceived benefits which accrue to individuals as a result of their participation in the social division of labor. The rationalist approach is thus nonteleological and eschews any attempt to foretell the exact course of human history. Social progress is identified with the intensification and extension of the social division of labor, which proceeds from the recognition by ever-increasing numbers of individuals and groups that it is advantageous to endeavor to satisfy a growing number of wants by consciously organizing their productive activities in accordance with the law of comparative advantage (Salerno 1990, pp. 27–31). As Mises ([1936) 1951, p. 287) points out, in the rationalist view, "[t]he end of social evolution can be no other than that of society itself." The law of comparative advantage which is "the law of social evolution" yields "insight, not into man's destiny, but into man's doings" (Mises [1936] 1951, pp. 287–88).

Because the rationalist theorist relies only on ratiocinative processes in formulating his explanation of the evolution of society, his theory is exoteric and subject to critical examination and refutation by other reasoning beings. Indeed, in order for much progress to be made toward the formation of a world-embracing division of labor and market society, the law of comparative advantage requires conscious affirmation by human reason. In history, this affirmation takes the form of the deliberate development and popular acceptance of a coherent ideology of social life which supports human liberty, private property, and a market economy, while abhorring political omnipotence, privilege, and warfare (Salerno 1990, pp. 46–53). The millennialist approach, on the other hand, posits the existence of a metaphysical and supra-rational force which, through "the cunning of History," drives human beings to those actions which are necessary to the achievement of humanity's final goal.

In the next section, I provide a brief overview of Keynes's most important intellectual influences. These influences are small in number and relatively parochial, involving two Cambridge dons and a British political theorist. In creating his sociopolitical vision, Keynes drew mainly upon the ethical philosophy of G. E. Moore, the political philosophy of Edmund Burke, and the economics of Alfred Marshall. From Marshall, Keynes also adopted the millennialist theoretical framework which the former constructed as a prop for his "preaching of mid-Victorian morality, seasoned by Benthamism" (Schumpeter [1951) 1965, p. 104).

In section 3, I trace the development of Keynes's millennialist theory of social evolution, upon which, I argue, his sociopolitical vision is based. I also suggest that, during the decade of the 1920s, in which this development mainly occurred, Keynes viewed Marshallian economics as a tool for guiding a dynamic and useful but unsteady and unethical capitalist economy toward the impending post-scarcity millennium and that his *Treatise on Money* (Keynes [1930] 1958) was intended as a handbook for just this purpose.

Section 4 contains an account of Keynes's apostasy from Marshallian economics in consequence of the Great Depression and his endeavor, beginning in 1932, to formulate a heretical body of economic analysis and policy, which was designed to effect a rapid transition to the millennium. In the fifth and concluding section of the paper, I present the case that the basic building blocks of the *General Theory*, including the theories of effective demand and liquidity preference and the concept of the marginal efficiency of capital, are fashioned out of the Moorite ethical precepts that Keynes presumed would guide action in his imagined millennial state.

Keynes's Intellectual Influences

G. E. Moore served as Keynes's guide in his conception and pursuit of the ethical good. In Keynes's interpretation of Moore, ethical goodness or "the Good" is an attribute uniquely related to "states of mind," which are the only things valuable in and of themselves. In elaborating upon his version of the Moorite "religion," Keynes (quoted in Skidelsky [1983] 1986, p. 141) writes:

> Nothing mattered except states of mind. . . . These states of mind were not associated with action or achievement or with consequences. They consisted in timeless passionate states of contemplation and communion, largely unattached to "before" and "after." . . . The appropriate subjects of passionate contemplation and communion were a beloved person, beauty and truth, one's prime objects in life were love, the creation and enjoyment of aesthetic experience and the pursuit of knowledge. . . . [The Moorite] religion was altogether unworldly—with wealth, power, popularity or success it had no concern whatever, they were thoroughly despised.

According to Keynes (quoted in Skidelsky [1983] 1986, p. 142), he and the other early proselytes of Moore's religion:

> lived entirely in present experience, since social action as an end in itself and not merely as a lugubrious duty had dropped out of our Ideal, and not only social action, but the life of action generally, power, politics, success, wealth, ambition, with the economic motive and economic criterion less prominent in our philosophy than with St. Francis of Assisi, who at least made a collection for the birds.

Thus the Moorite contribution to Keynes's thought is a concept of the highest good as consisting in a succession of timeless states of consciousness to be experienced in the present moment. There is further a tendency in Moore to treat these internal states of goodness as wholly independent of any external means for their achievement. As Skidelsky ([1983] 1986, p. 146) points out, not only is economic welfare not the same as ethical goodness, "there is nothing in Moore's argument to show that it is a necessary condition of it." Thus Keynes absorbed a radical present orientation from Moore's thought and a related tendency to denigrate "economizing" or purposeful behavior associated with scarcity, since attainment of ethical goods did not directly depend upon—indeed was inhibited by—the undertaking of time-consuming processes of production employing scarce means.

On two crucial points, however, Keynes broke with Moore. First, while he accepted the sharp distinction drawn by Moore between economic welfare and ethical goodness, Keynes struggled mightily to

forge a logical link between economic, social, and political goods on the one hand and the Moorite ethical good on the other. Keynes supplies this link by conceiving the existence of society as an absolute and necessary precondition for the realization of the individual's "good states of mind." The overall social good, including economic welfare, while not intrinsically good, is therefore to be sought after as a "useful" and "valuable" means to the ultimate end of the ethical good (Skidelsky [1983] 1986, p. 154). For Keynes, however, because the ethical quality of the end could never be imputed to or reflected by the means, the Good is always to be valued absolutely above its means of attainment, thereby precluding the logical development of a universal principle on which resources are to be allocated between the immediate attainment of good states of mind and the securing of conditions that may be useful for their attainment in the future. Thus the claim of the ethical good on behavior appears to be absolute, indivisible, and beyond the pale of scarcity and economic science. Of course, Keynes did believe that non-ethical ends had a claim on behavior in certain circumstances, but, as Skidelsky ([1983] 1986, p. 154) states, "the connection [between economics and ethics] for Keynes was never mechanical, always problematic."

For guidance in identifying the social good and the proper method for its achievement, Keynes turned to the political philosophy of Edmund Burke. As Skidelsky ([1983] 1986, p. 154) states, "[i]f Moore was Keynes's ethical hero, Burke may lay strong claim to be his political hero."

Keynes (quoted in Skidelsky [1983] 1986, p. 155) broadly characterized Burke as a utilitarian, for whom politics and government were the essential means to securing the "happiness of the people" in the form of "physical calm, material comfort, and intellectual freedom." For Keynes these qualities are, in turn, the "great and essential means" for the attainment of the ultimate Moorite "good things" in life, which flow from the cultivation of the "tastes and emotions, good feeling and right judgment."

According to Keynes (quoted in Skidelsky [1983] 1986, p. 155), one of the most important corollary principles of Burkean utilitarianism is an "extreme timidity in introducing present evils for the sake of future benefits." In support of this principle, Keynes argued that:

> Our power of prediction is so slight, it is seldom wise to sacrifice a present evil for a doubtful advantage in the future. Burke ever held, and held rightly, that it can seldom be right to sacrifice the well-being of a nation for a generation, to plunge whole communities in distress, or to destroy a beneficent institution for the sake of a supposed millennium in the comparatively remote future. . . . It

> is the paramount duty of governments and of politicians to secure the well-being of the community under the case in the present and not to run risks overmuch for the future.

Keynes (quoted in Skidelsky [1983] 1986, p. 157) summed up Burke's political philosophy in the following terms:

> His goods are all in the present—peace and quiet, friendship and affections, family life, and those small acts of charity whereby one individual may sometimes help his fellows. He does not think of the race as marching through blood and fire to some great and glorious good in the distant future; there is, for him, no great political millennium to be helped and forwarded by present effort and present sacrifice.

Thus, Keynes derived two things from Burke: (1) the belief that government and politicians are competent to directly secure the material conditions that foster "general happiness" or "the wide dissemination of comfort" and that are also the means for attaining the spiritual or mental states that constitute the ultimate good; and (2) a strong present orientation in policy matters which dovetails with the severely foreshortened time horizon that is entailed by acceptance of Moore's notion of the ethical good.

The second point on which Keynes disputed his mentor on ethics involves probability theory. As a utilitarian, Moore contended that it is rational to pursue one's own immediate good only if this pursuit will, on balance, increase or at least not decrease the good of the Universe. However, in attempting to judge which course of action is rational in this sense, the individual actor is confronted with the daunting task of correctly forecasting and assessing the myriad consequences of his action, which may ramify into every corner of the remote future. The insuperable difficulty of this task leads Moore (quoted in Skidelsky [1983] 1986, p. 152) to argue that "[o]ur utter ignorance of the far future gives us no justification for saying that it is even probably right to choose the greater good within the region over which a *probable* forecast may extend." Moore concludes, therefore, that, in most cases, an individual rationally pursuing the ethical good can do no better than to conform to general rules of conduct, such as those embodied in the dictates of conventional morality.

Keynes reacted to this argument by challenging Moore's underlying approach to probability, which Keynes identified as a frequency theory of probability involving certain knowledge of the distribution of outcomes. In Keynes's view, the concept of probability which is relevant to action is one which refers to the available evidence regarding alternative actions. A proposition about the outcome of a

contemplated action is more probable than a proposition regarding an alternative outcome, if, however slight the presently existing evidence, it indicates that the first outcome is more likely than the second. As Keynes ([1921] 1962, pp. 307, 310) states:

> Given as our basis what knowledge we actually have, the probable . . . is that which it is rational for us to believe. . . . To believe one thing *in preference* to another, as distinct from believing the first true or more probable and the second false or less probable, must have reference to action and must be a loose way of expressing the propriety of *acting* on one hypothesis rather than another. . . . We might put it, therefore, that the probable is the hypothesis on which it is rational for us to act. . . . The results of our endeavors are very uncertain, but we have a genuine probability, even when the evidence upon which it is founded is slight. . . .

With this theory of probability, Keynes is able to free the Moorite pursuer of good mental states from the shackles of conventional rules of correct conduct that were clamped on by Moore himself as a utilitarian concession to the uncertain future. According to Keynes ([1921] 1962, pp. 309–10): "If good is additive, if we have reason to think that of two actions one produces more good than another in the near future, and if we have no means of discriminating between their results in the distant future, then by what seems a legitimate application of the Principle of Indifference we may suppose that there is a probability in favor of the former action." Thus, the claims of the immediate good upon action are even stronger for Keynes than for Moore, because Keynes's theory of probability permits him to ignore the unforeseeable future ramifications of present action.

The final major influence on Keynes's social philosophy is his mentor in economics, Alfred Marshall. Marshall's influence on the early Keynes is difficult to overestimate. From all accounts, Keynes the economist was steeped in Marshall. Dating from his academic appointment to Cambridge in 1909, Keynes "taught straight Marshallian doctrine . . . the doctrine he mastered as few people did and with which he remained identified for twenty years to come" (Schumpeter [1951] 1965, p. 263).

Revelations of Keynes's astonishing parochialism in economic theory are provided by Harrod, his disciple and authorized biographer. In urging the young Harrod to attend Cambridge, Keynes "brushed aside" the London School of Economics and rejected the alternative of a foreign university because, according to Keynes, "they knew nothing at all of Economics on the Continent" (Harrod 1951, p. 319). Harrod (1951, p. 322) refers to "Keynes's dictum that there wasn't any place but Cambridge where one could learn economics."

After enrolling at Cambridge, Harrod was impressed by Keynes's view that "the content of economic theory was extremely small" and that "wide reading in economic theory" was not necessary. Keynes believed, as Marshall had, that "there was not much further work to be done" in the field of economic theory, and Keynes's "recipe for the young economist was to know his Marshall thoroughly and read his *Times* every day carefully, without bothering too much about the large mass of contemporary publication in book form" (Harrod 1951, p. 324).

More recently, Moggridge (1976, p. 153) has affirmed that "broadly Marshallian modes of analysis pervade all Keynes's work, even when Marshall and his successors were the objects of attack, as in the *General Theory*."

In the judgment of his fellow Cantabrigian, A. C. Pigou (quoted in Keynes 1973, p. 22), even after he discarded some of the technical apparatus of Marshallian theory in the 1930s Keynes remained, in terms of his philosophical approach to economics as a branch of applied ethics, "a firm disciple of the 'Master.'" As late as 1938, for example, Keynes defended Marshall's view, as against Robbins's, that economics is "a moral science" which "employs introspection and judgments of value" (Moggridge 1976, p. 22).

Writing in 1941, Keynes (quoted in Hession 1984, p. 326) described the doctrinal filiation of his own intensely ethical approach to economics in the following terms:

> Along one line of origin, at least, economics more properly politico-economy is a side of ethics. Marshall used always to insist that it was through ethics he arrived at political economy, and I would claim myself in this, as in other respects, to be a pupil of his. I should have thought that nearly all English economists in the tradition, apart from Ricardo, reached economics that way. There are practically no issues of policy as distinct from technique which do not involve ethical considerations.

Accordingly, one of the main props for Keynes's social philosophy is the value-laden theory of wants developed by Marshall. Marshall's classification of wants is threefold. "Natural" human wants refer to the biological needs for, e.g., food and shelter, which characterize both the lower animals and uncivilized man. According to Marshall ([1920] 1949, p. 86), the wants in this class "are countless in number and very various in kind: but they are generally limited and capable of being satisfied." As civilization progresses, however, there emerges a second class of "artificial" wants, which are not capable of satiation. Marshall ([1920] 1949, p. 88) includes in this class the craving for distinction among one's fellows which, for example, in the case of

women's dress, gives rise to "the evil dominion of the wanton vagaries of fashion."

Marshall's third category encompasses "wants adjusted to activities." In the early stages of social evolution, wants are the prod to human "activities," which are aimed almost exclusively at satisfying these wants. In the higher stages, in which natural wants have been satisfied, "higher" activities begin to be undertaken for their own sake leading to the creation of wants. Marshall's example of this inverted relationship between wants and activities is the pursuit of science, literature, and art for their own sake, generating a demand for the labor of those who pursue these activities professionally (Marshall [1920] 1949, pp. 88–89). The rapid increase in the consumption of tea, while the consumption of alcohol stagnates, affords another illustration, because, according to Marshall ([1920] 1949, p. 89 1n), tea is desired to "stimulate the mental activities," just as alcohol serves to "merely gratify the senses." As the pursuit of higher activities becomes increasingly widespread in society, there emerges a pervasive "desire for excellence for its own sake" causing the processes of production, heretofore seen as merely a means to want satisfaction, to be transformed into higher activities pursued as ends in themselves. Thus the work of the fisherman begins to take on the character of the "activities" of a Newton or a Stradivarius (Marshall [1920] 1949, p. 89). For Marshall (quoted in Parsons [1937] 1968, p. 141 1n), then, "[w]ork in its best sense, the healthy energetic exercise of faculties is the aim of life, is life itself."

Marshall's theory of wants and activities serves as the basis of his theory of social evolution, which also deeply influenced Keynes. Thus Marshall ([1920] 1949, p. 85) tells us that "it is to changes in the forms of efforts and activities that we must turn when in search for the keynotes of the history of mankind." The reason is that "man's character has been molded by his every-day work, and the material resources he thereby procures, more than any other influence unless it be that of his religious ideals" (Marshall [1920] 1949, p. 1). Human character is thus developed in the very process of economic and social evolution in which, in the later stages, "each new step upwards is to be regarded as the development of new activities giving rise to new wants" (Marshall [1920] 1949, p. 89).

Most important for Marshall, economic and social progress is expressed in a "rising standard of life," a term which Marshall never clearly defines but which can be understood as "some kind of index of human quality: a scalar function of a vector of attributes or 'activities,' physical or mental, such as energy, dexterity, rationality, foresight, honesty, unselfishness, striving for self-improvement and

social improvement, and so on" (Whitaker 1977, p. 180). An increase in the standard of life implies, e.g., a reduction of expenditure on debilitating alcoholic beverages and an increase of expenditure on healthful food and drink and children's education, as well as an increase in saving and therefore capital accumulation. The resulting improvement in the laborer's health, morale, and human capital as well as in the material structure of complementary capital goods will tend to increase labor efficiency and real wage rates. Increased wage rates will, in turn, provide the wherewithal, including the greater opportunity for the enjoyment of leisure, which is needed to satisfy the wants induced by the pursuit of "higher activities" (Whitaker 1977, 179, pp. 184–85).

Marshall's almost obsessive emphasis on leisure—albeit leisure to pursue ennobling or "higher" activities—as a prerequisite of character development and social progress should be noted. In his own words, "Some free time from the fatigue of work that tires without educating, is a necessary condition of a high standard of life." For the young, in particular, it is "an essential condition" for developing "their higher nature" and making them "efficient producers" that they be given "long-continued freedom from mechanical toil; together with abundant leisure for school and for such kinds of play as strengthen and develop the character" (Marshall [1920] 1949, p. 720).

The improvement of character that results from higher activities pursued during leisure time will further heighten the standard of life and lead to a further round of improvement in consumption habits and of increased investment in material and human capital, with the consequent increase in real wages starting the whole process over again. Marshall ([1920] 1949, p. 690) implies, however, that this development process may be short-circuited if an increase in real wage rates is squandered on increasing the "standard of comfort," by which he means "a mere increase of artificial wants, among which perhaps the grosser wants may predominate."

And if the masses persist in wallowing in a degraded standard of life, thereby obstructing social progress, Marshall ([1920] 1949, p. 714) suggests a two-pronged solution. The "residuum," or those who are "physically, mentally or morally incapable of doing a good day's work with which to earn a good day's wage," are to be prevented from perpetuating themselves by rearing up children "in their own patten." To this end, those with young children are to "come under a paternal discipline" and to incur "a more strict subordination of personal freedom to public necessity." As a last resort, Marshall ([1920] 1949, pp. 714–15 1n) advocates that "the homes might be closed or regulated with some limitation on the freedom of the parents."

Marshall's second method of "causing the residuum to cease from the land" and hastening social progress involves "the application of the principles of Eugenics to the replenishment of the race from its higher rather than its lower strains. . . ." (Marshall [1920] 1949, pp. 714, 248). Theodore Levitt (1976, p. 429) perceptively refers to this second method as "the ultimate solution," because "ultimately what Marshall preached was not so much economics as it was moral and aesthetic development."

Although Marshall advocated a political solution to the problem of the residuum, "It was free enterprise, softened and modified by altruism and chivalry, which was to be the main agent of human evolution" (Whitaker 1977, p. 181). According to Marshall, as society progressed, men in the realm of business would increasingly foreswear the single-minded pursuit of the coin of pecuniary gain and substitute competition for the coin of chivalric achievement and the social acclaim and approbation it purchased. In this way business activities would come to resemble the arts and sciences. Such "chivalrous competition," to use Marshall's term, would be undertaken primarily as a "higher activity," which, as Whitaker (1977, p. 173) describes it, unites "public spirit and conscientiousness with a delight in doing noble and difficult things and a desire for full exercise of one's own abilities."

As members of the middle and upper classes come to exert themselves more and more for chivalric motives, the supply prices of the various kinds of managerial and professional effort, especially of what Marshall ([1920] 1949, p. 618) calls "business ability in command of capital," decline absolutely and relative to the wage rates of the more common grades of labor, and this effects a spontaneous redistribution of income toward the working class. As Marshall (quoted in Whitaker 1977, p. 174) puts it, "if society could award . . . honor, position, and influence by methods less blind and wasteful; and if it could at the same time maintain all that stimulus which the free enterprise of the strongest business men derives from present conditions, then the resources thus set free would open out to the mass of the people new possibilities of a higher life." Thus does chivalrous competition promote social evolution, permitting members of the working class to attain to the "society of gentlemen" wherein "no one is to do in the day so much manual work as will leave him little time or little aptitude for intellectual and artistic enjoyment in the evening" (Marshall quoted in McWilliams-Tullberg 1975, p. 102).

As noted above, all millennialist social theories are essentially teleological, typically attempting to describe the precise course of

evolution by positing a series of well-defined historical stages through which society must evolve before reaching its final goal in the culminant stage of human history. Now this is certainly typified by Marshall's theory of social evolution. This theory is centered upon what Talcott Parsons ([1937] 1968, p. 158) has identified as "Marshall's belief in an absolute goal of evolution, the development of character in his peculiar sense." Marshall (quoted in Whitaker 1977, p. 183) himself describes the final stage of social evolution as a state with "no rights but only duties; where everyone shall work for the public weal with all his might expecting no further reward than that he in common with his neighbors shall have whatever is necessary to enable him to work well, and to lead a refined and intellectual life." In a more mature work, Marshall (quoted in Levitt 1976, p. 439) posits a "distant goal where the opportunities of the noble life may be accessible to all."

In the *Principles*, Marshall ([1920] 1949, p. 752) gives a decidedly Hegelian cast to his desiderated millennium, referring to "an order of social life, in which the common good overrules individual caprice, even more than it did in the early ages before the sway of individualism had begun. But unselfishness then will be the offspring of deliberate will; and, though aided by instinct, individual freedom will develop itself in collective freedom. . . ." Thus, for Marshall, human history is to culminate in what we may call the Era of the Noble Life, in which all human activities, from sipping tea to mining coal, are completely transformed into "higher activities" not driven by wants but undertaken as an aid to or an exercise of the higher human faculties.

Before society can enter into this paradisiacal state, however, humanity and the human character must be prepared by passing through two earlier stages. In the first stage, let us call it the "Era of Scarcity," almost all human activities are directed toward solving the problem of scarcity, conceived of in Marshall's peculiar and narrow sense of satisfying *basic* human wants. The transitional stage or the "Era of Chivalry" dawns with the arrival of the Victorian gentleman upon the scene: the solution of the economic problem for at least some segments of the population yields the leisure and material resources necessary to an enhanced "standard of life" marked by the pursuit of character-developing and productivity-improving higher activities. The resulting character development effects a progressive transformation of the motive, from pecuniary to chivalric, for which capital is invested and business activities are undertaken, thereby lowering the supply price at which "business ability in command of capital" is forthcoming and raising the real wages of

the working class. In this way, free enterprise conducting itself in accord with chivalrous competition will insure that the resources and opportunities for character development and a rising standard of life trickle down to the working classes.

To the extent that members of the working class invest the newly won additions to their incomes in the acquisition of higher skills for themselves and for their offspring, the supply of unskilled labor will eventually diminish, augmenting the rise in the real wages of the unskilled and offering increased access to a higher standard of life. The residuum who, due to defect of will or ability, do not avail themselves and their children of this opportunity for character improvement will be eventually suppressed by compulsory State education and supervision of child rearing and, in the last resort, of reproductive activities. Thus will the chivalrous and duty-bound Victorian businessman, abetted by a bracing dose of State paternalism and eugenics administered to the physically and morally unfit, usher humanity into the Era of the Noble Life.

Marshall's theory of social evolution leads to a peculiar conception of the economic problem confronting humanity. Construed conventionally as the confrontation between virtually limitless human wants and limited resources, scarcity is not the permanent problem burdening humanity. For Marshall, the central problem of economic science and of social evolution is the devising of a framework for society's business and productive activities which promotes the unimpeded development of human character. To put it another way, once the Era of Scarcity has been transcended, consumption is no longer the *end* of production but the *means* which permits men to "work well" and improve their standard of life. Thus Marshall ([1920] 1949, pp. 530, 193) proclaims that the "end of all production" is to "raise the tone of human life" and that "the chief importance of material wealth lies in the fact that, when wisely used, it increases the health and strength, physical, mental and moral of the human race."

What Marshall ([1920] 1949, p. 85) calls the "keynote of the history of mankind," therefore, is not the struggle against scarcity, which is an ephemeral condition capable of resolution, but the proper development of human character. Marshall (quoted in McWilliams-Tullberg 1975, p. 93) is emphatic on this point, declaring that "I have always held that poverty and pain, disease and death are evils of greatly less importance than they appear, except in so far as they lead to weakness of life and character. . . ." The *raison d'être* of economic science is therefore to study the evolutionary process of human character formation in order to guide it to its fruition in the millennium of the Noble Life. In Marshall's words (quoted in Whitaker 1977,

p. 179): "[The] progress of man's nature . . . is I conceive, the center of the ultimate aim of economic studies. . . . human will, guided by careful thought, can so modify circumstances as largely to modify character; and thus to bring about new conditions of life still more favorable to character; and therefore to the economic, as well as moral well-being of the masses of the people."

In a revealing comment, Keynes (quoted in Whitaker 1977, p. 185) observes that "[t]he solution of economic problems was for Marshall, not an application of the hedonistic calculus, but a prior condition of the exercise of man's higher faculties." In fact, as we shall now see, Keynes adopted Marshall's view of the economic problem as well as the latter's millennialist vision of social evolution.

The Development of Keynes's Sociopolitical Vision

Keynes's social philosophy and particularly his theory of social evolution are not coherently stated in any one of his works but must be pieced together from scattered discussions in articles and books written over the span of more than a decade. Nevertheless, this endeavor does lead us to view Keynes as a consistent and thoroughgoing millennialist in his approach to social evolution.

We get an early and brief glimpse of Keynesian themes in this area in *The Economic Consequences of the Peace*, first published in 1919 (Keynes [1920] 1971). In a chapter on "Europe before the War," there appears a section blandly entitled "The Psychology of Society." In little more than four pages, Keynes suggests the fundamental irrationality of abstaining from present consumption, emphasizes the importance of capital accumulation and compound interest to social evolution, delineates a teleological approach to human history whose goal is inexplicably known to him, and speculates on an evolutionary solution to the problem of scarcity. All of these themes were absorbed from his mentors and were to become hallmarks of Keynes's later works.

To begin with, Keynes ([1920] 1971, p. 19) points to the "immense accumulations of fixed capital" which occurred, "to the great benefit of mankind," in the fifty years leading up to the World War I and attributes these to the inequality of the distribution of wealth in favor of that class least likely to consume it. Thus the maintenance and accumulation of capital depends on what Keynes ([1920] 1971, p. 19) calls "a double bluff or deception." On the one hand, the laboring classes were deceived into accepting "a situation in which they could call their own very little of the cake that they and Nature and the capitalists were cooperating to produce" (Keynes [1920] 1971, p. 20). The capitalists, on the other hand, were equally deceived because, although

the greatest part of the national income "cake" accrued to them, it could remain in their possession only "on the tacit underlying condition that they consumed very little of it in practice" (Keynes [1920] 1971, p. 20). Any attempt by the capitalists to exercise their *de jure* right to expend their vast accumulation of wealth on present consumption would provoke the wrath of the much more numerous laboring class and result in the capitalists' expropriation.

But how was this elaborate deception maintained, by whom, and to what end? According to Keynes, the deception was maintained by ordaining saving as a virtue and the consequent growth of the capital structure and national income as "the object of true religion." Says Keynes ([1920] 1971, p. 20), "There grew round the non-consumption of the cake all those instincts of puritanism which in other ages has withdrawn itself from the world and has neglected the arts of production as well as those of enjoyment." But, clearly, saving or "the non-consumption of the cake" is, from the individual's point of view, without reason or purpose. The conventional motives of saving for one's dotage or for one's offspring, Keynes ([1920] 1971, p. 20) suggests, were based on a self-delusion, for "the virtue of the cake was that it was never to be consumed, neither by you nor by your children after you."

Who is the perpetrator of this grand deception and the founder of the false religion of saving? Keynes's answer is a hypostatized Society, which is wisely propelling humanity forward to the millennium through the actions of the deluded savers and investors. Writes Keynes ([1920] 1971, pp. 20–21):

> In the unconscious recesses of its being Society knew what it was about. The cake was really very small in proportion to the appetites for consumption, and no one, if it were shared all round, would be much the better off by the cutting of it. Society was working not for the small pleasures of today, but for the future security and improvement of the race. . . .

The progressive accumulation of capital insures that, eventually, Society reaches its pre-ordained goal, the problem of scarcity is resolved and the millennium is at hand. As Keynes ([1920] 1971, p. 21) prophesies, "[i]n that day overwork, overcrowding, and underfeeding would have come to an end, and men, secure of the comforts and necessities of the body, could proceed to the nobler exercises of their faculties." Note that Keynes's brief description of the millennial state reflects the narrow Marshallian conception of scarcity as the inability to provide for the basic human wants of food, shelter, and clothing. Once such biological needs are adequately met, humanity is freed from the shackles of scarcity to pursue, if it only will, ennobling activities.

Note also that, for Keynes, the primary force propelling humanity toward its destiny is not Marshallian free enterprise rendered pure and chivalrous but capital accumulation pure and simple. This is why, as Brunner (1987, p. 37) has recognized, "Keynes was very much concerned with the accumulation of real capital in modern economies." As we will see, Keynes never wavered in his belief that capital is the foremost agent of social transformation.

Also noteworthy is Keynes's view that the accumulation of capital and, hence, the progress of society toward the millennium depends on a thoroughly irrational propensity of human beings to save. This poses a conundrum of great moment which Keynes, at this early stage, attempts to resolve by reference to mysterious social forces that perpetrate a "double bluff." The bluff misleads two classes of individuals, capitalists and laborers, whose interests are irrevocably opposed, into undertaking activities and entering into social arrangements that are in the interests of neither class. But Keynes was understandably uneasy with this resolution and, as I shall argue below, the evolution of Keynes's technical economics can be viewed as a long struggle to unravel the conundrum.

In a series of articles written in the 1920s, Keynes further transformed Marshall's millennialist vision by incorporating additional elements of Moore's philosophy into it. In particular, Keynes called into question what was firmly averred by Marshall: the intrinsic value of the activities and mental states inspired by competitive capitalism. Keynes also emphatically rejected Marshall's belief that humanity's millennium lay in the distant future and that progress toward this desideratum still demanded stiff present sacrifices. For Keynes, the millennium was close at hand, and humanity would be wise to sample its fruits in the present.

In "A Short View of Russia," first published in 1925, Keynes ([1931] 1963, pp. 297–311) favorably contrasts the religious spirit at the core of Russian communism to the spiritual poverty that attends the pursuit of money-making under modern capitalism. According to Keynes ([1931] 1963, pp. 302–03),

> [the] *emotional and ethical essence* [of Leninism] *centers about the individual's and the community's attitude toward the Love of Money.* . . . [I]n the Russia of the future it is intended that the career of money-making, as such, will simply not occur to a respectable young man as a possible opening, any more than the career of a gentleman burglar or acquiring skill in forgery and embezzlement. Even the most admirable aspects of the love of money in our existing society, such as thrift and saving, and the attainment of financial security and independence for one's self and one's family, whilst not deemed

> morally wrong, will be rendered so difficult and impracticable as to be not worth while.

Even in the contemporary Russia he was observing, Keynes ([1931] 1963, p. 304) detected evidence of the denigration of money-making, remarking that "[t]he private trader is a sort of permitted outlaw, without privileges or protection, like the Jew in the Middle Ages—an outlet for those who have overwhelming instincts in this direction, but not a natural or agreeable job for the normal man." Keynes ([1931] 1963, p. 304) deems a society which treats money-making in this manner "a tremendous innovation."

In comparison to communism, Keynes ([1931] 1963, pp. 306–07) portrays capitalism as "absolutely irreligious, without internal union, without much public spirit, often, though not always, a mere congeries of possessors and pursuers." In order to survive in the face of its profound spiritual poverty and in the teeth of "religious Communism," capitalism must prove itself to be not merely more efficient than communism but many times more efficient. In Keynes's estimation, however, capitalism at the beginning of the twentieth century had proven itself to be only "moderately successful." In fact, in breach of another tenet of the Marshallian faith, Keynes wonders whether capitalism is losing its efficacy, and therefore its limited value, as a means of economic progress and social transformation.

Keynes ([1931] 1963, p. 307) confesses his doubts in the following terms:

> We used to believe that modern capitalism was capable, not merely of maintaining the existing standards of life, but of leading us gradually into an economic paradise where we should be comparatively free from economic cares. Now we doubt whether the business man is leading us to a destination far better than our present place. Regarded as a means he is tolerable; regarded as an end he is not so satisfactory.

If capitalism is not leading toward the millennium, then Keynes ([1931] 1963, p. 307) questions "whether the material advantages of keeping business and religion in different compartments are sufficient to balance the moral disadvantages." He explicitly rejects the "Protestant and Puritan" view that business and religion naturally belong to different domains, as well as the view of the Marshallian "believer in progress," who affirms capitalism "as the means to the establishment of heaven upon earth hereafter." In their place, Keynes counsels a radically present-oriented, Moorite "third state of mind," which exalts the pursuit and enjoyment of the ethical good in the here and now.

According to Keynes ([1931] 1963, pp. 307–08), those who have attained to this third state of mind:

> do not fully believe either in a heaven which is elsewhere or in progress as a sure means towards a heaven upon earth hereafter; and if heaven is not elsewhere and not hereafter, it must be here and now or not at all. If there is no moral objective in economic progress, then it follows that we must not sacrifice, even for a day, moral to material advantage—in other words, that we may no longer keep business and religion in separate compartments of the soul.

Whether or not capitalism remains a useful means for further amelioration of the economic problem, Keynes affects no doubt as to its degraded moral quality, because it distracts men from the immediate enjoyment of exalted mental states, while absorbing their minds and lives in the love and pursuit of money and in its accumulation for an ever-receding future. Thus Keynes ([1931] 1963, p. 308) concludes that "it seems clearer every day that the moral problem of our age is concerned with the love of money, with the habitual appeal to the money motive in nine-tenths of the activities of life, with the universal striving after individual economic security as the prime object of endeavor, with the social approbation of money as the measure of constructive success, and with the social appeal to the hoarding instinct as the foundation of the necessary provision for the family and for the future."

In "Am I a Liberal?" also first published in 1925, Keynes ([1931] 1963, pp. 323–38) embraces the theory of stages of economic development outlined by the American institutionalist, Joseph R. Commons. Commons's first epoch, the Era of Scarcity, is marked by very little individual liberty and a great deal of coercive control exercised by governmental and other institutions. This, Keynes (1925, p. 334) tells us, was "the normal state of the world up to (say) the fifteenth or sixteenth century." The transition to Commons's Era of Abundance occurred in the seventeenth and eighteenth centuries and culminated "gloriously in the victories of *laissez-faire* and historic Liberalism" in the nineteenth century (Keynes [1931] 1963, pp. 334–35). In this epoch, individual liberty is given its full head and coercive political control is minimized.

The contemporary world, according to Keynes and to Commons, was in transition to the third stage, characterized by Keynes as the Era of Stabilization. Keynes ([1931] 1963, p. 335) argues that progress into this stage requires "[t]he transition from economic anarchy to a regime which deliberately aims at controlling and directing economic forces in the interests of social justice and social stability. . . ." No longer can "the economic Juggernaut [be] allowed

to crash along the highway of Progress without obstruction and even with applause," as it was allowed to do in the nineteenth century (Keynes [1931] 1963, p. 337). For Keynes ([1931] 1963, p. 335), "*laissez-faire* individualism and the free play of economic forces" have outlived their usefulness while socialism offers no better alternative because both are "Sprung from the presuppositions of the Era of Abundance."

Like Moses, capitalism had gotten society within sight of the promised land but was morally unfit to enter. Now, Keynes believed, an alternative system must be devised and readied to secure humanity in its impending enjoyment of millennial bliss. Yet a more immediate source of concern for Keynes involved certain defects which he perceived in the technical operation of *laissez-faire* capitalism, particularly in the area of money, and which needed to be remedied to assure a smooth transition to the millennium. It was the task and destiny of what Keynes ([1931] 1963, pp. 335, 337) referred to as the "New Liberalism" to prepare the solutions to the immediate technical problems of the transition as well as to "invent new wisdom for a new age."

Unlike Marshall, Keynes did not foresee a spontaneous remedy for capitalism's technical shortcomings and moral failings in the replacement of the profit motive by Victorian chivalry. It was on this issue that Keynes abandoned Marshall for Burke.

Keynes's Burkean tract "The End of Laissez Faire," which first appeared in print in 1926, proposes an "Agenda of State," which is aimed at effecting "improvements in the technique of modern Capitalism by the agency of collective action" (Keynes [1931] 1963, p. 319). The criterion governing these agenda, according to Keynes ([1931] 1963, p. 317), is not to replace private decisionmaking with State decisionmaking but relates "to those decisions which are made by *no one* if the State does not make them." Three examples of the applicability of State agenda are given by Keynes.

First there are the "economic evils" associated with risk, uncertainty, and ignorance, including inequality of wealth, unemployment of labor, and reduction of efficiency and production. The State agendum in this matter lies in "deliberate control of the currency and of credit by a central institution" and "the collection and dissemination on a great scale of data relating to the business situation," including the legally coerced publication of all useful business facts (Keynes [1931] 1963, pp. 317–18). (Regarding the latter, business secrecy had been an especial bugbear of Marshall's.)

The second example Keynes ([1931] 1963, pp. 318–19) offers refers to saving and investment. In this area, the State agendum is to provide "a co-ordinated act of intelligent judgment" regarding how much the nation should save, what proportion of aggregate savings

should be invested abroad, and whether the private capital market is channeling domestic investment to the most productive uses.

The third agendum of State mentioned by Keynes ([1931] 1963, p. 319) is control of the quantity and quality of the national population. Keynes still has enough of the classical economist in him to fear that the Malthusian devil may forever bar the door to the millennium by wasting the fruits of capital accumulation on sustenance for an ever-expanding population. Keynes's reference to the Marshallian devil of a genetically incorrigible residuum is veiled and tentative: "The time may arrive . . . when the community as a whole must pay attention to the innate quality as well as to the mere numbers of its future members" (Keynes [1931] 1963, p. 319).

Having contrived Burkean expedients for overcoming problems in its technique, Keynes once again expresses satisfaction, if only half-heartedly, that capitalism is capable of producing steady progress toward the millennium. Nevertheless, he is even more firmly convinced that a new system, which is consistent with Moorite ethical precepts, must be excogitated as a final replacement for the spiritually desolate capitalism. Donning the mantle of the millennialist prophet, Keynes boldly proposes to undertake this task by consulting his internal gnosis. Thus, he (Keynes [1931] 1963, pp. 321–22) concludes that:

> capitalism, wisely managed, can probably be made more efficient than any alternative system yet in sight, but that in itself it is in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life.
>
> The next step forward must come, not from political agitation or premature experiments, but from thought. We need by an effort of the mind to elucidate our own feelings. . . . We need a new set of convictions which spring naturally from a candid examination of our own inner feelings in relation to the outside facts.

Apparently, Keynes took seriously the task he set himself in 1926 and he pondered long and hard on the problems of social evolution in the next few years. In 1930 he published "Economic Possibilities for Our Grandchildren," which is based on ideas expressed in a speech in early 1928 and wherein is presented a fully developed theory of humanity's path to "our destination of economic bliss" (Keynes [1931] 1963, p. 373). In particular, Keynes provides answers to some of the questions he raised in previous articles. Most importantly, he foretells the process by which human nature will be spontaneously purged of the pecuniary motive without the necessity of institutional transformation.

While some of Keynes's disciples, including Harrod (1951, p. 399), discount its significance as a serious expression of Keynes's ideology, Hession (1984, p. 242) has insightfully characterized this article as "an important statement of his personal philosophy or *Weltanschauung*. . . . Indeed, this essay may be regarded as analogous to Marshall's 'Possibilities of Economic Chivalry' or to John Stuart Mill's speculations on the 'Stationary State,' both well-known examinations of the future of Western Society."

Significantly, in 1930, Keynes ([1930] 1958) also published his *Treatise on Money*, which he had been working on during the previous five years and which can be seen as a technical guide for carrying out the State's agenda with respect to the "gaps" in modern capitalism caused by uncertainty, foreign investment, and the lack of a mechanism for equating saving and investment. As I shall argue below, the *Treatise* was intended by Keynes to be a handbook to guide Burkean policymakers in their charge of keeping society on course and on time in the last leg of its journey to the millennium.

Keynes begins "Economic Possibilities" by emphatically reaffirming his faith in the continuation of economic progress in the face of widespread and growing doubt attributable to the slowdown of economic activity that was beginning to take hold in the world economy in 1930. In fact, Keynes regards the downturn, quite sanguinely, as evidence of the transition to the next stage of history. Opines Keynes ([1931] 1963, p. 358): "We are suffering, not from the rheumatics of old age, but from the growing-pains of over-rapid changes, from the painfulness of readjustment between one economic period and another. The increase of technical efficiency has been taking place faster than we can deal with the problem of labor absorption; the improvement in the standard of life has been a little too quick. . . . "

As merely a problem of the transition, the downturn can be remedied by the implementation of the appropriate State agendum. However, Keynes's express purpose in this essay is not to treat short-term problems of economic management but "to take wings into the future" and to reveal his new intuitions regarding the course of the long-term evolution of British economy and society (Keynes [1931] 1963, p. 360). He begins by presenting a more detailed stage theory of history, which focuses almost exclusively on capital accumulation as the agent of social transformation. The first stage of history spans the period from 2,000 B.C. to 1,700 A.D. and is characterized by a stagnant standard of life for the average man dwelling in the centers of civilization due "to the remarkable absence of important technical improvements and to the failure of capital to accumulate" (Keynes [1931] 1963, p. 360). Keynes's intuition leads

him to speculate that, during some epoch before the dawn of recorded history, "there must have been an era of progress and invention comparable to that in which we live today" (Keynes [1930] 1963, p. 361).

Following, then, what we might call the pre-historical and pre-modern eras is the third stage or "modern age." Keynes ([1930] 1963, p. 361) holds that the transition to the modern age was precipitated by "the accumulation of capital which began in the sixteenth century" with the influx of gold and silver from the Americas into Spain. Once begun, the process of capital accumulation begets its own continuous growth through the wondrous power of compound interest. Gone is Keynes's belief, expressed in the *Economic Consequences of the Peace*, that capital accumulation depends on psychologically unstable and irrational motives to save. The link between saving and investment is explicitly severed in the *Treatise* and Keynes is already halfway to the views of the *General Theory* that saving actually impedes the process of capital investment and destroys its fruits. Thus, in the latter work, saving is considered the enemy of social evolution and of the ethical good, to be shown no quarter and hounded unto death polemically.

For now, Keynes ([1931] 1963, p. 361) writes: "From that time [of the influx of the precious metals into Spain] until today the power of accumulation by compound interest, which seems to have been sleeping for many generations, was re-born and renewed its strength. And the power of compound interest over two hundred years is such as to stagger the imagination."

The modern age is also "the great age of science and technical inventions," the beginning of which Keynes ([1931] 1963, p. 363) dates from the sixteenth century and which has been "in full flood" since the start of the nineteenth century. Keynes estimates that a one-hundredfold increase of the capital stock combined with rapid technological advance have worked to raise the contemporary standard of life in Europe and the United States fourfold since the end of the pre-modern era. So rapid has been the advance of labor-saving technology in the decade of the 1920s in Europe, and especially in the United States, that it has unleashed a new economic affliction which Keynes ([1931] 1963, p. 364) labels "technological unemployment." Thus, for the Keynes ([1931] 1963, p. 364) of 1930, the contemporary employment situation is only "a temporary phase of maladjustment" and is, in fact, a welcome harbinger of the impending dawn of the millennium. According to Keynes ([1931] 1963, pp. 364–65), "All this means in the long run [is] *that mankind is solving its economic problem*. I would predict that the standard of life in progressive

countries one hundred years hence will be between four and eight times as high as it is today."

For support of his assertion that scarcity is a transitory historical stage, rather than a fundamental and categorial precondition of human life and action, Keynes draws on the Marshallian classification of wants. He distinguishes between two classes of wants, which he designates as "absolute" and "relative" respectively. Wants of the second class, which are based on a desire to attain superiority over one's fellows, very well may be insatiable "for the higher the general level, the higher still are they" (Keynes [1931] 1963, p. 365). However, in the case of absolute wants, "a point may soon be reached, much sooner perhaps than we are all of us aware, when these needs are satisfied in the sense that we prefer to devote our further energies to non-economic purposes" (Keynes [1931] 1963, p. 365). With his typical gnosticism, Keynes ([1931] 1963, p. 366) then reveals to his readers that, assuming no significant wars or growth in population, the economic problem will be solved or "in sight of solution" within one hundred years and that, therefore, the economic problem is not "the permanent problem of the human race."

Echoing Marshall, Keynes ([1931] 1963, p. 367) characterizes the "real" and "permanent" problem confronting man as "how to use his freedom from pressing economic cares, how to occupy the leisure, which science and compound interest will have won for him, to live wisely and agreeably and well." In other words, the problem is one of adjusting human nature to the millennium, and, not surprisingly, it is a problem to which Moore's philosophy is the ready-made solution.

The problem stems from the fact that, from its very creation, humanity has been in a death match with scarcity and, thus, has been "expressly evolved by nature" to solve the economic problem. The impending solution of the latter problem therefore deprives humankind "of its traditional purpose." The consequence is that the "ordinary man" will be required to cast aside, within the space of a few decades, inbred habits and instincts that have served him for centuries (Keynes [1931] 1963, p. 366).

Failure to come to grips with this problem will result, according to Keynes ([1931] 1963, p. 366), in a "general 'nervous breakdown,'" quite like the condition afflicting the wives of the well-to-do in the United States and England of Keynes's time. In fact, it is these women who are humanity's vanguard in the millennium. It is they "who have been deprived by their wealth of their traditional tasks and occupations—who cannot find it sufficiently amusing, when deprived of the spur of economic necessity, to cook and clean and mend, yet are quite unable to find anything more amusing" (Keynes [1931]

1963, p. 367). In general, the wealthy are humanity's "advance guard" in the millennium, "who are spying out the promised land for the rest of us and pitching their camp there," and, for the most part, they have "failed disastrously . . . to solve the problem which has been set them" (Keynes [1931] 1963, p. 368).

Despite the failures of the vanguard, Keynes is confident that right thinking can serve as a guide in the millennial "age of leisure and of abundance," and he maps out the steps that must be taken in this direction. In general, his plan involves abandoning the long-accepted attitudes toward activities and morals that evolved in response to the economic problem and inculcating Moorite attitudes in their stead. In particular, attitudes toward work, money, purposefulness, and futurity must undergo radical transformation.

In the case of work, it is to be recognized as an activity which, in small doses, is necessary to human contentment or will be for ages to come. Keynes ([1931] 1963, p. 369) recommends that the work still to be performed in the millennium be spread very thinly so that everyone might content himself with a fifteen-hour work week carried out in three-hour shifts.

There must also be great changes in the code of morals. This is to be purged of the "pseudo-moral principles" which " have exalted some of the most distasteful of human qualities into the position of the highest virtues" but which were nonetheless necessary to foster the accumulation of capital (Keynes [1931] 1963, p. 269). For example, the desire to possess money, valueless and irrational in itself and finally rendered useless as a means, will be seen for what it is: according to Keynes ([1931] 1963, p. 369), "a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease." The same reappraisal will take place with regard to customs and practices involving the distribution of wealth and income, which while "distasteful and unjust in themselves," are "tremendously useful in promoting the accumulation of capital" (Keynes [1931] 1963, pp. 369–70).

Moreover, for Keynes, the individual's pursuit and accumulation of wealth is only a subspecies of purposive behavior. Such behavior, as Keynes recognizes, implies the logical and temporal separation of means and ends: all action employs means in the present and is aimed at achieving an end in the more or less remote future (Mises 1966, pp. 100–01). The elements of futurity and teleology inherent in purposive action, however, offend Keynes's Moorite notion of the good, involving as they do the sacrifice of immediate and direct experience of timeless, self-contained, and intrinsically valuable

mental states. As Mises (1966, p. 100) points out, "[f]or contemplative meditation, time is only duration," with no distinction between present and future; it is purposeful action "that provides man with the notion of time and makes him aware of the flux of time. . . . [I]t is not recollection that conveys to man the categories of change and of time, but the will to improve the conditions of his life."

Thus, as Keynes also recognizes, the very notion of present and future is ineluctably bound up with purposiveness. From the insight that action is necessarily aimed at the future, however, Keynes ([1931] 1963, p. 370) incorrectly deduces a non-marginal or absolute preference to postpone present consumption *forever* into the future or, in the terminology of the later *General Theory*, a "propensity to save." This leads him to lash out at the seeming irrationality of purposeful activity:

> For purposiveness means that we are more concerned with the remote future results of our actions than with their own quality or their immediate effects on our own environment. The "purposive" man is always trying to secure a spurious and delusive immortality for his acts by pushing his interest in them forward into time. He does not love his cat but his cat's kittens; nor, in truth, the kittens, but only the kittens' kittens, and so on forward for ever to the end of cat-dom (Keynes ([1931] 1963, p. 370).

If Keynes had fully grasped the time preference theory of interest, he would have been aware that acting man does not demonstrate an *absolute* preference for future satisfactions (which, of course, implies forever postponing consumption in the present) but *discounts* future vis-à-vis present satisfactions. All other things equal, human beings, acting in isolation or on the market, will only save and invest resources in provision for the future, if such investment promises a level of future consumption that exceeds the sacrificed present consumption by an amount that overcomes their subjective time preferences. The rate of interest, then, is the catallactic reflection of the universal phenomenon of time preference.

At this point in time, however, Keynes construes capital as an independently productive factor, coordinate with land and labor and automatically generating an interest return (a view which he was to renounce in the *General Theory*). Keynes thus sees the phenomenon of compound interest, not as a categorial implication of action, but as simply another rationalization for the delusive future orientation of purposive action. For Keynes, interest serves to reinforce and reward an innate or evolved propensity to wealth accumulation present in human beings of the "modern age." This explains Keynes's strange and oblique reference to the Jews in the following terms: "Perhaps it

is not an accident that the race which did the most to bring the promise of immortality into the heart and essence of our religions has also done the most for the principle of compound interest and particularly loves this most purposive of human institutions" (Keynes [1931] 1963, p. 371).

Once the burden of scarcity and the need for capital accumulation have been eliminated, the human race will at long last be free to return to what Keynes ([1931] 1963, p. 371) calls "some of the most sure and certain principles of religion and traditional virtue" as its guide in the millennium. Keynes ([1931] 1963, pp. 371–72) recites and extols these Moorite virtues, while condemning the vices associated with purposiveness, in terms worthy of the Sermon on the Mount:

> avarice is a vice, . . . the exaction of usury is a misdemeanor, and the love of money is detestable, . . . those walk most truly in the paths of virtue and sane wisdom who take least thought for the morrow. We shall once more value ends above means and prefer the good to the useful. We shall honor those who can teach us how to pluck the hour and the day virtuously and well, the delightful people who are capable of taking direct enjoyment in things, the lilies of the field who toil not, neither do they spin.

But, counsels Keynes ([1931] 1963, p. 372), a century yet must pass before such values can be embraced and, so, "[a]varice and usury and precaution must be our gods a little while longer." Even so, Keynes ([1931] 1963, p. 373) encourages "mild preparations for our destiny" in the form of experiments in "the arts of life" as well as in "the activities of purpose."

The Renunciation of Marshallian Orthodoxy

As the 1930s wore on and the world economic crisis deepened, however, Keynes began to doubt that capitalism as constituted could ever bring about the ripening of the modern age into the millennial. Beset by this growing doubt, Keynes was inspired to rethink the economics of capitalism and the implied State agenda as these were presented in the *Treatise on Money* in 1930. His exhortation—as expressed in his popular writings—to experiment in the "activities of purpose," i.e., in the institutions and organization of the economy, became more insistent.

As his thought evolved during this period, Keynes came increasingly to believe that the sins of "avarice, usury, and precaution" (which, in the language of the *General Theory*, became "liquidity preference, interest payments to the *rentier*, and saving"), not only were evil and had no use in the paradisiacal age of leisure and abundance, but were at the root of the economic instability and

stagnation of the present age of economic scarcity and therefore must be expunged by the State. It was at this point that Keynes's intuition suggested the extension of the Moorite perspective from personal ethics and social philosophy to technical economics.

In fact, we already see this beginning to occur in the *Treatise*. Here, Keynes breaks the link between saving and investment, theorizing that investment and capital growth can occur without necessitating saving to an equal extent and, conversely, that saving can occur without generating equal investment, an insight which Keynes, under the influence of Dennis Robertson, incorporated into his thought as early as 1926 (Patinkin 1976, pp. 36, 46, 50, 124). However, while Robertson and the early Keynes argued that excess investment and excess saving were the consequences of and equal to bank credit expansion and contraction, respectively, the later Keynes explicitly and emphatically repudiates this view in controversy with Robertson and Hayek (Patinkin 1976, pp. 28, 30–31). From the later perspective of the *Treatise*, Keynes (1973, p. 251) argues that "[s]aving and investment can get out of gear without any change on the part of the banking system from 'neutrality' as defined by Dr. Hayek, merely as a result of the public changing their rate of saving or the entrepreneurs changing their rate of investment, *there being no automatic mechanism in the economic system to keep the two rates equal*" [Emphasis added].

Thus Keynes in the *Treatise* identifies saving-investment disequilibria as arising from within the capitalist economy itself, and therefore necessitating a Burkean State agendum to match decentralized decisions to save and to invest. Moreover, these disequilibria create instabilities in prices and output, causing what Keynes calls "credit cycles." Taking direct aim at the sinful "love of money as a possession," Keynes ([1930] 1958, pp. 2, 347) attributes such disequilibria to the increased "bearishness" of a public, which, in the grip of heightened uncertainty about the future, is suddenly possessed of an increased "propensity to hoard" savings deposits and forego ownership of securities. This irrational behavior drives the long-term rate of interest above its equilibrium level thereby driving down "the value and volume of new investment."

In fact, the *Treatise* was written with the primary purpose of setting out detailed State agenda for "the control of the rate of investment," and, therefore, of capital accumulation and the *pace* of the approach to the millennium. This is consistent with Keynes's statement at the end of "Economic Possibilities for Our Grandchildren" (Keynes [1931] 1963, p. 373) that "[t]he pace at which we can reach our destination of economic bliss will be governed" by, among

other things, "the rate of accumulation as fixed by the margin between our production and our consumption."

Not surprisingly, as Patinkin (1976, pp. 125–26 6n) has pointed out, the *Treatise* is infected with a "magic-formula mentality." Surely someone who is blessed with knowledge of history's final goal can be presumed to have the formula for reaching that state. Thus, Keynes (1973, p. 354) himself refers to the *Treatise*'s "fundamental equations" of price-level determination as "my secret" to the explanation and, presumably, to the remedy of booms and slumps. The remedy Keynes advocates in the *Treatise* for disequilibrium between saving and investment is bank rate and Treasury bill policy. Especially during a slump, Keynes believed that central bank action designed to lower interest rates and spur investment must be complemented by international central bank cooperation or, if cooperation is either not forthcoming or not successful, supplemented by government borrowing for expenditures on public works (Patinkin 1982, pp. 205–07).

Patinkin (1976, p. 55) characterizes the development of Keynes's technical economic thought between the publication of the *Treatise* and the publication of the *General Theory* as progressing through three stages. These stages can be related to the progressive shattering of Keynes's Marshallian faith, under the impact of the Great Depression, in the efficacy of contemporary capitalism to maintain a rate of capital accumulation sufficiently high to see society through the transition to the millennium within a reasonable period of time, i.e., Keynes's prophesied one hundred years. In the face of his lapsing faith in the Marshallian orthodoxy, Keynes began to formulate a deliberately "heretical" economics which emphasized the Moorite value of radical present orientation in private and governmental spending decisions as the key to restarting and maintaining the engine of capital accumulation on the road to the age of leisure and abundance. Conversely, the new faith sought to "criminalize" saving, particularly the piling up of idle and barren money balances, and the taking of interest as the main impediments to capital accumulation.

In 1930, although he declared that the desire to possess money as an end in itself would be recognized as a "semi-pathological, semi-criminal propensity" in the coming age of abundance and leisure, Keynes did not dissent in the slightest from the orthodox Marshallian economic doctrine that such a propensity was necessary to the achievement of permanent victory over economic scarcity. However, by the time the *General Theory* was published in 1936, the moral crimes of "liquidity preference" and "the propensity to save" stood indicted by Keynes, the Moorite heretic, as the main obstructions on the road to the solution of the economic problem. In explicit opposition to

Marshall's belief that the constraint on capital accumulation is to be explained by "the preference which the great mass of humanity have for present over deferred gratifications," Keynes ([1936] 1964, p. 242), writing in the *General Theory*, propounded the doctrine that the paucity of accumulated capital "after several millennia of steady individual saving . . . is to be explained . . . neither by the improvident propensities of mankind, nor even by the destruction of war, but by the high liquidity-premiums formerly attaching to the ownership of land and now attaching to money."

Let us now examine the process by which, during the crucial period of 1930-36, Keynes transformed his technical economics by the infusion of Moorite insights. In the first stage of this transformation, (which by Patinkin's account lasted through 1931), Keynes was engaged in what Patinkin (1976, p. 55), borrowing Moggridge's terminology, calls the "arguing out of the *Treatise*." During this time Keynes continued to adhere to the technical economics and policy prescriptions of the *Treatise* and, on the broadly philosophical side, to his earlier belief that current institutional arrangements would continue to produce steady progress to the millennium. Nonetheless, toward the end of this period, Keynes waxed increasingly critical of the role of saving in perpetuating Britain's slump and was perfervid in his advocacy of a massive increase in public and private spending as the cure for the depression.

In an article published in January 1931, Keynes ([1931] 1963, pp. 152–54) declaimed against increased thrift and in favor of unleashing "the improvident propensities" of both consumers and government as a remedy for depression:

> The best guess I can make is whenever you save five shillings, you put a man out of work for a day. Your saving that five shillings adds to unemployment to the extent of one man for one day—and so on in proportion. On the other hand, whenever you buy goods you increase employment—though they must be British, home-produced goods if you are to increase employment in this country. . . .
>
> Therefore, oh patriotic housewives, sally out tomorrow early into the streets and go to the wonderful sales which are everywhere advertised. . . . Lay in a stock of household linen, of sheets and blankets to satisfy all your needs. And have the added joy that you are increasing employment, adding to the wealth of the country because you are setting on foot useful activities. . . .
>
> For what we need now is not to button up our waistcoats tight, but to be in a mood of expansion, of activity—to do things, to buy things, to make things. . . . Now is the time for municipalities to be busy and active with all kinds of sensible improvements. . . .
>
> Nationally, too, I should like to see schemes of greatness and

> magnificence designed and carried through. . . . For example, why not pull down the whole of South London from Westminster to Greenwich, and make a good job of it—housing on that convenient area near to their work a much greater population than at present, in far better buildings with all the conveniences of modern life, yet at the same time providing hundreds of acres of squares and avenues, parks and public spaces. . . . Would that employ men? Why, of course it would.

The great weight placed on current spending in the foregoing passage and the lack of reference to techniques of monetary policy in the balance of the article from which it is extracted represents a departure, at least in emphasis, from the agenda Keynes elaborated in the *Treatise* for righting a capitalist economy in a slump. Also, in this passage the view is clearly expressed—which is at the core of the technical economics of the *General Theory* and is not to be found in the *Treatise*—that, in depression conditions, spending *per se* is productive of income.

Despite all this, however, Keynes ([1931] 1963, pp. 155–56), at the end of the article, is at pains to demonstrate that labor productivity and national income are continuing to grow at a healthy clip. He concludes with a stirring reaffirmation of his Marshallian belief that the slump is evidence of an ongoing transition to the millennium:

> Be confident, therefore, that we are suffering from the growing pains of youth, not from the rheumatics of old age. We are failing to make full use of our opportunities, failing to find an outlet for the great increase in our productive powers and our productive energy. Therefore we must not draw in our horns; we must push them out. Activity and boldness and enterprise, both individually and nationally, must be the cure. (Keynes [1931] 1963, p. 156)

In a series of lectures presented in June 1931 and published the same year, it is evident that Keynes (1973, pp. 343–67) is still analyzing the depression from the philosophical perspective and using the theoretical apparatus of the *Treatise*. Thus, he draws attention to the worldwide investment boom which occurred in the lustrum 1925 to 1929, speculating that "[a] very few more quinquennia of equal activity might, indeed, have brought us near to the economic Eldorado where all our reasonable economic needs would be satisfied" (Keynes 1973, p. 348).

In a polemical swipe at supporters of the Mises-Hayek theory of the business cycle, represented in Great Britain by Lionel Robbins and other economists associated with the London School of Economics, Keynes (1973, p. 349) chastises those "austere and puritanical souls" who hold that the investment boom was inflationary and

unsound and, therefore, requires a period of liquidation. For Keynes, any acquiescence in a period of "prolonged liquidation" of previous capital investments postpones or even reverses progress toward the millennium. The thing is to get the aborted investment boom restarted as quickly as possible. What is required, according to the "magic formula" of the *Treatise*, is to restore business confidence and profits via "a drastic fall in the long-term rate of interest" (Keynes 1973, p. 359).

Striking a Burkean note, Keynes (1973, p. 365) emphasizes that it is "the prime object of financial statesmanship" to insure that the long-term rate of interest is properly adjusted to "the technical possibilities of [the] age," so as to produce equality between the volume of savings and the demand for new capital. Failure to achieve such equality will not only produce cyclical fluctuations but runs the risk of throwing society off its long-run course to economic bliss.

Keynes (1973, p. 369) concludes:

> Thus we need to pay constant attention to the long-term rate of interest for fear that our vast resources may be running to waste through a failure to direct our savings into constructive uses and that this running to waste may interfere with that beneficent operation of compound interest which should, if everything was proceeding smoothly in a well-governed society, lead us within a few generations to the complete abolition of economic want.

It is thus clear that Keynes's vision of capitalism during the period of "arguing out the *Treatise*" was still a fundamentally Marshallian one of a self-steering vehicle carrying humanity forward along the road to the millennium. Although this vehicle proceeded unsteadily in fits and starts, Keynes did not doubt that its direction on balance was forward and that it would eventually reach its destination. Extending the metaphor, what the vehicle lacked, according to Keynes, was not so much a pilot as a governor to steady and maximize its rate of speed in order to expedite its journey. In particular, saving and investment rates needed to be governed and equilibrated at the margin by means of continual political manipulations of the long-term interest rate.

As the world and Britain's economic crisis deepened, however, Keynes began to doubt the accuracy of this vision. The vehicle had stopped dead in its tracks and was even threatening to reverse its course. Capitalism had ceased to deliver the goods, now or in the future, as both consumption and investment shrank to drastically low levels. By 1932, Keynes entered into what Patinkin (1976, pp. 55, 61) calls "the formative stage of the *General Theory*." It was during this period that Keynes consciously set out to overturn the Marshallian

orthodoxy and found a self-proclaimed heretical religion based on Moorite ethics.

In an unpublished two-page note, probably written in 1932, Keynes (1973, pp. 406–07) confesses his apostasy, at the same time revealing the central tenets of his new faith. First, he denies that the capitalist economy embodies "natural forces" which operate to restore output to its "optimum level" whenever it is disturbed. Second, Keynes) singles out "the strength of the forces in the community which tend toward saving" as the factor which causes real output to achieve an equilibrium at a level below the optimum. Contrary to the "orthodox theory," which emphasized "the importance of saving as the means of making a community wealthy," Keynes stresses the primacy of investment. He also denounces orthodox policy prescriptions, revealing that "it now seems to me that the economists, in their devotion to a theory of self-adjusting equilibrium, have been, on the whole, wrong in their practical advice and that the instincts of practical men have been, on the whole, sounder."

Keynes (1973, p. 407) also upholds certain policies favored by "uninstructed public opinion and the common sense of the business world" as "tending towards optimum output." These include: "Mercantilist and protectionist policies," which tend to foster foreign investment by improving the balance of trade; "Anti-usury laws and principles and cheap money policies," which reduce the rate of interest thereby spurring domestic investment; and "Expenditure as a thing in itself 'good for trade'" since it decreases saving in excess of investment. These "popular policies" are economically justified, declares, because, under modern capitalism, "it is a normal thing . . . for output to be below the optimum level."

Keynes concludes with the suggestion, which was to become a central insight of the *General Theory*, that an increment in investment will generate the saving necessary to finance itself. Writes Keynes (1973, p. 407): "Thus so far from its being true that, if we look after saving, output and investment will look after themselves, the opposite is more nearly true, namely that, if we look after investment, output and saving will look after themselves. For it is frequently the case in practice that a deliberate increase in saving will diminish investment and hence output . . . while a deliberate increase in investment will increase output and hence saving."

Now, it is true that in 1932, Keynes had not yet elaborated the theoretical structure to properly house these insights. As Patinkin (1973, p. 72) says of this among, other fragments of Keynes's writings in 1932, "[t]he voice is that of the *General Theory*: but the analytical framework is still largely that of the *Treatise*." And, it might be added,

the voice is clearly calling for economic salvation through renunciation of the sin of saving. For Keynes, at long last, the precepts of economic rationality have become one with those of virtuous behavior. Virtue receives its reward in this age as well as in the next, after all; and one can have one's economic pie in the millennium and still consume it in the here and now.

In 1933, Keynes published an article entitled "National Self-Sufficiency," whose significance has been downplayed by his followers. Generally, if it is alluded to at all, it is treated as a temporary deviation by Keynes from his internationalist principles in a desperate and ill-advised search for an expedient to alleviate domestic unemployment (Harrod 1951, p. 446; Harris 1955, pp. 186–87; Harris ([1947] 1973, pp. 319–22). One of the few to grasp its true import was the neglected international monetary economist Michael A. Heilperin (1962, pp. 111, 116), who referred to the article "for all its brevity, as one of Keynes's most significant writings" and as representing "far more than a passing mood."

Indeed, the article represents much more than Keynes's profession of disbelief—spewed forth in desperation and soon to be retracted—in the classical arguments in favor of free trade and the international division of labor. When considered in the context of the development of his *Weltanschauung*, it is nothing short of Keynes's public declaration of a loss of faith in the ability of capitalism ever to solve the problem of scarcity and deliver society to the promised land. Accordingly, the article also sends forth a clarion call for experimentation with alternative economic institutions and arrangements.

Until this point, Keynes had been unwavering in his view that, despite its intrinsic viciousness, capitalism was tolerable and even indispensable as the means to a future age of abundance in which virtue could be cultivated in comfort and leisure. In this article, Keynes signals a radical departure from this view, arguing now that capitalism is intolerable because it is unable to deliver humanity from scarcity and that it is precisely its lapses from virtue that prevent it from doing so.

Thus Keynes (1933, pp. 760–61) declares that "[t]he decadent international but individualistic capitalism . . . is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous—and it doesn't deliver the goods. In short, we dislike it, and we are beginning to despise it." However, Keynes does confess to perplexity about what to put in its place, while noting that "the world is embarking on a variety of politico-economic experiments." Russia, Germany, Italy and other countries are or will be seeking "after new

economic gods." Keynes (1933, p. 761) expects "many mistakes" to be made in these bold experiments in Bolshevism, Nazism, and Fascism, but "[n]o one can tell which of the new systems will prove itself best."

As Heilperin (1962, p. 114 30n) has pertinently remarked on this passage, "[t]he fact that the 'new economic gods' of Russia, Italy and Germany were totalitarian despotic gods, destructive of human dignity and human rights did not, it seems, appear worthy of note. They were experimenting—that was the wonderful thing about it!" Heilperin's judgment on the implications of Keynes's unbounded zeal for politico-economic experimentation is certainly borne out by Keynes's own revelation in the article that he is "one whose heart is friendly and sympathetic to the desperate experiments of the contemporary world, who wishes them well and would like them to succeed, who has his own experiments in view, and who in the last resort prefers anything on earth to what the financial reports are wont to call 'the best opinion in Wall Street'" (Keynes 1933, p. 766).

Keynes's almost exclusive concern at this point is that capitalism be gotten rid of, so that the world will be free to experiment. What replaces it depends on one's "own fancy." In Keynes's millennialist terminology, "[n]ot believing that we are saved already, we each should like to have a try at working out our own salvation. We do not wish, therefore, to be at the mercy of world forces working out, or trying to work out, some uniform equilibrium according to the ideal principles, if they can be called such, of *laissez-faire* capitalism." Accordingly, Keynes proclaims the dawning of a "transitional, experimental phase" during which "we all need to be as free as possible of interference from economic changes elsewhere, in order to make our own favorite experiments toward the ideal social republic of the future."

While Keynes's "favorite experiment," at least in its economic aspect, must await full elaboration in the *General Theory*, he does offer suggestive hints in this article. In particular, although he favors "retaining as much private judgment and initiative and enterprise as possible," Keynes (1933, p. 762) reveals that he has "become convinced that the retention of the structure of private enterprise is incompatible with that degree of material well-being to which our technical advancement entitles us, unless the rate of interest falls to a much lower figure than is likely to come about by natural forces operating on the old lines. Indeed, the transformation of society, which I preferably envision, may require a reduction in the rate of interest towards vanishing point within the next thirty years." Economic internationalism, by which Keynes means not only the free

movement of goods but especially a structure of interest rates determined on a globally integrated capital market, is thus emphatically rejected by Keynes (1933, p. 763), because it "may condemn my own country for a generation to come to a much lower degree of material prosperity than could be attained under a different system."

The conventional view, therefore, is doubly wrong in contending that, for Keynes, economic autarky represented a temporary expedient for palliating a desperate employment situation in Great Britain. To the contrary, Keynes's overriding concern, as expressed in the last paragraph, is not with "full employment" *per se*, but with what he later refers to as "full investment"; and "greater national self-sufficiency and a planned domestic economy" (Keynes 1933, p. 767) is proposed as a necessary and *permanent* framework for an economic experiment—here only alluded to but fully developed in the *General Theory* (Keynes [1936] 1964, especially chapters 16 and 24)—in which the interest rate is reduced to zero and underinvestment and artificial capital scarcity forever banished from the British Isles.

The long-accepted belief that, in writing the *General Theory*, Keynes was seeking to provide a blueprint for "saving capitalism" from its own instability is thus anachronistic at best. In fact, while this was indeed Keynes's objective in contriving the "magic formulas" of the *Treatise*, he abandoned it after 1931 and certainly by the time he came to plump for indiscriminate politico-economic experimentation and national self-sufficiency in 1933. With respect to capitalism, then, the Keynes of the *General Theory* is not a savior in any sense but a vengeful angel come at last to destroy what is immoral and unaesthetic because it has finally proven useless.

Near the end of his article on "National Self-Sufficiency," as if to accentuate the radical and irreversible nature of the "reorientation" of his mind, Keynes (1933, pp. 763–65) undertakes what can only be characterized as a diatribe against capitalist society and culture which is as remarkable for its candor as it is for its unrestrained vituperativeness. In this, Keynes recognizes and seizes upon economic calculation in the form of financial accounting as the intellectual foundation of market economy and the calculating mind as the consummate product of social evolution under capitalism. Thus, he contends that consistently judging action by the criterion of "the financial results" transformed the conduct of life in the nineteenth century "into a sort of parody of an accountant's nightmare" (Keynes 1933, p. 763).

Keynes rails against economic calculation because it represents an artificial constraint on the current use of resources, which is imposed by the illusory notion of futurity inherent in purposive action

and, thereby, obstructs the living of a bountiful and cultured life in the present. Thus Keynes (1933, pp. 763–64) declares that:

> Instead of using their vastly increased material and technical resources to build a wonder city, the men of the nineteenth century built slums; and they thought it right and advisable to build slums because slums, on the test of private enterprise, "paid," whereas the wonder city would, they thought, have been an act of foolish extravagance, which would, in the imbecile idiom of the financial fashion, have "mortgaged the future"—though how the construction today of great and glorious works can impoverish the future, no man can see until his mind is beset by false analogies from an irrelevant accountancy. . . . For the minds of this generation are still so beclouded by bogus calculations that they distrust conclusions which should be obvious. . . . We have to remain poor because it does not "pay" to be rich. We have to live in "hovels," not because we cannot build palaces but because we cannot "afford" them.

But once one has "reoriented" his mind to an economics imbued by the ethical verities, as Keynes has already done by this time, he is enabled to pierce through the intellectual fog created by economic calculation and perceive clearly that the active pursuit of virtues and values in the present calls forth and multiplies the bounty of resources necessary to their attainment. In the technical language of the *General Theory*, financing considerations are never a constraint on private (or public) investment, because investment creates the saving needed to finance it and raises present income and consumption into the bargain. As Keynes (1933, p. 764) expresses it here: "If I had the power to-day, I should most deliberately set out to endow our capital cities with all the appurtenances of art and civilization on the highest standards of which the citizens of each were individually capable, convinced of what I could create, I could afford. . . ."

Keynes is especially averse to the "rule of self-destructive financial calculation," when it justifies, for example, through the promotion of free trade, the eradication of activities whose unquantifiable intrinsic value can find no entry into such calculation. Writes Keynes (1933, p. 764): "we have until recently conceived it a moral duty to ruin the tillers of the soil and to destroy the age-long human traditions attendant on husbandry, if we could get a loaf of bread thereby a tenth of a penny cheaper." Such present sacrifices in the name of economic calculation, "this Moloch and Mammon in one," according to Keynes (1933, pp. 764–65), have been carried out with equanimity because of a delusive concern for the future, "for we faithfully believed that the worship of these monsters would overcome the evil of poverty and lead the next generation safely

and comfortably, on the back of compound interest, into economic peace."

For Keynes (1933, p. 765), the tragedy of adherence to the old doctrines does not lie in the absolute reduction of the British "standard of life," which, even in 1933, is at a higher level than ever before. It lies mainly in the fact that sacrifices of ethical values and modes of living have been made and made wholly in vain, because capitalism has been unable "to exploit to the utmost the possibilities for economic wealth afforded by the progress of . . . technique." The implication, of course, is the principle of the multiplier by which it is held that, under the normal operation of capitalism, the present "standard of life" need never be diminished and is indeed enhanced by an act of investment, which is aimed at fructifying the future and advancing society closer to the millennium.

Keynes (1933, p. 765) is thus able to conclude that "once we allow ourselves to be disobedient to the test of an accountant's profit, we have begun to change our civilization." This, of course, is tantamount to the call for the progressive socialization of investment, since the State is the only organization, with its almost unlimited power to appropriate scarce resources via taxation and monetary inflation, that is unconstrained by the criterion of economic calculation. This is realized by Keynes (1933, p. 765), who writes that "[i]t is the state, rather than the individual, which needs to change its criterion. . . . Now if the functions and purposes of the state are to be thus enlarged, the decisions as to what, broadly speaking, shall be produced within the nation and what shall be exchanged with abroad, must stand high among the objects of policy."

Keynes's article on "National Self-Sufficiency" thus presents the core of what Patinkin (1976, p. 95) labels the "antivision" of the *General Theory*. This is the "rejection of the traditional view that there existed in the capitalist world an automatic, self-adjusting mechanism that could be relied upon to maintain an acceptable state of employment" and, I would add, investment. In fact, for Keynes, the attainment of full-employment levels of income and consumption is the consequence of and the present reward for expediting progress to the future state of bliss by deliberately optimizing the rate of investment.

In a radio address on "Poverty in Plenty: Is the Economic System Self-Adjusting?" delivered in 1934, Keynes (1973, p. 488) explicitly ranges himself with "the heretics" who would "demolish the forces of nineteenth-century orthodoxy." Bringing his antivision to bear, Keynes argues that the orthodox or "self-adjusting" school assumes that "the rate of interest adjusts itself more or less automatically, so

as to encourage just the right amount of production of capital goods to keep our incomes at the maximum level which our energies and our organization and our knowledge of how to produce efficiently are capable of providing. This is, however, pure assumption."

Thus it is the failure of capitalism to provide the optimum level of investment spending, or, what is the same thing for Keynes, the maximum rate of progress toward the millennium (given prevailing consumption habits) which is the root cause of its technical inadequacy. For Keynes (1973, p. 491) the solution is straightforward and closed to all doubt: "The right course is to get rid of the scarcity of capital goods—which will rid us at the same time of most of the evils of capitalism—whilst also moving in the direction of increasing the share of income falling to those whose economic welfare will gain most by their having the chance to consume more." Of course, the solution will not emerge spontaneously from the operation of the capitalist system and must be imposed from without by the State, because "[t]he system is not self-adjusting, and, without purposive direction, it is incapable of translating our actual poverty into our potential plenty."

The positive vision of the *General Theory*, then, emerges out of Keynes's deliberate use of Moorite philosophical insights and doctrines to revolutionize the analytical apparatus of Marshallian economic theory in order to provide an explanation of the capitalist economic process that elucidates the causes and consequences of its failure to achieve adjustment at an employment- and investment-maximizing level of output. According to research by Patinkin (1976, pp. 55, 73), the analytical structure of the *General Theory* was completed by mid-1934, and, in the third and final stage of its preparation lasting through 1935, Keynes was engaged in eliciting detailed criticisms of the galley proofs of the book.

As identified by Keynes himself (Patinkin 1976, p. 66), the analytical components the development of which mark entry into the third stage of transition to the *General Theory* consist in the theory of effective demand, the theory of liquidity preference, and the concept of the marginal efficiency of capital. To these three, I would add the generally overlooked scarcity theory of capital, which Keynes adumbrated in the *General Theory* only partly in response to Hayek's stinging criticism of the *Treatise on Money* for lacking reference to a "clear and definite theory of capital" (Hayek 1931, p. 278). Taken together, these four components form a powerful analytical apparatus that permits Keynes to weave a vision in which the sins of futurity and calculation—which characterize purposive action

under capitalism—prove also to be irrational, self-defeating, and socially retrogressive. In particular, according to Keynes, attempts by individuals to make monetary and financial provision for the future cause humanity to be less well-provided for in the present and the future.

The *General Theory* as Millennialist Economics

Let me broadly indicate the millennialist ethical orientation of the technical economic analysis of the *General Theory*.

The theory of effective demand transmutes Keynes's Moorite emphasis on present activities and states of being from a recipe for individual salvation into the true path to the social millennium. Thus, according to Keynes, present employment and income is determined strictly by effective demand which, with the technical conditions of production assumed constant, depends solely upon aggregate spending for consumption and investment activities. While it is evident that consumption is a present activity, investment, as defined by Keynes ([1936] 1964, pp. 62, 104), denotes "the current addition to the value of the capital equipment which has resulted from the productive activity of the period" and therefore involves "present provision for future consumption."

Saving, on the other hand, is defined not in terms of activity but as the passive "residual or margin" between aggregate income and consumption (Keynes [1936] 1964, p. 64). As such, saving in the aggregate cannot be determined independently of the set of decisions relating to consumption and investment (Keynes [1936] 1964, p. 65). In the words of Abba Lerner (1983, p. 394): "With S thus almost completely sterilized (as nothing but the conceptual arithmetic difference between actual income and actual consumption) it became easier to concentrate on analyzing only the actual constituents of income and sources of employment, C and I."

With consumption rigidly determined by the propensity to consume—according to Keynes ([1936] 1964, pp. 96–97), a "fairly stable function" and one of the " more permanent psychological propensities"—investment spending becomes the sole factor determining levels of present as well as of future income and consumption. Hence "employment can only increase *pari passu* with an increase in investment; unless, indeed there is a change in the propensity to consume" (Keynes [1936] 1964, p. 98). Nor does an increase in investment require an antecedent increase in saving because, according to "the fundamental psychological law" governing the marginal propensity to consume, an increment to social income always calls forth a positive but less than

equal increment to consumption. Thus, as income increase, it induces an automatic increase in saving in the form of an expansion of the absolute size of the gap between income and consumption. The multiplier sums up the process by which, with a given marginal propensity to consume, an increase of investment results in a rise in the level of income sufficient to generate the additional saving necessary to finance itself.

From Keynes's ethical standpoint, the multiplier apparatus is a masterstroke because it permits him to argue that investment promotes higher standards of income and consumption in the present as well as in the future. The all-important growth in society's capital stock is no longer dependent on the semi-pathological, semi-criminal, and, in any event, unethical propensity to abstain from present enjoyments in order to provide for a chimerical and ever-receding future. The ethical maxim of the Sermon on the Mount is thus transformed into the eminently practicable policy prescription of rational economics: those who would be well cared for, in the present and in the future, are those who do not trouble themselves overmuch about provision for the future.

But Keynes is not satisfied merely with demonstrating that individual efforts to provide for the future by financial accumulation are superfluous to the process by which social income and capital are created; he seeks to portray private saving as self-defeating and socially destructive. Here, again, the concepts of effective demand and the multiplier are ready at hand. Any attempt by an individual to increase saving by accelerating the rate at which he "pile[s] up claims to enjoyment which he does not intend to exercise at any definite time" (Keynes [1936] 1964, p. 131), *ipso facto*, lowers the propensity to consume and causes a slackening of effective demand. The result is a destruction of social income whose size is a determinate multiple of the original reduction in consumption.

However, the social ravages of vicious and irrational precaution do not end with reductions in the current income level; the greater enormity lies in its retardation of the growth of the capital stock, resulting from the circumstance that estimates of the prospective yield rate or marginal efficiency of capital partly depend on "the strength of the existing consumers' demand for goods that require for their efficient production a relatively larger assistance from capital" (Keynes [1936] 1964, p. 147). For Keynes ([1936] 1964, p. 106), therefore, "every weakening in the propensity to consume regarded as a permanent habit must weaken the demand for capital as well as the demand for consumption." Thus, a decline in investment due to a weakening propensity to consume reduces

potential future income and living standards at the same time that it aggravates the declines in current levels of effective demand, income, and consumption.

The ultimate and cruel irony, of course, is that the individual's attempt to increase saving is incapable of generating a realized increase of saving in the aggregate and, in fact, serves to reduce aggregate realized saving, since the margin between income and consumption, as determined by the marginal propensity to consume, necessarily narrows as the level of income decreases. As Keynes ([1936] 1964, p. 65) puts it, "A decision to consume or not to consume truly lies within the power of the individual; so does a decision to invest or not to invest." But aggregate saving is merely one of the "*results* of the free choices of individuals whether or not to consume and whether or not to invest. . . ."

Based on his economic analysis of saving as a self-frustrating and socially deleterious activity, Keynes ([1936] 1964, p. 161) contemplates, as "the only radical cure" for economic crises, that saving be outlawed, that is, that the individual be allowed "no choice" between spending his income on consumption or investment in a "specific capital asset" and saving it in the form of cash hoards or debt purchases. As we shall see, however, Keynes ultimately opts for an alternative set of policies involving the socialization of investment and the euthanasia of the rentier via the reduction of the rate of interest to zero.

This brings us to the marginal efficiency of capital (MEC), which Keynes defines as the prospective rate of return on an increment of monetary investment in the current production of capital goods. For Keynes ([1936] 1964, p. 145), the MEC schedule "is of fundamental importance because it is mainly through this factor (much more than through the rate of interest) that the expectation of the future influences the present." In this passage, the parenthetical remark about the rate of interest underscores Keynes's determination to maintain a rigid analytical distinction between the concepts of the MEC and the rate of interest. Indeed, Keynes ([1936] 1964, pp. 192–93) devotes a special excursus to refuting those Austrian-Wicksellian interest theorists, such as Mises, Hayek, and the early Alvin Hansen, who identify the basic rate of interest with the rate of price differentials between the products of successive stages of the structure of production. These writers, as well as Keynes of the *Treatise* (Keynes [1936] 1964, pp. 173–74), stand accused of "confusing the marginal efficiency of capital with the rate of interest."

The apparent eagerness with which Keynes seeks to disentangle the two concepts can be explained by their different standings in terms of his ethical thought. The MEC represents a return to a

current and productive activity, investment, which is legitimately, even nobly, future-oriented. In Keynes's words, "[t]he social object of skilled investment should be to defeat the dark forces of time and ignorance which envelope our future" (Keynes [1936] 1964, p. 155). The rate of interest, in contrast, is a sop to avarice, a "bribe" paid to the nonproductive saver to induce him to part with liquidity, an irrational and nugatory provision for the future.

For Keynes, the all-important task of estimating the prospective rate of return on newly-produced capital equipment is apt to be badly done under capitalism, because open markets and monetary calculation tend to promote irrational expectations of the more remote future. Keynes's argument runs briefly as follows: The knowledge which governs our expectations of the outcome of a long-term investment rests on an extremely precarious basis at best and "is usually very slight and often negligible" (Keynes [1936] 1964, p. 149). Thus, were it not for the fact that human beings take direct pleasure in the riskiness and activity of constructing factories and farms, not much investment would be undertaken "merely as a result of cold calculation" (Keynes [1936] 1964, p. 150). However, under modern capitalism, it is precisely considerations of cold calculation which predominate in investment decisions, because the irrational striving for liquidity has led to the emergence of the stock exchange, an organized market on which investments may be resold and revalued on a daily or even hourly basis.

The result is that most investments come to be "governed by the average expectation of those who deal on the stock exchange as revealed in the price of shares, rather than by the genuine expectations of the professional entrepreneur." Hence, for example, if an existing investment can be had on the stock market at a purchase price below the cost of constructing a new investment of a similar type, this class of investment will be discouraged regardless of its prospective yield. Moreover, the average investor, because his knowledge of the factors governing the prospective yield of the various investment opportunities is virtually nil, bases his decisions on an "arbitrary convention," according to which it is assumed that the existing market valuation of the investment reflects the existing knowledge of the facts which determine its yield and is therefore "uniquely correct" (Keynes [1936] 1964, pp. 152–53). A change in the investment's market value will only occur, therefore, as a result of the (presumably slow and orderly) revision of knowledge as new and relevant facts come to light.

However, such "conventional valuation," in actuality, is not based on genuine, if incomplete, knowledge of the future laboriously accumulated by the experts, but on the "state of confidence" of the mass

of ignorant investors, which reflects their vague, uninformed, and mercurial doubts, fears, and hopes. Any change in the state of confidence, whether or not in reaction to events reasonably expected to effect long-term investment prospects, brings about a dissolution of the existing conventional valuation and the emergence of a new one. As a consequence, investment markets are inherently volatile and, therefore, divert "the energies and skill of the professional investor and speculator" from attempting to forecast the long-term prospective yield of an investment to contriving to beat the mass of investors in foreseeing and profiting from short-term changes in the conventional basis of valuing stocks (Keynes [1936] 1964, p. 154).

For Keynes ([1936] 1964, p. 153), then, it is ultimately perfidious calculation and irrational convention that account for the "problem of securing sufficient investment." As noted above, both calculation and convention represent serious departures from the ethical code Keynes supposes will prevail in the millennium. The absorption of one's skill and energy in the service of monetary calculation is the very negation of the Moorite notion of the ideal life as the enjoyment of a sequence of good states of mind. The reason is that money, as Keynes ([1931] 1963, p. 356) characterized it, is "the grand substitute motive, the perfect *Ersatz*, the anodyne for those who, in fact, want nothing at all."

Regarding the ethics of relying upon convention as a guide to action in the face of an uncertain future, which was a position espoused by Moore himself, the theory of probability propounded by Keynes in the *Treatise on Probability* implies that such a reliance is irrational, and therefore counterproductive, as a means to attaining the good. As pointed out above, in Keynes's approach to probability, a probability exists in favor of an action as long as the balance of existing evidence, however slight or precarious such evidence is, suggests that it is the most productive of desirable results. Applied to the case of a long-term investment, therefore, although knowledge of the factors affecting the success of its outcome is bound to be precarious, the probability of its success can always be rationally determined as an ordinal ranking in a hierarchy of alternative investment projects.[1] Even where evidence concerning the long-term results of alternative actions or investments is completely absent, as is

[1]The reference to ordinal ranking of probabilities in this case illustrates Keynes's skepticism toward cardinal estimates of probability which is based on his general reluctance to conceive the theory of probability as synonymous with the theory of statistical frequency (Keynes [1921] 1962, esp. chap. 8). I am indebted to an anonymous referee for raising this point.

sometimes bound to be the case, if there is evidence that one will yield greater advantages in the near future than the others, then, according to Keynes ([1921] 1962, p. 310), "by what seems a legitimate application of the Principle of Indifference we may suppose that there is a probability in favor of the former action."

Keynes's opposition to the conventional valuation of investments alleged to occur in the stock market therefore derives ultimately from a deep-seated ethical belief that, in its recourse to convention, humanity abandons rationality and succumbs to "the dark forces of time and ignorance." In organized investment markets, the abandonment of rationality is reflected in the fact that, since conventional valuation is unrelated to long-term yield considerations and rests on no objective foundation at all, continual and wholesale fluctuations in the state of confidence of investors result from random events. These fluctuations provide lucrative opportunities for "speculation," which divert the professional investors away from the activity of "enterprise" or the task of reasonable estimation of long-term yield prospects. The consequence of such recurrent bouts of overoptimism followed by crises of confidence is the collapse in the MEC, which precipitates the dreaded trade cycle (Keynes [1936] 1964, pp. 315–16).

The existence of the trade cycle thus bespeaks a moral as well as an economic failing of financial capitalism, since it is attributable to "the uncontrollable and disobedient psychology of the business world" (Keynes [1936] 1964, p. 317). Regarding the activity of speculation, which feeds on and profits from such "disobedience"—presumably, to the conclusions of his laboriously elaborated probability theory—Keynes ([1936] 1964, p. 359) draws an explicit connection between its degraded moral quality and its pernicious social consequences: "When the capital development of a country becomes a byproduct of the activities of a casino, the job is likely to be ill-done."

By extending the nexus of monetary calculation to include second-hand investments, organized financial markets thus promote the sins of convention and speculation and suppress capital accumulation. These markets further dampen the rate of investment by increasing its risk. By facilitating the differentiation of the saver-lender from the entrepreneur-borrower, the existence of financial markets requires that, before it may be undertaken, a risky investment promise a return that is sufficient to yield, in addition to the pure rate of interest plus a premium for the borrower's or entrepreneur's risk, compensation for "lender's risk." Unlike the entrepreneurial risk premium, the premium accounting for lender's risk is not "a real social cost" which may be diminished by increased skill in forecasting,

but "is a pure addition to the cost of investment which would not exist if the borrower and lender were the same person" (Keynes [1936] 1964, p. 144). Moreover, the lender's risk component includes and duplicates a part of the entrepreneur's risk component, because the lender as well as the borrower require a greater premium before committing funds to riskier investments (Keynes [1936] 1964, p. 145).

Keynes ([1936] 1964, p. 164) sees only two remedies for the distorted and volatile MEC schedule and the continually fluctuating and, on average, chronically insufficient level of investment which result from convention, speculation, and the unnecessary and wasteful duplication of risk. The first involves the implementation of a monetary policy designed to manage interest rates in such a way as to elicit continuously the "appropriate volume of investment." But Keynes confesses skepticism toward this alternative. The second, and Keynes's preferred remedy, is to extirpate the root cause of the problem by forthrightly abolishing markets and monetary calculation for investment, i.e., by socializing investment. Writes Keynes ([1936] 1964, p. 164):

> I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment; since it seems likely that the fluctuations in the market estimation of the marginal efficiency of different types of capital . . . will be too great to be offset by any practicable changes in the rate of interest.

Given his analysis of the MEC, Keynes ([1936] 1964, p. 378) must be taken very seriously when he concludes that "a somewhat comprehensive socialization of investment will prove the only means of securing an approximation to full employment." This is in contrast to the conventional view, as expressed, for example, by Alvin Hansen (1953, pp. 215–16), which portrays Keynes as advocating short-run fiscal fine-tuning, at the same time discounting lengthy discussions of socialization of investment and the attainment of capital saturation as examples of Keynes allowing "his fancy to roam in an irresponsible manner," "flying his kite," and engaging in "fascinating flights of fancy."

Indeed, it has been definitively established by Meltzer (1988, p. 182), that in the *General Theory* "Keynes's main policy recommendation is for public direction of investment" and "Keynes believed that his main recommendations were policy implications drawn from his theory." Moreover, as Meltzer (1988, p. 295) also shows, Keynes did not originate the basic concept of fiscal fine-tuning or functional finance but learned it from Abba Lerner. After initially rejecting Lerner's ideas, Keynes intellectually accepted and praised them, but

never gave any indication that "he accepted functional finance as a basis for policy." Accordingly, in his wartime memos on post-war reconstruction, Keynes "favored policies to stabilize investment and opposed policies to increase consumption on grounds . . . [that] income can be raised permanently by increasing and stabilizing investment" (Meltzer 1988, p. 186).

We now turn to the liquidity preference theory of interest, which may be characterized as the keystone of Keynes's analytical structure. With the interest rate determined solely by the interaction of the liquidity preference function and the quantity of money, rather than by the supply and demand for saving as in the classical theory, the progressive social force of capital accumulation is, at long last, rendered logically and wholly independent of the sin of saving. In the process, the activity of saving is thoroughly criminalized and deprived of its last shred of redeeming social advantage. No longer is an increase in the rate of saving seen as operating to lower interest rates and thereby to induce the additional spending on investment necessary to offset the negative effect on income of the concomitant decline in the rate of consumption expenditure. To the contrary, the attempted allocation of savings to the accumulation of additional cash balances to satisfy heightened preferences for liquidity actually *raises* the interest rate and reduces investment.

In a nutshell, the theory of liquidity preference tells the story of how the interest rate develops as a purely monetary phenomenon, which is rooted in avarice and precaution and determined on a superfluous market ruled by convention and speculation. Once determined, the interest rate confronts an irrationally determined MEC in an arbitrary monetary calculation that serves only to limit investment and to burden society with an artificial scarcity of capital goods.

In explicating his theory, Keynes begins by bifurcating the decisionmaking process which expresses the individual's "psychological time preferences." In the initial stage of the process, the propensity to consume determines what proportion of his current income the individual will consume and what proportion "he will reserve in *some* form of command over future consumption." Once this decision has been made, the individual's liquidity preference dictates how much of his current stock of savings, which includes savings accumulated from past income flows, he holds in the form of money, which yields "immediate liquid command," and how much he invests in debt, which represents "deferred command over specific goods" convertible into money only at an uncertain future market price.

From this *ad hoc* and contrived description of the process by which an individual allocates his monetary assets, Keynes ([1936]

1964, pp. 166–67) deduces that "the rate of interest cannot be a return to saving or waiting as such. For if a man hoards his savings in cash, he earns no interest, though he saves just as much as before. . . . Thus the rate of interest at any time, being the reward for parting with liquidity, is a measure of the unwillingness of those who possess money to part with their liquid control over it."

But why does such a thing as liquidity preference exist, especially when it is considered that the holding of money yields no explicit return? The first reason that Keynes ([1936] 1964, p. 168) gives involves the "transactions motive": the current transaction of business by consumers and producers requires a ready supply of cash and, in a world in which the individual's income receipts and disbursements are not synchronized, this entails that "up to a certain point it is worthwhile to sacrifice a certain amount of interest for the convenience of liquidity."

Two additional factors, unrelated to anticipated transactions, motivate a preference for liquidity: precaution and speculation. According to Keynes ([1936] 1964, p. 168), the necessary precondition of both the precautionary and speculative motives for holding cash "is the existence of uncertainty as to the future of the rate of interest. . . ." The precautionary motive explains the compensation for the sacrifice of interest by the insurance which the possession of liquid wealth provides against the capital loss that may be incurred when an unforeseen need for cash necessitates a hasty liquidation of debt securities. The speculative motive for cashholding emerges in an economy where, in addition to interest-rate uncertainty, there exists "an organized market for dealing in debts," e.g., a bond market (Keynes [1936] 1964, p. 169). Thus the individual "who believes that future rates of interest will be above the rates assumed by the market, has a reason for keeping actual liquid cash" (Keynes [1936] 1964, p. 170).

While liquidity preferences due to the transactions and precautionary motives are assumed by Keynes to depend on income and to be insensitive to fluctuations in the current rate of interest, the demand for liquidity for speculative purposes, where there exists a divergence of expectations among speculators regarding the future, is portrayed as varying inversely with the rate of interest. Thus, concludes Keynes ([1936] 1964, p. 171), "the rate of interest and the price of bonds have to be fixed at the level at which the desire on the part of certain individuals to hold cash (because at that level they feel bearish of the future of bonds) is exactly equal to the amount of cash available for the speculative-motive." Particularly where "the existence of an organized market gives an opportunity for wide fluctuations in

liquidity preference due to the speculative motive" (Keynes [1936] 1964, pp. 170–71), changes in the interest rate in a capitalist economy reflect nothing more significant than the irrational migrations of speculators to and fro between the herds of bulls and bears.

From this analysis, Keynes ([1936] 1964, p. 203) is led to conclude that "the rate of interest is a highly conventional . . . phenomenon. For its actual value is largely governed by the prevailing view as to what its value is expected to be. *Any* level of interest which is accepted with sufficient conviction as *likely* to be durable *will* be durable. . . ." Moreover, where the opinion prevails that "the level of the rate of interest is self-adjusting, so that the level established by convention is thought to be rooted in objective grounds much stronger than convention," the interest rate may persist at a level that is too high for full employment. Keynes ([1936] 1964, p. 204) refers to "[t]he difficulties in the way of maintaining effective demand at a level high enough to provide full employment, which ensue from the association of a conventional and fairly stable long-term rate of interest with a fickle and highly unstable marginal efficiency of capital. . . ."

Even if an enlightened monetary authority were determined to drive the gross market rate of interest down in order to create a gap between the MEC and the interest rate sufficiently large to call forth a full-employment or "optimum" level of investment spending, its efforts in this direction would be limited by two factors. First, there is what has come to be termed the "liquidity trap," which raises the possibility that "after the interest rate has fallen to a certain level, liquidity preference may become absolute in the sense that almost everyone prefers cash to holding a debt which yields so low a rate of interest" (Keynes [1936] 1964, p. 207).

While a good case can be made that many commentators on the *General Theory* have routinely misinterpreted and overemphasized the theoretical and practical significance which Keynes attaches to the liquidity trap (Meltzer 1988, pp. 270–80), the same certainly cannot be said of the second factor that Keynes cites as impeding any attempt to reduce the interest rate, which has been virtually ignored. This second impediment consists, according to Keynes ([1936] 1964, p. 208) of "the intermediate costs of bringing the borrower and ultimate lender together, and the allowance for risk, especially for moral risk, which the lender requires over and above the pure rate of interest." Thus, even if the monetary authority were to succeed in reducing the pure rate of interest or the liquidity premium to zero, an insuperable barrier to optimum investment and full employment could still exist in the form of the "effective rate of interest" stuck at too high a level and composed of irreducible costs of financial intermediation plus a

risk premium to compensate the lender for moral and other risks of the borrower's default. This factor "may prove important in an era of low interest rates" (Keynes [1936] 1964, p. 208), which, as we shall see, Keynes looks forward to as the precondition of the transition to capital superabundance.

The liquidity preference theory thus represents the perfect instrument allowing Keynes to translate his longstanding ethical prepossessions regarding usury and avarice into scientific policy dicta. Keynes's reference to the impending "euthanasia of the rentier" is not an isolated flight of fancy but the central implication of his program to rid the economy of the baneful effects of usury and avarice by suppressing the rate of interest and thereby abolishing the bond market.

As noted above, for Keynes, the bond market is born out of the irrational and otiose separation between those who finance and those who implement investment projects. This separation serves to create a unique and unnecessary risk, i.e., of the borrower's default, which increases the cost of investment. Furthermore, by providing an arena for speculation on interest-rate uncertainty, the organized bond market promotes avarice in the form of the speculative demand for cash holding. It is this demand which is the active factor in determining and driving the pure rate of interest; that is, the liquidity premium which must be paid to the avaricious for parting with monetary investment funds. Because the existence of the pure interest rate renders the ownership of debts competitive with the ownership of real capital assets, it further raises the cost and retards the rate of investment.

It is because the liquidity preference theory of interest establishes such a clear causal link between vice and economic instability and waste that Keynes steadfastly refused to relinquish it in favor of the scientifically more rigorous, general-equilibrium explanation, which emphasizes the simultaneous determination of the levels of income and the interest rate by saving and investment on the one hand and liquidity preference and the quantity of money on the other. As Patinkin (1976, p. 99) argues: "This tenet [that liquidity preference is the sole determinant of the interest rate] indeed served Keynes as a test of faith for all who wanted to be regarded as true converts to his new theory." In this spirit, Keynes was to "absolve" Harrod of misunderstanding this crucial aspect of his analysis (Patinkin 1976, p. 99).

Hansen (1953, p. 155) characterizes those chapters of the *General Theory* in which Keynes discusses the nature of capital as "another detour which could be omitted without sacrificing the main argument." And it is true that Keynes did not emphasize the "scarcity

theory" of capital, which he develops in chapter 16, as a contribution on a par with effective demand, liquidity preference, and the marginal efficiency of capital. Keynes may have downplayed his contribution in this area because his treatment consisted of a series of loosely connected observations rather than a fully integrated theory. Nonetheless, the view of capital which emerges from these observations is crucial to the analytical progression of the main argument of the *General Theory*.

Keynes aims at establishing two fundamental propositions regarding capital. The first is that "an asset offers a prospect of yielding during its life services having an aggregate value greater than its initial supply price . . . because it is scarce; and it is kept scarce because of the competition of the rate of interest on money" (Keynes [1936] 1964, p. 213). The implication is that, given its physical productivity, the less scarce capital becomes the lower its yield in excess of its supply price.

In support of this proposition, Keynes ([1936] 1964, p. 213) alludes to the "pre-classical doctrine" that "everything is *produced* by *labor*," aided by technology, natural resources and capital or "past labor embodied in assets." Like natural resources, then, the price of the latter aid to labor is also determined by its "scarcity or abundance."

Keynes's second proposition holds that at any given moment in time, the opportunity for capital investment is strictly limited. According to Keynes ([1936] 1964, p. 214), while there are admittedly some roundabout processes of production that are physically efficient, probably most are very inefficient due to the phenomenon of "spoiling or wasting with time." This implies a conception of roundaboutness that is restricted to currently used techniques and production functions in which there is little scope for intertemporal substitution among inputs. Thus Keynes ([1936] 1964, p. 217) writes that "[i]n the case of the great majority of articles, it would involve great technical *in*efficiency to start up their input more than a very modest length of time ahead of their prospective consumption."

But the investment of labor in the production of capital assets is even more narrowly limited by the fact that, for any given quantity of labor, there is an optimum proportion between capital and labor, i.e., "between the amount of labor employed in making machines and the amount which will be employed in using them" (Keynes [1936] 1964, p. 214). The structure of production could be advantageously lengthened beyond this limit to exploit the remaining physically more efficient and even some inefficient lengthy processes of production, only if preferences to postpone consumption into the future were

strong enough to necessitate a rate of investment so great as to provoke a negative MEC. In this case, short efficient processes must be rendered sufficiently scarce to compensate for the effect on their product price of the relative disagreeableness attending early consumption.

The optimum roundaboutness of the production structure is thus fixed and depends on the given supply of labor in conjunction with the given structure of dates at which consumer demand for the various products is expected to become effective, taking into account the circumstance that the lengthening or shortening of certain processes may so improve the quantity or quality of their products as to induce consumers to postpone or anticipate their prospective demands. Thus, in the case of a zero rate of interest, "there would be an optimal interval for any given article between the average date of input and the date of consumption, for which labor cost would be a minimum" (Keynes [1936] 1964, p. 216). A shorter or longer interval would be technically, as well as economically, less efficient. If the interest rate were above zero, the optimum interval would be contracted, necessitating a curtailment of current investment so as to achieve the greater scarcity of future products necessary to raise their prices enough to absorb the interest charge and the higher costs associated with the employment of technically less efficient shorter processes.

For Keynes, then, the interest rate constitutes the narrowest limit on investment. But even if a zero interest rate prevailed, Keynes's analysis implies that "there is a strict limit to the proportion of consumers' demand which it is profitable to begin providing for in advance" (Keynes [1936] 1964, p. 217).

In terms of practical policy, the conclusion Keynes ([1936] 1964, p. 375) draws from this analysis is momentous: "I feel sure that the demand for capital is strictly limited in the sense that it would not be difficult to increase the stock of capital up to a point where its marginal efficiency had fallen to a very low figure."

Keynes's analysis of capital completely ignores Böhm-Bawerk's seminal insight that capital accumulation permits the adoption of new techniques and production functions which, though previously known, remained unexploited precisely because the prevailing scarcity of capital rendered their implementation uneconomic. Thus, contrary to Keynes, progressive accumulation of capital requires and facilitates, within wide limits, an ever-increasing proportion of the given labor supply to producing capital goods. The growing quantity of labor inputs is applied not merely to "making machines," i.e., replicating existing machinery with existing techniques, but to making different and more efficient machines, to making existing machines

more efficiently by building and using machines to make machines, to making the new machines necessary to mass produce luxury goods, e.g., the automobile, and to inventing new production processes and machines intended to supply heretofore latent wants.

It is illuminating to note the subtle connection between Keynes's analysis of the limits to capital accumulation and his Marshallian theory of wants and its key role in his millennialist social vision. It is precisely the assumption that the broad classes of wants are definitely limited, easily identified and enumerated, and capable of being supplied by existing production techniques, which enables Keynes to envisage that human wants will be surfeited and the millennium achieved with an extra generation or two of capital accumulation. However, once the possibility is raised, as it is by Böhm-Bawerkian capital theory, that capital accumulation itself is capable of stimulating the realization and expression of hitherto undreamed of wants, the rat race for progressively increasing living standards is on and the vision of capital saturation amid the blissful stagnation of the millennium recedes into the remote future or dissipates altogether (compare Johnson and Johnson 1978, pp. 80–81, and Minsky 1975, pp. 151–53).

As Minsky (1975, p. 154) perceptively comments, Keynes's world is one "in which 'civilized' standards discipline and control relative needs and move consumption away from capital-intensive patterns. A world in which an endless accumulation of gadgetry and weaponry is the desire of man is not a world in which full investment will soon occur." It is open to speculation whether Keynes's initial hatred of the automobile (Hession 1984, p. 57) and his reported discomfort with the telephone stemmed from his view that such capital-absorbing gadgets represented a departure from the "state of disciplined wants" (Minsky 1975, p. 155) that is necessary to achieve capital saturation.

Indeed, it is precisely because almost all "Keynesian" economists, especially in the United States, have ignored the fourth building block of the strict limitation on the demand for capital that they have been able to regard the analytical technique of the *General Theory* as providing the means for fine-tuning and stabilizing capitalism, instead of, as Keynes intended it, the justification and recipe for its destruction. Thus, no sooner is the fourth and final building block represented by the scarcity theory of capital rolled into place, than Keynes uses his completed theoretical apparatus to deliver the *coup de grace* to capitalism. This is the demonstration that laissez-faire capitalism, given prevailing institutions and psychological propensities, even if it miraculously found itself in the blessed state of capital satiety, would be unable to sustain this economic Eldorado.

For his demonstration, Keynes ([1936] 1964, p. 217) supposes a society that possesses a capital stock of such a magnitude that any further investment would render the MEC negative. In graphical terms, we may envision an MEC schedule which intersects the origin and otherwise lies entirely within the second and fourth quadrants, with any level of positive investment inducing a negative MEC. It is also supposed by Keynes that, in this economy, money does not physically depreciate or involve significant costs of storage, therefore implying that the interest rate can never be negative, and the social propensity to save exceeds zero at the full-employment level of income. In these conditions, effective demand would consist only of expenditures on consumption and would be insufficient to take up the full flow of output forthcoming at a full-employment level of income. The result is that both the level of employment and the capital stock will have to shrink in order to reduce income to a level at which aggregate saving is zero.

Based on this analysis, Keynes ([1936] 1964, pp. 217–18) concludes that thus "for a society such as we have supposed, the position of equilibrium, under conditions of *laissez-faire*, will be one in which employment is low enough and the standard of life sufficiently miserable to bring savings to zero. . . . [T]he equilibrium stock of capital which will have a marginal efficiency of precisely zero, will, of course, be a smaller stock than would correspond to full employment of the available labor; for it will be the equipment which corresponds to that level of unemployment which ensures zero saving." The implication of course, is that pushing the rate of interest to "vanishing point" via government monetary policy may not be sufficient to induce the state of full investment prerequisite to entering the millennium. There is the possibility, however, that the desire of the public to make provision for the future would become satiated, causing the propensity to save out of full-employment income to fall to zero, at some point before the rate of interest reaches zero.

However, this unlikely possibility of spontaneous salvation under capitalism, according to Keynes ([1936] 1964, pp. 218–19), is rendered even less likely when it is considered that there are certain institutional and psychological factors, "in particular, the costs of bringing borrowers and lenders together and uncertainty as to the future of the rate of interest," operating to set a lower limit on the rate of interest significantly above zero.

Ensconced as it is in the generally neglected chapter on capital, most commentators on the *General Theory* have overlooked the most important application of its analytical apparatus. This is to the explanation of how an accumulation of capital, "so large that its

marginal efficiency has fallen more rapidly than the rate of interest can fall in the face of the prevailing institutional and psychological factors, can interfere, in conditions mainly of laissez-faire, with a reasonable level of employment and with the standard of life which the technical conditions of production are capable of furnishing" (Keynes ([1936] 1964, p. 219). The ultimate moral and technical perversity of capitalism thus rests on the demonstration that it transmogrifies and diverts the process of wealth creation and progress toward moral perfection to a descent into a permanent state of relative impoverishment wherein vice can never be transcended.

For Keynes ([1936] 1964, p. 219), however, there is a way out, because "This disturbing conclusion [regarding the effects of capital accumulation] depends, of course, on the assumption that the propensity to consume and the rate of investment are not deliberately controlled in the social interest but are mainly left to the influences of *laissez-faire*." The political economy of the *General Theory* is thus primarily addressed not to securing the short-run stability of output and prices but to promoting the long-run, evolutionary goal of solving the economic problem.

Keynes lays out his politico-economic proposals in the final chapter of the *General Theory*, and they are clearly and specifically aimed at "depriving capital of its scarcity-value within one or two generations." The measures elaborated to achieve this aim involve "central controls," a term Keynes ([1936] 1964, pp. 377–79) uses four times within the space of three pages. These measures are designed to enable the State "to determine the aggregate amount of resources devoted to augmenting the instruments [of production] and the basic rate of reward to those who own them" and also "to bring about an adjustment between the propensity to consume and the inducement to invest" (Keynes [1936] 1964, pp. 378–79). In addition to full investment, these measures are designed to achieve the supplementary goals of full employment and equitable distribution of income.

Keynes's primary policy prescription is for a gradual and steady reduction in the rate of interest to zero. Because Keynes is referring to the market or effective rate of interest, which includes, in addition to the liquidity premium, the various costs and risk premiums associated with bringing borrowers and lenders together, he argues that monetary policy is incapable of effecting this outcome on its own. Thus he advocates "a somewhat comprehensive socialization of investment," which is the only way in which the institutional rigidity of the interest rate can be broken and, therefore, "the only means of securing an approximation to full employment" in the conditions of accumulating capital and a secularly declining MEC.

While a longtime advocate of neo-Keynesian fine-tuning, such as Tobin (Brunner 1987, pp. 53–54), downplays the significance of Keynes's use of the term "socialization of investment" by adducing its varied connotations, Keynes is reasonably clear about the economic arrangements he intends to connote by the term. The central controls which Keynes ([1936] 1964, p. 378) advocates do not necessitate the assumption by the State of "the ownership of the instruments of production." Indeed, Keynes ([1936] 1964, p. 374) expatiates, albeit patronizingly, on the social usefulness of "money-making" and "private wealth-ownership" in the pre-millennial world in which men have not yet been "taught or inspired or bred" to take no interest in such activities.

What Keynes does envision in proposing the socialization of investment is the replacement of individual saving and allocation of investment funds via debt and equity purchases on private markets by "communal saving through the agency of the State" ([1936] 1964, p. 376).[2] In this way, the irrational and speculative stock and bond markets will give way to Marshallian owner-entrepreneurs, who, in consultation with Burkean State financiers and using the principles of Keynes's probability theory, will rationally forecast the marginal efficiencies of the various types of capital goods and defeat "the dark forces of time and ignorance" (compare Brunner 1987, p. 38).

The progressive expansion of the capital stock brought about by the policy of continually reducing the interest rate will drive the MEC

[2]There has been recurring and unresolved controversy surrounding the question of whether or not Keynes was an advocate of socialism. Of course, the resolution of this issue turns on the precise meaning to be attached to Keynes's call for "the socialization of investment." If it is interpreted, as I argue it should be, as a scheme to abolish equity and debt markets, then Keynes was indeed advocating the substitution of socialist central planning for a market economy. For as Mises points out, the existence of a stock exchange is precisely what distinguishes a functional market economy from a socialist economy. The retention of nominally private ownership of the means of production without the effective right of alienating such ownership titles in monetary exchanges deprives entrepreneurs of the ability to ascertain production costs, calculate ever-changing profit opportunities, and respond to these opportunities by rearranging existing combinations of capital goods. Centrally controlled investment, therefore, implies centrally planned production processes. Thus, for example, under National Socialism in Germany, although private ownership of business assets was formally retained, all important production activities were carried on under the directives of state officials.

Mises's remark on the existence of a stock exchange as the *sine qua non* of a market economy is reported in Rothbard 1991, p. 59. For the original statement of Mises's classic argument that the abolition of markets and prices for capital goods renders the rational allocation of resources impossible, see Mises [1920] 1990. For a detailed description of the pre-war Nazi economy which emphasizes its essentially socialistic character, see Reimann 1939.

schedule steadily to the left until it reaches its evolutionary terminus at its intersection with the origin point. Actually, the MEC would not quite reach zero but would fall to "a very low figure" which would provide "some margin to cover risk and the exercise of skill and judgment" of the investing entrepreneur. Thus the gross yield on capital goods over their lives would "just cover their labor costs of production *plus* an allowance for risk and the costs of skill and supervision," there being no surplus left over for payment of a scarcity premium for the use of capital (Keynes [1936] 1964, pp. 375–76). In this state of full investment would therefore occur "the euthanasia of the rentier" and "the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity-value of capital" (Keynes [1936] 1964, p. 376). Depriving the rentier or functionless investor of an income would also improve the equity of income distribution.

While the goal of an optimum rate of investment is to be insured by the policy of steady reduction of the interest rate, the goal of full employment depends upon the level of aggregate demand, composed of consumption and investment expenditures. Although a declining interest rate also tends to weaken the incentive to save and thus to stimulate consumption, Keynes still requires a second lever adapted specifically to changing the average propensity to consume. According to Keynes ([1936] 1964, pp. 378, 380), "[t]he State will have to exercise a guiding influence on the propensity to consume. . . ." by virtue of its involvement "in the task of adjusting to one another the propensity to consume and the inducement to invest" to generate a full-employment level of income.

For this purpose, Keynes proposes a "scheme of direct taxation" which aims at redistributing income from higher to lower income groups and thereby raising the average propensity to consume. Keynes discounts any adverse supply-side effects of this taxation policy by asserting that the prevailing price of entrepreneurial ability and risk-taking is far in excess of its supply price. According to Keynes ([1936] 1964, pp. 376–77) "the entrepreneur *et hoc genus omne* . . . are certainly so fond of their craft that their labor could be obtained much cheaper than at present. . . ." Thus Marshall's attempt to enlist economic chivalry in the service of his fondest dream of increasing standards of life for the workers by reducing the supply price of "business ability in command of capital" is replaced by Keynes's intuition that the dream is already half true and awaits for its completion only the arrival of the tax collector.

With the interest rate, the rentier, and the speculator on financial markets suppressed by socialized investment and the "economic rent" received by entrepreneurs taxed away and used to subsidize

State-provided benefits for laborers, the monetary expenses of producing goods are effectively reduced to reflect only their "real" costs of production, basically the disutilities of labor and legitimate risk-taking. Thus, for Keynes, the same central controls that secure full investment and full employment also operate to squeeze out from the production process all income payments that are unrelated to labor costs and to establish an equitable distribution of income.

Although sparse in its details, Keynes's scheme for State direction of investment and remuneration for productive activity bears more than a passing resemblance to Hjalmar Schacht's Nazi command economy, which was "based on three main controls: of costs, investment, and international trade" (Woolston [1941] 1968, p. 236). Indeed, as Brunner (1987, p. 38) points out, in order to preclude the inevitable capital efflux induced by the pegging of domestic interest rates below world levels, Keynes recognized the necessity of a system of exchange controls that "would have to be rather far-reaching and also cover domestic transactions related in some manner to international transactions." In the early 1940s, Keynes also vigorously promoted the "Schachtian device" of international barter as an alternative policy for Britain in the post-war world, if some version of his scheme for international monetary reconstruction were not accepted. Keynes (quoted in Hession 1984, p. 331) labelled anyone who signed an agreement to preclude the use of such a device in advance "as great a traitor to his country as if he were to sign away the British navy before he had a firm assurance of an alternative means of protection."

There is some evidence that Keynes himself recognized the similarity between the nationalist system based on socialized investment which he espoused and the National Socialist system of political economy implemented by Schacht in Germany. Thus, in the Foreword to the German edition of the *General Theory* published in 1936, Keynes notes that the aggregative theory of production expounded in the book "can be much easier adapted to the conditions of a totalitarian state than the theory of production and distribution of a given production put forth under conditions of free competition and a large degree of laissez-faire." Keynes also expresses satisfaction if his theory "can contribute a single morsel to a full meal prepared by German economists" (Martin 1971, pp. 203–05).

In the foregoing, I do not intend to tar Keynes with the brush of National Socialism. Far from it, I merely wish to point out that, as a millennialist theorist, Keynes trusted to his own intuition and moral rectitude in choosing and applying policies which, in the hands of the less enlightened or less righteous, would result in a social holocaust.

Keynes himself makes this point in a revealing letter written to Hayek, in which he comments on the latter's critique of planning, *The Road to Serfdom*. Writes Keynes (quoted in Meltzer 1988, p. 191):

> I should say that what we want is not no planning, or even less planning, indeed I should say that we almost certainly want more. . . . Moderate planning will be safe if those carrying it out are rightly oriented in their own minds and hearts to the moral issue. . . .
>
> I accuse you of perhaps confusing a little bit the moral and the material issues. Dangerous acts can be done safely in a community which thinks and feels rightly which would be the way to hell if they were executed by those who think and feel wrongly.

While a great deal more can and should be said regarding the evolution of Keynes's economics under the influence of his sociopolitical vision, I believe that my investigation is sufficient to indicate that the technical economics and the political economy of the *General Theory* have a definite millennialist orientation. The analytical apparatus was developed by Keynes to embody the ethical principles which he believed would govern his envisioned millennium. It was designed *ab ovo* to link up the economic failures of capitalism with the vices it characteristically fosters, "avarice, usury, and precaution."

Moreover, it was Keynes's eagerness to attain the economic precondition of this millennial state, the abolition of capital scarcity and the satiating of "disciplined" wants, which guided his application of this apparatus in formulating policy conclusions. Thus, to emphasize again, the policies which Keynes deduced were not policies of short-run fiscal fine-tuning that have come to be associated with his name. Keynes was single-minded in his politico-economic advocacy: What was required was a socialized investment policy designed to abolish financial markets and the interest rate and achieve capital saturation.

Even when he was specifically addressing the issue of short-run instability in his chapter on the "trade cycle," the tune he was playing never changed or even wavered in pitch. Under *laissez-faire* capitalism, the recurrence of "wide fluctuations in employment" could not be avoided "without a far-reaching change in the psychology of investment markets such as there is no reason to expect." He concluded that ". . . the duty of ordering the current volume of investment cannot safely be left in private hands" (Keynes [1936] 1964, p. 320). Again this is not to deny that Keynes ([1936] 1964, p. 325) supported measures for manipulation of the level of consumption, but it is clear that he viewed such measures as supplementary to his policy of socialized investment.

References

Brunner, Karl. 1987. "The Sociopolitical Vision of Keynes." In David A. Reese, ed., *The Legacy of Keynes*. New York: Harper & Row. Pp. 23–56.

Hansen, Alvin H. 1953. *A Guide to Keynes*. New York: McGraw-Hill.

Harris, Seymour E. 1955. *John Maynard Keynes: Economist and Policy Maker*. New York: Charles Scribner's Sons.

——. [1947] 1973. *The New Economics: Keynes' Influence on Theory and Public Policy*. New York: Augustus M. Kelley.

Harrod, R. F. 1951. *The Life of John Maynard Keynes*. New York: Harcourt, Brace.

Hayek, F. A. 1931. "Reflections on the Pure Theory of Money of Mr. J. M. Keynes." *Economica* 3–4 (August 1931–February 1932): 270–95, 22–44.

Heilperin, Michael A. 1962. *Studies in Economic Nationalism*. Geneva, Switzerland: Librairie E. Droz.

Hession, Charles H. 1984. *John Maynard Keynes: A Personal Biography of the Man Who Revolutionized Capitalism and the Way We Live*. New York: Macmillan.

Johnson, Elizabeth S. and Harry G. Johnson. 1978. *The Shadow of Keynes: Understanding Keynes, Cambridge and Keynesian Economics*. Chicago: University of Chicago Press.

Keynes, John Maynard. 1933. "National Self-Sufficiency." *Yale Review* 22 (June): 755–69.

——. [1930] 1958. *A Treatise on Money*. 2 vols. London: Macmillan.

——. [1921] 1962. *A Treatise on Probability*. New York: Harper & Row.

——. [1931] 1963. *Essays in Persuasion*. New York: W. W. Norton.

——. [1951] 1963. *Essays in Biography*. Ed. Geoffrey Keynes. New York: W. W. Norton.

——. [1936] 1964. *The General Theory of Employment, Interest, and Money*. New York: Harcourt, Brace and World.

——. [1920] 1971. *The Economic Consequences of the Peace*. New York: Harper & Row.

——. 1973. *The Collected Writings of John Maynard Keynes*. Vol. 13. Ed. Donald Moggridge. London: Macmillan.

Lerner, Abba. 1983. "From *The Treatise on Money to The General Theory*." In idem, *Selected Economic Writings of Abba P. Lerner*. New York: New York University Press. Pp. 393–97.

Levitt, Theodore. 1976. "Alfred Marshall: Victorian Relevance for Modern Economics." *Quarterly Journal of Economics* 90 (August): 425–43.

Marshall, Alfred. [1920] 1949. *Principles of Economics: An Introductory Volume*. 8th ed. New York: Macmillan.

Martin, James J. 1971. "J. M. Keynes's Famous Foreword to the 1936 German Edition of the *General Theory*." In idem, *Revisionist Viewpoints: Essays in a Dissident Historical Tradition*. Colorado Springs, Colo.: Ralph Miles. Pp. 197–205.

McWilliams-Tullberg, Rita. 1975. "Marshall's Tendency to Socialism." *History of Political Economy* 7 (Spring): 75–111.

Meltzer, Allan H. 1988. *Keynes's Monetary Theory: A Different Interpretation*. New York: Cambridge University Press.

Minsky, Hyman P. 1975. *John Maynard Keynes*. New York: Columbia University Press.

Mises, Ludwig von. [1936] 1951. *Socialism: An Economic and Sociological Analysis*. Trans. J. Kahane. London: Jonathan Cape.

——. 1966. *Human Action: A Treatise on Economics*. Chicago: Henry Regnery.

——. [1920] 1990. *Economic Calculation in the Socialist Commonwealth*. Trans. S. Adler. Auburn, Ala.: Ludwig von Mises Institute.

Moggridge, D. E. 1976. *John Maynard Keynes*. New York: Penguin.

Parsons, Talcott. [1937] 1968. *The Structure of Social Action: A Study in Social Theory with Special Reference to a Group of Recent European Writers*. Vol. 1. New York: Free Press.

Patinkin, Don. 1976. *Keynes' Monetary Thought: A Study of Its Development*. Durham, N.C.: Duke University Press.

——. 1982. *Anticipations of the General Theory and Other Essays on Keynes*. Chicago: University of Chicago Press.

Reimann, Günter. 1939. *The Vampire Economy: Doing Business under Fascism*. New York: Vanguard Press.

Rothbard, Murray N. 1990. "Karl Marx: Communist as Religious Eschatologist." *Review of Austrian Economics* 4: 123–79.

——. 1991. "The End of Socialism and the Calculation Debate Revisited." *Review of Austrian Economics* 5 (2): 51–76.

Salerno, Joseph T. 1990. "Ludwig von Mises as Social Rationalist." *Review of Austrian Economics* 4: 26–54.

Schumpeter, Joseph A. [1951] 1965. *Ten Great Economists: From Marx to Keynes*. New York: Oxford University Press.

Skidelsky, Robert. [1983] 1986. *John Maynard Keynes*. Vol. 1: *Hopes Betrayed, 1883–1920*. New York: Viking Penguin.

Viner, Jacob. 1952. "Viner on Marshall." In Henry William Spiegel, ed., *The Development of Economic Thought: Great Economists in Perspective*. New York: John Wiley & Sons. Pp. 718–33.

Whitaker, John K. 1977. "Some Neglected Aspects of Alfred Marshall's Economic and Social Thought." *History of Political Economy* 9 (Summer): 161–97.

Woolston, Maxine Y. [1941] 1968. *The Structure of the Nazi Economy*. New York: Atheneum House.

How and How Not to Desocialize

Murray N. Rothbard*

Everyone in Eastern Europe and the Soviet Union is seemingly anxious to desocialize, to institute free markets and privatization. Plans profilerate, and innumerable Western economists are being consulted on how to go about this daunting task. It is generally acknowledged that bureaucrats are obstructing the process, but confusion abounds among free-market proponents themselves. Matters are scarcely helped by the fact that Western economists, to whom the former Eastern bloc is looking for wisdom, have themselves done virtually nothing to study, let alone solve, this problem during the sixty years since Stalin established socialism in the Soviet Union and the half-century since the Soviets imposed it on Eastern Europe. For ever since the mid-1930s, almost all Western economists have accepted the view that there is no calculation problem under socialism, and most have accepted the subsequent notion that the Soviet economy has been successful and growing, and would shortly overtake that of the United States.[1]

How Not to Desocialize

We may first clear the way on how to desocialize by examining various paths that have become popular, and yet are decidedly *not* the way to arrive at our presumably common goal.

How *not* to go about desocialization may be highlighted by the story of a friend of mine, who told me recently about a Soviet colleague

*Murray N. Rothbard is S. J. Hall distinguished professor of economics at the University of Nevada, Las Vegas and editor of the *Review of Austrian Economics*. An earlier version of this paper was delivered at the annual meeting of the Southwestern Social Science Association, at a panel on "The Downfall of Communism," at San Antonio, Texas, in March, 1991.

[1]Murray N. Rothbard, "Ludwig von Mises and the Collapse of Socialism," delivered at the annual meeting of the Allied Social Science Association, at Washington, D.C., 1990, and published as "The End of Socialism and the Calculation Debate Revisited," *Review of Austrian Economics*, 5, no. 2 (1991): 51–76.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 65–77
ISSN 0889-3047

in his department, who came to the United States to study diligently the problem of how to create a futures market in the U.S.S.R. He has been stymied by the fact that he cannot seem to figure out what laws or edicts the Soviet state should lay down, so as to replicate the futures market in the United States. In short, he cannot find a way to plan a futures market. Here then is a crucial point: *you cannot plan markets*. By their very nature, you can only set people free so that they can interact and exchange, and thereby develop markets themselves. Similarly, several of the socialist countries, seeing the importance of the capital markets in the West, have been trying to develop stock exchanges, but with little success. First, again, because stock markets cannot be planned, and, second, because, as we will see further, you cannot have markets in titles to capital if there are still virtually no private *owners* of capital in existence.

Do not Phase In

It is, again, generally accepted that free markets must be arrived at quickly, and that phasing them in slowly and gradually will only delay the goal indefinitely. It is well known that the giant socialist bureaucracy will only seize upon such delay to obstruct the goal altogether. But there are further important reasons for speed. One, because the free market is an interconnected web or lattice-work; it is made of innumerable parts which intricately mesh together through a network of producers and entrepreneurs exchanging property titles, motivated by a search for profits and avoidance of losses, and calculating by means of a free price system. Holding back, freeing only a few areas at a time, will only impose continuous distortions that will cripple the workings of the market and discredit it in the eyes of an already fearful and suspicious public. But there is also another vital point: the fact that you cannot plan markets applies also to planning for phasing them in. Much as they might delude themselves otherwise, governments and their economic advisers are not in a position of wise Olympians above the economic arena, carefully planning to install the market step by measured step, deciding what to do first, what second, etc. Economists and bureaucrats are no better at planning phase-ins than they are at dictating any other aspect of the market. To achieve genuine freedom, the role of government and its advisers must be confined to setting their subjects free, as fast and as completely as it takes to unlock their shackles. After that, the proper role of government and its advisers is to get and keep out of the subjects' way.

Do Not Crack Down on Black Markets

One route toward freedom that former President Gorbachev had adopted was to crack down on the villains of the black market. We

might conclude that the mindset of the Eastern bloc has a long way to go in understanding freedom, except that there are precious few Westerners who understand this problem either. For the black marketeers are not villains; if they sometimes look and act like villains, it is only because their entrepreneurial activities have been made illegal. The "black market" is simply *the market*, the market which Soviets claim to be searching for, but which has turned "black" precisely because it has been declared illegal. It is the market crippled and distorted, but it is there, in this despised "black" area, that the Soviets will find the market most readily. Instead of cracking down, then, the governments should, immediately, set the black market free.

Do Not Confiscate the People's Money

The Soviet Union suffers from the problem of "ruble overhang," that is too many rubles chasing too few goods. It is generally admitted that the "overhang" is the result of comprehensive price fixing, by which the government has set prices far below market-clearing levels. Over the years, the Soviet government has been rapidly printing new money to finance its expenditures, and this increased money supply, coupled with ever-dwindling supply of goods resulting from the breakdown of socialist planning, has created aggravated shortages and an excess supply of money over goods available.

It is commonly acknowledged that the shortages will be relieved and the overhang abolished, if prices were set free to move. But the government fears the wrath of unhappy consumers. Perhaps, but it is scarcely a solution to do what Gorbachev did, that is, follow the uninspired path of the Brazilian "free market" President Collor de Mello, who in the spring of 1990, in an attempt to reverse hyperinflation, arbitrarily froze 80 percent of all bank accounts. Gorbachev did one better by suddenly making useless all large-ruble bills, allowing only a small number to be exchanged for smaller dominations. This is no way to eliminate an overhang; at best, the cure is much worse than the disease. In the first place, in this supposed strike at black marketers, it has been rather the savings of the average Soviet that has been destroyed, since the black marketeers were shrewd enough to have moved already into precious metals and foreign currency. But even more important: By this action, the government delivers the second body blow of a one-two punch at the average citizen, and at the economy. The first punch was for the government to inflate the money supply so as to engage in its usual, wasteful expenditures. Then, after the money has been spent, and prices driven up—in either open or repressed fashion—then the government, in its wisdom, begins

to exclaim at the horrors of inflation, blames black marketeers, greedy consumers, the rich, or whatever, and proceeds to the second monstrous punch of confiscating the money long after it has come into private ownership. Whether or not one calls this process "free market," it remains confiscatory, unjust, statist, and a double set of implicit taxes and burdens upon the economy.

Do Not Increase Taxes

Unfortunately, one of the "lessons" that many East Europeans have absorbed from Western economists is the alleged necessity of sharply raising taxes and making them progressive. Taxes are parasitic and statist; they cripple energies, savings, and production. Taxes invade and aggress against the rights of private property. The higher the taxes, the more the economy becomes socialistic; the lower they are, the closer the economy approaches true freedom and genuine privatization, which means a system of complete rights of private property. The Mazowiecki attempt to achieve privatization and free markets in Poland was greatly hampered by the imposition of far higher and progressive taxes.

As part of the shift toward freedom and desocialization, then, taxes should be drastically lowered, not raised.

Government Firms Owning Each Other is Not Privatization

I owe to Dr. Yuri Maltsev the information that the much-vaunted Shatalin plan for the Soviet Union, which was supposed to bring about privatization and free markets in 500 days, was really not privatization at all. Apparently, existing government firms in each industry, instead of being actually privatized—that is, owned by private individuals—would have been owned (or 80 percent owned) by other firms in the same industry. This would mean that giant state monopoly firms would continue to be state monopoly firms, and be self-perpetuating oligarchies rather than truly privately owned. Privatization must mean private property.[2]

[2]As Maltsev writes: "When the Soviets say privatization, however, they don't mean what we do by the term. The [Shatalin] plan would mandate that 80 percent of the stock of any enterprise be owned by other enterprises in the same field, not the public. To use a U.S. analogy, it would be as if General Motors owned 80 percent of Ford's stock and vice versa, and it were illegal to have it otherwise." Maltsev notes that Stanislav Shatalin, and the original author of his plan for the Russian Republic, Grigory Yavlinsky, "are both econometricians whose . . . lives have been spent in mathematizing the delusions of Marxism-Leninism. They are both long-time central planners who became disillusioned with full-blown socialism." Yuri N. Maltsev, "A 500-Day Failure?" *The Free Market* 8 (November 1990): 6.

How to Desocialize

The following points of desocialization must necessarily be written or read sequentially, but they need not be carried out in that manner: all the following points could, and should, be instituted immediately and all at once.

Legalize the Black Market

The first two planks are implicit in the previous part of this paper. One, is to legalize the black market, that is to make all markets free and legal. That means that the private property of all those engaging in such markets must, along with everyone else, be made secure from government depredation, secure as a right of ownership. It means also that all goods and services hitherto illegal are now to be legal, whether they are legal in the West or not, and that all transactions are to be engaged in freely, that is, that prices are to be set voluntarily by the exchanging parties. Thus, all government price control is to be abolished forthwith. If such genuine prices for real transactions are to be higher than pseudo-"prices" set by the government for non-existent transactions, then so be it. Consumer griping should simply be ignored; any consumers who still prefer the previous regime of fixed prices for non-existent goods will, of course, be free to boycott the new prices and try to find cheaper sources of supply elsewhere. My hunch, however, is that consumers will adjust soon enough to these one-shot changes, especially since unprecedented abundance of consumer goods will quickly pour forth onto the markets.

By "legalizing," by the way, I mean simply abolishing a previous outlaw status; I do not propose to engage in semantic exercises trying to distinguish between "legalizing" and "decriminalizing."

Drastically Lower All Taxes

Another implication of our previous analysis is that taxation should be cut drastically. There is, in the literature on taxation, far too much discussion about which types of taxes are to be imposed, and who is to pay them and why, and not nearly enough on the height or amount of taxes to be levied. If the tax rate is low enough, then the form or principles of tax distribution really makes very little difference. To put it starkly, if all tax rates are kept below one percent, then it really does not matter much economically whether the taxes are on incomes, sales, excises, property, or capital gains. It is important instead to focus on how much of the social product is to be siphoned off to the unproductive maw of government, and to keep that burden ultra-minimal.

While the form of taxation would not then matter economically, it would still matter *politically*. An income tax, for example, however low, would still maintain an oppressive system of secret police ready and willing to investigate everyone's income and spending and hence his entire life. Economists' opinion to the contrary, there is no tax or system of taxes that could be neutral to the market.[3] Whatever taxation that might exist after desocialization should, however, be as close to neutral as possible. This would mean, in addition to very low rates and amounts, that the taxation be as unobtrusive and harmless as possible, and imitate the market as closely as it can. Such imitation might include the voluntary sale of goods and services at a price, or setting a price for participating in voting. The sale of goods or services by the government would, of course, be drastically limited in our desocialized system, because of the enormous scope of privatization of government activities. Privatization will be treated below.

Abolish the Government's Ability to Create Money

There are three parts to any government's ability to generate revenue: taxation, the creation of new money, and the sale of goods or services.[4] There can be no genuine free market or desocialization so long as government is permitted to *counterfeit* money, that is create new money, whether it be paper tickets or bank deposits, out of thin air. Such money creation functions as a hidden and insidious form of taxation and expropriation of the property and resources of producers. Ending counterfeiting means getting the government out of the money business, which in turn implies eliminating both government paper money and central banking. It also means denationalizing currency units, such as the ruble, forint, zloty, etc., and returning them to private market hands. Denationalizing currency can only be achieved by redefining paper currencies in terms of units of weight of a market metal, preferably gold. When the central banks are liquidated, they could disgorge their gold hoards; as their last act on earth they could redeem all their paper tickets at the redefined weight in gold coins.

While, given the will to desocialize, this monetary denationalizing process is not as complex or difficult as it may first seem, it might indeed take longer than the one day required for the other

[3]See Murray N. Rothbard, "The Myth of Neutral Taxation," *Cato Journal* 1 (Fall 1981): 519–64.

[4]A fourth form of revenue, borrowing from the public, is strictly dependent on the other three sources.

parts of our plan.[5] There could then be transitional steps of a few days' length: that is, the ruble or forint could be allowed to fluctuate freely and be convertible at market exchange rates into other currencies. It would still be imperative to take the money-creating power out of the hands of the national government; a possible way of doing that, and a second transitional step, would be to make the ruble convertible into harder currencies, such as the dollar, at some fixed rate. Pending return to a pure gold standard and liquidation of the central bank, it would also be important to curb the government's power to create money by freezing permanently all central bank activities including open market operations, loans, and note issues. It need hardly be added that a law or edict limiting or freezing the government itself is *not* an act of intervention into the economy or society. Quite the contrary.

Just as black markets and all private markets would be set free, so too private credit institutions, for the lending of savings or the channeling of the savings of others, would be set free to develop.

Fire the Bureaucracy

A question may have occurred to the reader: If taxation is to be drastically lowered, and the government is to be deprived of its power to print or create money, then how is the government going to finance its expenditures and operations? The answer is: It wouldn't have to, because there would be precious little left for government to do. (This will be explained further in the discussion of privatization below.) The socialist economy is a command economy, staffed and run by a gigantic bureaucracy. That bureaucracy would immediately be fired, its members set free at long last to find productive jobs, and develop whatever productive abilities they might have, in the now rapidly expanding and flourishing private sector.

This brings us to a fascinating problem which, while resting long in the hearts and minds of the oppressed subjects of socialism, has now unexpectedly become a live political issue. What is to be done with and to the top Communist party cadre, to the *nomenklatura*, to the vast apparatus of the once all-powerful secret police? Should justice at last be meted out to them by a series of state-crime trials, followed by proper and condign punishment? Or should bygones be bygones, a general amnesty be declared, and ex-KGB men hired as private guards or detectives? I confess an ambivalence on this issue,

[5]See Yuri N. Maltsev, "A One Day Plan for the Soviet Union," *Antithesis* 2 (January/February 1991): 4, and in the earlier account, "The Maltsev One-Day Plan," *The Free Market* (November 1990): 7.

in weighing the competing claims of justice and of social peace. Fortunately, the decision can be left to the peoples of the former Soviet Union and of Eastern Europe. There is not much that an economist, even a free-market economist, can say to resolve this issue.

Privatize or Abolish Government Operations

This brings us to the final, but scarcely the least important, plank of our proposed desocialization platform: privatizing government operations. Since theoretically all, or in practice *most*, production in socialist countries has been in the hands of the State, the most important desideratum, the crucial route for attaining a system of private property and free market, must be to privatize government operations.

But simply to say "privatize" is not enough. In the first place, there are many government operations, especially in socialist states, that we don't *want* to privatize, but rather to abolish completely. For example, we would not, as libertarians and desocializers, wish to privatize concentration camps, or the Gulag, or the KGB. God forbid that we should ever have an *efficient* supply of concentration-camp or secret police "services"!

Here is a point that needs to be underlined. The basic assumption of national income and GNP analysis is that all government operations are productive, that they contribute their expenses to the national output and the common weal. But if we truly believe in freedom and private property, we must conclude that many of these operations are not social "services" at all but *dis*services to the economy and society, "bads" rather than "goods."

This means that desocialization must involve the abolition, not the privatization, of such operations as (in addition to concentration camps and secret police facilities) all regulatory commissions, central banks, income tax bureaus, and, of course, all the bureaus administering those functions that are going to be privatized.[6]

Principles of Privatization

Genuine goods and services, then, are to be privatized. How is this to be accomplished? In the first place, private competition with

[6]It is important to realize that if a government activity is a bad rather than a good, we would want its exercise, so long as it exists, to be as *in*efficient rather than as efficient as possible. One of the most hated organizations in early modern Europe was the "tax farmer," who purchased from the king, the right to collect taxes for a certain term of years. We might consider: would we want income taxes to be privatized, and collected, fully armed with state power, by IBM or McDonald's rather then the IRS? The industrialist Charles F. Kettering is supposed to have cheered up a friend in the hospital, who was complaining about the accelerated growth of government: "Cheer up, Jim, thank God we don't get as much government as we pay for."

previous government monopolies is to be free and unhampered. This would legalize not only the black market, but all competition with existing government operations. But what about the massive accumulation of government firms and capital assets themselves? How are they to be privatized?

Several possible routes have been suggested, but they can be grouped into three basic types. One is egalitarian handouts. Every Soviet or Polish citizen receives in the mail one day an aliquot share of ownership of various previously state-owned properties. Thus, if the XYZ steel works is to be privately owned, then, if there are 300 million shares of XYZ steel company issues, and 300 million inhabitants, each citizen receives one share, which immediately becomes transferable or exchangeable at will. That this system would be impossibly unwieldy is evident. The number of people would be too much and shares too few to allow every person to have a share, and there would be shares of innumerably large numbers and varieties that would quickly descend upon the heads of the average citizen. Much of this chaos would be eliminated in the suggestion of Czech finance minister Vaclav Klaus, who proposes that each citizen receive basic certificates, which could be exchanged for a certain number or variety of shares of ownership of various companies on the market.

But even under the Klaus plan, there are grave philosophical problems with this solution. It would enshrine the principle of government handouts, and egalitarian handouts at that, to undeserving citizens. Thus would an unfortunate principle form the very base of a brand new system of libertarian property rights.

It would be far better to enshrine the venerable *homesteading* principle at the base of the new desocialized property system. Or, to revive the old Marxist slogan: "all land to the peasants, all factories to the workers!" This would establish the basic Lockean principle that ownership of owned property is to be acquired by "mixing one's labor with the soil" or with other unowned resources. Desocialization is a process of depriving the government of its existing "ownership" or control, and devolving it upon private individuals. In a sense, abolishing government ownership of assets puts them immediately and implicitly into an *unowned* status, out of which previous homesteading can quickly convert them into private ownership. The homestead principle asserts that these assets are to devolve, not upon the general abstract public as in the handout principle, but upon those who have actually worked upon these resources: that is, their respective workers, peasants, and managers. Of course, these rights are to be genuinely *private*; that is, land to individual peasants, while

capital goods or factories go to workers in the form of private, negotiable shares. Ownership is not to be granted to collectives or cooperatives or workers or peasants holistically, which would only bring back the ills of socialism in a decentralized and chaotic syndicalist form.

It should go without saying that these ownership shares, to be truly private property, must be transferable and exchangeable at will by their holders. Many current plans in the socialist countries envision "shares" which must be held by the worker or peasant and, for a term of years, could only be sold back to the government. This clearly violates the very point of desocialization. Other suggested plans impose severe restrictions upon the transfer of ownership to foreigners. Once again, genuine privatization requires complete private property, including sale to foreigners. There is, furthermore, nothing wrong with "selling the country" to foreigners. In fact, the more that foreigners purchase "the country" the better, for it would mean rapid injections of foreign capital, and therefore more rapid prosperity and economic growth in the impoverished socialist bloc.

A problem immediately arises in granting shares to workers in the factories, a problem akin to the question what is to be done with the Communist cadres and the KGB: Should the managing *nomenklatura* be cut in on the shares of ownership? In advising the Soviets in an address in Moscow in early 1990, the economist Paul Craig Roberts observed that the Soviet people could either cut the throats of the *nomenklatura* or cut them in on shares of ownership; for the sake of social peace and smooth transition to a free economy, he recommended the latter. As I wrote above, I would not be that quick to thwart the demands of justice; but I would like to point out again a third possible route: not doing either one, and freeing the *nomenklatura* to find productive jobs in the private sector. The philosophic point in contention is to what extent, if at all, the managers' activities in the old Soviet economy were productive, and therefore participant in homesteading-labor, and to what extent they were crippling and counter-productive, and therefore deserving of nothing better than a curt dismissal.[7]

A third commonly suggested route to privatization deserves to be rejected out of hand: that the government sell all its assets to the public at auction, to the highest bidder. One grave flaw in this approach is that since the government owns virtually all the assets,

[7]Yuri Maltsev recommends adoption of the homesteading plan, with the Vaclav Klaus distribution scheme to be adopted in cases where homesteading would not be feasible. Maltsev, "A One-Day Plan for the Soviet Union."

where would the public get the money to purchase them, except at a very low price that would be tantamount to free distribution? But another, even more important flaw hasn't been sufficiently stressed: why does the government deserve to own the revenue from the sale of these assets? After all, one of the main reasons for desocialization is that the government does not deserve to own the productive assets of the country. But if it does not deserve to own the assets, why in the world does it deserve to own their monetary value? And we do not even consider the question: What is the government supposed to do with the funds after they have been received?[8]

A fourth principle of privatization should not be neglected; indeed, it should take priority. Unfortunately, by the nature of the case this fourth route cannot be made into a general principle. That would be for the government to return all stolen, confiscated property to its original owners, or to their heirs. While this can be done for many parcels of land, which are fixed in land area, or for particular jewels, in most cases, especially capital goods, there are no identifiable original owners to whom to restore property.[9] In the nature of the case, finding original landowners is easier in Eastern Europe than in the Soviet Union, since far less time has elapsed since the original theft. In the case of capital goods built by the State, there are no owners to identify. The reason why this principle should take priority wherever it applies is because property rights imply above all restoring stolen property to original owners. Or to put it another way: An asset becomes philosophically unowned, and therefore available to be homesteaded, only where an original owner, if one had existed, cannot be found.

There is one nagging remaining problem: How large should the newly private firms be? Every industry in socialistic countries is generally locked into a monopoly firm, so that if each firm is privatized into an equivalent-sized firm, the size of each will be far larger than the optimum on the free market. A fundamental problem, of course, is that there is no way for anyone in a socialized economy to figure out what the optimum size or number of firms is going to be under freedom. In a sense, of course, mistakes made in the shift to

[8]One leading argument for the government selling its assets is that this process would have the anti-inflationary effect of sopping up the dread "ruble overhang." The fallacy in this egregious argument is that, unless the government officials propose to have a mass public bonfire of the rubles, the overhang would not be reduced at all. The government would spend the rubles, and they would remain in circulation.

[9]In Hungary, the Smallholders Party was formed to stress priority in privatization to returning land to the expropriated landholders of Southern Hungary.

freedom will tend to iron themselves out after a free market is established, with tendencies to break up or to consolidate in the direction of optimum size and number. On the other hand, we must not make the mistake of blithely assuming that the costs or inefficiencies of this process may be disregarded. It would be preferable to come as close as possible to the optimum in the initial privatization. Perhaps each plant, or each group of plants in an area, may be initially privatized as a separate firm. It goes without saying that a very important aspect of a free market and of this optimizing process is to allow the market complete freedom to work: e.g., to merge, combine, or dissolve firms as it proves profitable.

Conclusion

The dimensions of the proffered Rothbard Plan for desocialization should now be clear: (1) Enormous and drastic reductions in taxes, government employment, and government spending. (2) Complete privatization of government assets: where possible to return them to the original expropriated owners or their heirs; failing that, granting shares to productive workers and peasants who had worked on these assets. (3) Honoring complete and secure property rights for all owners of private property. Since full property rights imply the complete freedom to make exchanges and transfer property, there must be no government interference in such exchanges. (4) Depriving the government of the power to create new money, best done by a fundamental reform that at one and the same time liquidates the central bank and uses its gold to redeem its notes and deposits at a newly defined unit of gold weight of existing currencies. All this could and should be done in one day, although the monetary reform could be done in steps taking a few days.

One point we have not specified: precisely how low should taxes or government employment or spending be set, and how complete should be the privatization? The best answer is that of the great Jean-Baptiste Say, who should be known for many other things than Say's Law: "The best scheme of [public] finance is, to spend as little as possible; and the best tax is always the lightest."[10] In short, that government is best that spends and taxes and employs the least, and privatizes the most.

A final point: I have been criticized by libertarian colleagues for proposals of this sort because they involve action by government. Isn't

[10]Jean-Baptiste Say, *A Treatise on Political Economy*, 6th ed. (Philadelphia: Claxton, Remsen & Haffelfinger, 1880), p. 449. Also see Rothbard, "The Myth of Neutral Taxation," pp. 551–54.

it inconsistent and statist for a libertarian to advocate any government action whatever? This seems to me a silly argument. If a thief has stolen someone's property, it is scarcely upholding "robber-action" to advocate that the robber disgorge his stolen property and return it to its owners. In a socialist state, the government has arrogated to itself virtually all property and power of the country. Desocialization, and a move to a free society, necessarily involves the action of that government's surrendering its property to its private subjects, and freeing those individuals from the government's network of controls. In a deep sense, getting rid of the socialist state requires that state to perform one final, swift, glorious act of self-immolation, after which it vanishes from the scene. This is an act which can be applauded by any lover of freedom, act of government though it may be.

The Role of Entrepreneurship in Desocialization

Jeffrey M. Herbener*

Now that communism has been repudiated across Central and Eastern Europe, the most pressing challenge for economic theory is to outline a process of desocialization for the former communist countries. Socialism's most obvious economic failure is its inability to produce the goods necessary for its citizens to have even a modest standard of living by Western, capitalist standards. Because, as Ludwig von Mises stressed, the entrepreneur is the driving force behind the social creation of wealth, any policy of desocialization must incorporate an understanding of the role of entrepreneurship in social production.[1] Because entrepreneurship is an integral part of their theories, Austrian school economists have more readily provided viable desocialization plans than those of other schools of thought.[2] Formulating a social system with the proper channels for entrepreneurial expression is essential for newly emerging capitalist countries and for interventionist ones, such as the United States, as they seek to revitalize their stagnating economies.

To anyone concerned with the problems of economic prosperity and the progress of civilization, an understanding of entrepreneurship and its institutional prerequisites is essential. The first step is to develop the economic theory of entrepreneurship applicable to every action; The next is to discuss entrepreneurship in a free market

*Jeffrey M. Herbener is assistant professor of economics at Washington and Jefferson College.

[1]Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, [1949] 1966), pp. 297, 299, and 336.

[2]It is a widely accepted observation that neoclassical economics has no significant role for the entrepreneur due to its formalistic character. At best the entrepreneur is an afterthought in neoclassical theory, awkwardly appended to its formal, usually mathematical, models. For example, see Israel Kirzner, *Discovery and the Capitalist Process* (Chicago: University of Chicago Press, 1985), pp. 1–25 and 68–92.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 79–93
ISSN 0889-3047

and how it compares to entrepreneurship under a socialist system. Only then can one construct a program of desocialization that calls forth the greatest quantity and quality of entrepreneurial activity in social production and exchange.

The Role of Entrepreneurship in Human Action

Economic theory is constructed by deducing the necessary consequences of the irrefutable fact that human action exists.[3] The purposefulness of human action provides the foundational concepts from which all economic theory stems: ends, means, ideas, scarcity, choice, preference, value, cost, profit and loss, etc. When engaging in action an individual must evaluate potential courses of action, choosing one he prefers and setting aside others of lesser value; formulate ideas concerning how the end might be attained by the combining of means, choosing the highest evaluated recipe for action; and evaluate the means required by the recipe, come to control these means in action (i.e., own them) and so be able to combine them in an attempt to attain the end. In each action, the actor views means as either consumer goods, ones immediately available to satisfy an end, or producer goods, ones intermediate to the creation of a consumer good. Producer goods can be further sub-categorized into labor—human effort, land—naturally existing items, and capital—man-made goods. An essential feature of the means of production is diversity; not only is each person's labor different from that of every other person, so each parcel of land and each type of capital good is different from every other.

It follows immediately from the fact of action that when engaging in human action, i.e., applying means according to ideas to attain ends, individuals face an uncertain future. It is this uncertainty that calls forth the skill of entrepreneurship in each action a person takes. If the future state of affairs were known in advance with deterministic certainty, human action would be negated since the individual would not find it necessary to evaluate various ends (choosing the most preferred and setting aside others), to formulate ideas about how the end can be attained, nor to assess and accumulate the means he believes can be used cooperatively to attain the end. People would simply live out the preordained activities seen beforehand, never

[3]On the method of economics see Mises, *Human Action*, pp. 1–10 and 30–71; Hans-Hermann Hoppe, *Praxeology and Economic Science* (Auburn, Ala.: Ludwig von Mises Institute, 1988); and Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash Publishing, 1962), pp. 1–2 and 63–66. On these basic economic principles, see Rothbard, *Man, Economy, and State*, pp. 1–62.

making errors in action caused by lack of foresight. Choice, as action requires it, would no longer be necessary; rather the problem of choice would be solved mechanically, much like solving an algebra problem.[4]

While not deterministic, neither can a person's perception of future states of affairs be random. The very existence of human action negates this possibility as well, since no action could be purposeful in a random world lacking any ability to predict the outcome of using means in any particular way, e.g., drinking milk nourishes one time and poisons the next. For human action to exist, the world outside the actor's mind must be orderly; i.e., characterized by time-invariant physical laws governing relationships among means, and subject to discovery by acting individuals.[5]

Uncertainty as a condition of human action lies between determinism and randomness, and implies the human capacity to form expectations of the future that do not diverge completely from it nor adhere completely to it.[6] Entrepreneurship is the human ability to deal with uncertainty. Since every action is taken in the face of uncertainty, every action exhibits entrepreneurship, either to a lesser or greater degree.[7]

For an isolated individual the problem of uncertainty, for which entrepreneurship must provide a solution, concerns only the physical laws governing the relationships among means and the perceptions of his mind. Any action Robinson Crusoe takes requires him to apply his

[4]This is precisely the neoclassical view of choice. While necessary to draw out the conclusions from the aspects of choice not concerned with uncertainty, economic theory is incomplete at best and absurd at worst until propositions incorporating uncertainty are developed. This is one area where Austrian economics is far in advance of neoclassical economics. The neoclassical economists' frequent assumption of no uncertainty leads them to accept mathematical techniques in building theory and forces them to ignore the crucial role of entrepreneurship in human action. On the use of the technique of imaginary construction to build economic theory see Mises, *Human Action*, pp. 236–37; on uncertainty in action, pp. 105–18; and on general equilibrium and entrepreneurship, pp. 244–56.

[5]See Mises, *Human Action*, pp. 22–27 and 99–100; and Hoppe, *Praxeology and Economic Science*, pp. 18–19 and 32–34.

[6]The absence of randomness in human action precludes the use of statistical techniques based on the assumption of a data-generating process that produces data randomly. Econometrics violates both conditions: the absence of determinism, by assuming constants, and the absence of randomness, by assuming probability distributions. See Frank Knight, *Risk, Uncertainty and Profit* (New York: Kelley and Millman, 1957) pp. 22–48 and 197–232; and Mises, *Human Action*, pp. 106–15.

[7]On the differences between entrepreneurship in every action and specialized entrepreneurs see Mises, *Human Action*, pp. 252–55.

labor, which he owns naturally, to transform his physical surroundings into capital goods and eventually consumer goods (i.e., to homestead the island) which he then owns as the product of his labor. In so attempting to attain an end, he can act erroneously by, say, trying to catch fish with his bare hands because, e.g., he underestimates the difficulty of the task or he overestimates the benefit of having the fish.

The Role of Entrepreneurship in a Free Market

Those who wish to participate in the social interaction of voluntary exchange and the division of labor have additional and more difficult entrepreneurial tasks, namely, to discover and to forecast the subjective values of other people. Despite this obstacle, most people prefer engaging in social interaction, instead of acting in isolation, because they benefit from it. This benefit derives from a primal fact of human existence: Individuals differ from one another, both in subjective values and labor skills.[8] The former creates gain in subjective value from engaging in voluntary exchange as existing goods move from those who value them less to those who value them more, while the latter creates a gain in production from a division of labor as existing factors of production move from higher cost activities to lower cost activities. It is in these interactions that entrepreneurship finds its socially beneficial channels and plays its central role in the creation of society and progress of civilization.

The desire a person has to acquire the benefit of social interactions is insufficient to accomplish action in this setting. In addition, he must accurately forecast the subjective values of others to effectively participate in social production and exchange. Voluntary exchange requires that each person who wants to participate must produce and bring to market a good that other people find of sufficient subjective value that they will exchange valuable goods they own for it. While everyone must exhibit this skill to some extent, it is possible for individuals to arrange their production of consumer goods according to a division of labor where specialized entrepreneurs take over this function.

For most activities, people prefer the greater efficiency of arranging production according to comparative advantage and then obtaining goods by voluntary exchange, compared to self-sufficient productive

[8]Economic theories that ignore the diversity of labor, as well as that of other means, cannot adequately describe social production or explain the social role of entrepreneurship. See Mises, *Human Action*, pp. 157–65.

efforts. Taking the factors of production he justifiably owns (his labor and homesteaded land and capital), each individual voluntarily contracts with others to use his property for specific tasks in cooperation with them. Entrepreneurship becomes a part of the division of labor as some show greater abilities to deal with uncertainties inherent in the process of social production. Specialized entrepreneurs perform the social functions of dealing with uncertainty, coordinating the diverse labor (and other factors) of numerous individuals, and directing production into the most socially valuable ends. The latter two activities would be impossible without money as a basis for economic calculation.

Money is essential for the development of any advanced, i.e., industrial, economic production.[9] Without it no cardinal unit common to all exchange would exist and thus, participants would have no basis for making meaningful comparisons of the social value and cost of using diverse goods in action. Prices, which can exist only in money terms, that are determined in voluntary exchange indicate the degree of scarcity of goods; i.e., the subjective value placed on them relative to the amount of them in existence. Because money prices reflect subjective value and exist in cardinal units, they can be the ingredients of economic calculation.

Calculation of profit and loss is the process by which individuals determine what and how to produce in the complex latticework of social production.[10] Without economic calculation, a social system would not be able to register true preferences for consumer goods or produce them rationally, i.e., taking account of opportunity costs. Money prices determined by the free exchange of private property ownership reflect the social scarcity of goods as individuals, demonstrating their preferences, freely buy, surrendering the value of other consumer goods, or refuse to buy, preferring the value of other consumer goods. Existing prices provide indispensable information from which entrepreneurial forecasts of the future scarcity of consumer goods can be made. Only then can entrepreneurs coordinate current productive activities to create those consumer goods with the greatest future social value.

The more difficult problem solved by economic calculation is selecting from the numerous techniques available to create a given consumer good. Without money prices, different techniques using various amounts and types of factors of production cannot be compared

[9]See Ibid., pp. 257–69, 405–08, and 520–23.
[10]See Ibid., pp. 200–31 and 698–715.

since they are denominated in non-comparable units, e.g., labor in hours and land in acres. Each factor must be evaluated with a common standard, denominated in cardinal numbers, to make comparisons among the techniques possible. Money prices for the factors of production reflect the value of those factors in the production of alternative consumer goods; thus, by comparing the total monetary payments required to produce a given consumer good using different techniques, the entrepreneur can determine which technique is socially efficient; i.e., which results in the lowest value of foregone consumer goods. In the absence of economic calculation, choosing one technique from among the many available can only be done arbitrarily and hence, irrationally.[11]

Entrepreneurs guide social production toward the attainment of desirable consumer goods by assuming the function of coordinating those who cooperate in the division of labor. This is accomplished through voluntary exchange, as each entrepreneur forms a business firm to contract with owners of factors of production internally and then to contract with the firms of other entrepreneurs externally.[12] Through these contractual agreements, entrepreneurs construct a grand latticework of production from higher stage capital goods to lower stage capital goods to consumer goods. A structure of almost infinite complexity in its detail, requiring the coordination of all factors of production in the economic system, it is completely flexible in the service of changing consumer desires within the boundaries of private property ownership, technological possibilities, and existing capital goods. Entrepreneurs also bring about the transfer of factors of production across time, according to individual preferences, from producing current consumer goods to producing current capital goods necessary to build the structure so that the production of future consumer goods can increase.

It is through these contracts that entrepreneurs assume the uncertainty inherent in social production. They agree to pay the owners of the factors of production fixed sums of money in exchange

[11]This is why Mises describes central planners in socialism as "groping in the dark." See *Human Action*, pp. 700–01. He also points out that Robinson Crusoe cannot engage in economic calculation (*Human Action*, p. 205). However, calculation is unnecessary for solving the problem of acting for Crusoe; economic calculation is necessary only for social systems requiring coordination of a division of labor and hierarchy of capital goods.

[12]On contracting see Armen Alchian and Harold Demsetz, "Production, Information Costs, and Economic Organization," *American Economic Review* 62 (December 1972): 777–95.

for the use of these factors in production, the output of which they own, be it a capital good or consumer good. Because the market value of the factors is known in advance of production while the market value of the goods produced is not known until after they are produced, entrepreneurs become residual claimants, earning the profit or suffering the loss from the production process the magnitudes of which cannot be known in advance of production itself. It is their residual claimant status that links the incentive of entrepreneurs to actions that have demonstrable social value.

The ability to appeal to profit and loss gives entrepreneurs the information, incentive, and calculational process to act in accordance with social values, both externally from their business to others across the structure of production, and internally as a way to continuously check operations within their firm. Entrepreneurial activity can, therefore, penetrate into the firm's internal operations. Mises says:

> Business management or profit management is management directed by the profit motive. The objective of business management is to make a profit. As success or failure to attain this end can be ascertained by accounting not only for the whole business concern but also for any of its parts, it is feasible to decentralize both management and accountability without jeopardizing the unity of operations and the attainment of their goal. Responsibility can be divided. There is no need to limit the discretion of subordinates by any rules or regulations other than that underlying all business activities, namely, to render their operations profitable.[13]

The test of profit and loss applies not only to the firm vis-à-vis the market, but also within the firm as entrepreneurs use it to check the viability of internal operations. Thus, entrepreneurial activity has full reign both within firms (via both general and specialized entrepreneurship) and across firms (via specialized entrepreneurship) firms in a market system.[14]

While the process of exchange and production is driven by entrepreneurs, its goal is the satisfaction of the subjective values of those who participate as consumers and owners of factors of production. And thus, it is also a continuing testing ground for the selection of

[13]Ludwig von Mises, *Bureaucracy* (Cedar Falls, Iowa: Center for Futures Education, [1944] 1983), pp. 45–46.

[14]The need to check the profitability of each internal operation of the firm requires money prices that can only be determined by the buying and selling of those outside the firm. Thus, in capitalism if a firm grew to encompass the entire market, entrepreneurs would no longer be able to apply economic calculation to its internal operations. This is *the* economic problem of socialism. See Rothbard, *Man, Economy, and State*, pp. 544–50.

specialized entrepreneurs who best fulfill its goal. Those who cannot consistently earn profits and avoid losses will be weeded out from the ranks of specialized entrepreneurs, as capitalists, seek to provide funds to those who produce for them the highest returns.

The Role of Entrepreneurship in a Socialist System

Since social production requires the coordination of numerous, diverse individuals all engaging in human action, every social system must have channels for entrepreneurship. Social production cannot exist without entrepreneurship but each economic system opens different channels to it and opens them to different degrees. In the free market all channels are open to entrepreneurship within the boundaries of private property ownership and voluntary exchange. In socialism with state ownership of the means of production and legal prohibition of voluntary contracts, entrepreneurship is severely repressed and misdirected as its social functions are encroached upon by coercion and bureaucracy. Within the framework of the central plan, entrepreneurship takes on a peripheral role. Instead of being the driving force behind social production it becomes the means of coping with the contradictory and impossible demands of the plan. And yet, the ability of entrepreneurship to satisfy its social functions cannot be eradicated, a fact partially responsible for the economies of communist countries continuing to limp along year after year, providing their long-suffering citizens a meager standard of living.[15]

By eliminating private property and voluntary exchange, socialism eliminates money and money prices, and thus economic calculation and with it rational production. The planners not only cannot determine the relative scarcities, i.e., social value, of consumer goods, they have no meaningful way to choose among the various production techniques available to create the (socially) arbitrary list of consumer goods they have selected. They cannot rationally arrange a division of labor, lacking as they do information, incentives, and a calculational process. Under such conditions it becomes extremely difficult,

[15]For the most recent exposé on the suffering of the Soviet citizen, see Paul Craig Roberts and Karen LaFollette, *Meltdown Inside the Soviet Economy* (Washington, D.C.: Cato Institute, 1990), pp. 39–74. They report Mikhail Gorbachev himself publicly announcing in 1988 that the Soviet economy had not grown for twenty years (p. 1). Coupled with the fact that the Soviet citizen's standard of living lags behind that in many Third World countries (p. 5) the truth of the dismal failure of Soviet attempts at central planning is evident. For similar accounts of the Hungarian and Peruvian citizens respectively, see Ivan Szelenyi, *Socialist Entrepreneurs* (Madison: University of Wisconsin Press, 1988); and Hernando de Soto, *The Other Path* (New York: Harper & Row, 1989).

if not impossible, for the planners to exhibit entrepreneurship even if one assumed that they had comparative advantage in it.[16] Encompassed within the "single factory" that the economy becomes under socialism, the amount and accuracy of entrepreneurial insight are greatly diminished, severely hampering the social functions only entrepreneurs in the performance of their social functions.

Being planned from the top, the structure of production in a socialist economy must be simple and rigid vis-à-vis a capitalist economy since every production process in every stage of production must be written down and coordinated by the small group of planners.[17] This process parallels what a specialized entrepreneur does within his business firm in planning internal operations, which illustrates why such a plan must be almost infinitely more simple than the entire free market production structure encompassing, as it does, all the insight and plans of every entrepreneur across all businesses. Socialism formally taps the entrepreneurial skill of only the central planners while capitalism formally provides a channel for the entrepreneurial insight and energy of everyone, either in a specialized role or generally, i.e., in every action.

The absence of private property and voluntary contract also nearly eliminates the ability of (potential) entrepreneurs, within the "single factory," to assume the uncertainty of social production by becoming residual claimants. They are thus, unable to fulfill their social role in production or provide a testing ground to discover who has comparative advantage as specialized entrepreneurs. Instead, those involved in the process of production from the higher stage capital goods through to the lower stage capital goods and finally to the consumer goods become creatures of the bureaucracy. The central planners and bureaucrats issue orders, backed by coercion, to achieve production goals and thus, must rely on bureaucratic management, instead of profit and loss management, for fulfillment of the plan.

Mises defines bureaucratic management as, "the method applied in the conduct of administrative affairs the result of which has no cash value on the market," or "management of affairs which cannot

[16]The presumption would be quite the opposite; that those who rise to the top in the political process have comparative advantage in the skills needed to do so and not superior forecasting of future subjective values of others or propensity for accepting the burden of uncertainty. See F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944), pp. 134–52.

[17]For examples of how inferior the structure of production is in the Soviet Union, see Roberts and LaFollette, *Meltdown*, pp. 7–37. The contrast between the smooth operation within a capitalist firm and the chaos within the socialist "single factory" is remarkable.

be checked by economic calculation."[18] Lacking the method of economic calculation, bureaucrats cannot exhibit entrepreneurship to any significant degree. Mises says:

> Bureaucratic management is management bound to comply with detailed rules and regulations fixed by the authority of a superior body. The task of the bureaucrat is to perform what these rules and regulations order him to do. His discretion to act according to his own best conviction is seriously restricted by them.[19]

Bureaucracy places so many fetters on producers that most entrepreneurial activity is done illegally, some to nominally fulfill the plan, some to subvert it.[20]

Mises concludes:

> Socialism, that is, full government control of all economic activities, is impracticable because a socialist community would lack the indispensable intellectual instrument of economic planning and designing: economic calculation. The very idea of central planning by the state is self-contradictory. A socialist central board of production management will be helpless in the face of the problems to be solved. It will never know whether the projects considered are advantageous or whether their performance would not bring about a waste of the means available. Socialism must result in complete chaos.[21]

No country in history has ever fully adopted socialism since it would mean swift death for its population. Instead, socialist countries play at central planning, overlooking widespread violations of the plan and using prices on international markets to engage in calculation.[22]

A Policy of Desocialization Accounting for Entrepreneurship

To provide for the full expression of the creative energies of entrepreneurs, the former communist countries must fully desocialize their economies by privatizing all property and removing the fetters of government intervention.[23, 24] Complete desocialization requires putting

[18]Mises, *Bureaucracy*, pp. 47–48.

[19]Ibid., p. 45.

[20]For fascinating examples of the native entrepreneurship of the Soviet people tragically suppressed by the bureaucracy see Roberts and Lafollette, *Meltdown*, pp. 7–37.

[21]Mises, *Bureaucracy*, p. 57.

[22]For Soviet examples of this phenomenon see Roberts and LaFollette, *Meltdown*, pp. 9, 15–17, and 25–26.

[23]As in all cases where property ownership is concerned, desocialization raises ethical as well as economic questions. It is not surprising that the program of complete privatization not only creates the necessary point of departure for the free market but

full ownership (control of use in action including voluntary contract) of labor, land, and capital into the hands of individuals. With labor, this is relatively simple. Since each person naturally owns his labor it requires only that government interventions restricting the use of labor be abolished, allowing each person to freely contract and associate with others. Self-ownership and freedom of contract are necessary prerequisites of a completely entrepreneurial economy because entrepreneurship is an individual phenomenon and can only be expressed socially, by individuals, in the less-than-fully predictable process of earning profit and avoiding loss. Entrepreneurship cannot be centrally planned, either in specific decisions or personnel.

The initial ownership of land and capital is not as easily implemented but theoretically should follow the principle of homesteading since it in turn is derived from the principle of each person owning his labor. The application of homesteading to existing unjustly owned, i.e., state owned, property is a syndicalist strategy; that is, land to the farmers and capital to the workers.[25] The labor of those who have worked the land under the collective ownership system gives them sufficient claim to the land to supersede the claims of others, save those who could demonstrably justify, i.e., by homesteading or contract, their ownership prior to state confiscation. Each parcel of land should be returned to those peasant farmers who worked it under collectivization. Likewise the ownership of capital should initially be given to those who worked in the various state-owned factories.[26]

---

is morally justified as well. This is a corollary of the principle that selfownership and homesteading are the prerequisites of the free market. For the ethical justification of the free market see Murray N. Rothbard, *Ethics of Liberty* (Atlantic Heights, N.J.: Humanities Press, 1982); Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism* (Boston: Kluwer Academic Publishers, 1989); and Hans-Hermann Hoppe, "From the Economics of Laissez Faire to the Ethics of Libertarianism," in Walter Block and Llewellyn H. Rockwell, Jr., eds., *Man, Economy, and Liberty* (Auburn, Ala.: Ludwig von Mises Institute, 1988).

[24]Far from despoiling these formerly communist countries with crass Western materialism, the implementation of capitalism will allow each group of people to fully express its own unique culture in ways restricted and forbidden until now. Indigenous entrepreneurs will bring forth those consumer goods, and the capital goods most suited for producing them, that people find desirable within the constraint of their cultural norms.

[25]See Hans-Hermann Hoppe, "De-Socialization in a United Germany," *The Review of Austrian Economics* 5, no.2 (Fall 1991): 98–104.

[26]As a practical matter, this would probably need to include the former bureaucrats who presided over the production centers. Although those remote from the source of production, i.e., central planners, would only have homesteading rights to the particular state buildings they used in their former endeavors. On what to do with the bureaucrats, see Murray N. Rothbard, "How to Desocialize?", *The Free Market* 7, no. 9 (September 1989).

Privatizing property would significantly reduce the size of government, eliminating state production and provision of goods and the massive bureaucracy necessary to operate the state apparatus. In its place, specialized entrepreneurs would emerge as those who render the greatest returns to the initial owners of land and capital as these owners sought out investment in entrepreneurial ventures. This voluntary method of capitalizing the specialized entrepreneurs is the only one consistent with the property ownership and freedom of all individuals. Simultaneously, it elicits the greatest quantity and quality of social entrepreneurship.[27]

The privatizing of socialist production centers should be done by creating ownership shares and distributing them to the workers at each center. Alternative schemes for privatizing these centers have either economic or ethical defects or both. For example, having a national auction where the state sells all state-owned property is grossly unjust: akin to having slaves pay their masters for the "privilege" of their freedom. Since the state is an illegitimate confiscator of property it has no just claim to sell or even use the property it has appropriated. If anything, justice demands that state officials compensate the populace for the decades of virtual enslavement under their communist regimes. A national lottery to give away all state property cannot satisfy the demands of justice either. By what right can those who have not attached their labor to the capital and land make a superior claim to those who have? There is no justice in a random distribution of previously homesteaded and then expropriated property. Finally, a scheme to inventory all state property and issue equal ownership shares to each person fails on both economic and ethical grounds. Justice demands that ownership of capital and land be objectively identified with those who transformed this property with their labor, and economic ownership requires that the individual be able to sell his shares or liquidate them

[27]While there is a tendency on the free market for those individuals to emerge as specialized entrepreneurs who have the relevant comparative advantage regardless of the existing pattern of property ownership, the precise outcome of social production will not be identical under different patterns of initial ownership. The beginning distribution of capital and land must take into consideration the question of justice. If not, one should argue for the most expedient pattern of ownership; i.e., leave it in the hands of the bureaucrats and central planners. That such a suggestion is immediately ruled out is proof that justice makes a difference and must be appealed to unless the program of desocialization be discredited and abandoned. The tendency for efficient selection of specialized entrepreneurs on the market is actually an argument in favor of privatizing according to selfownership and homesteading principles. Since the general economic result will be similar with either an unjust pattern of initial ownership or a just one, the latter is preferable.

in specific pieces or limited aggregates of property. This ability is the counterpart to that of entrepreneurs who in creating new business firms could issue and initially sell shares only in their own firms. If they cannot do this they do not fully own their firms. These private shares would quickly out-compete the inefficient collective ownership shares, which would eventually be divided into economically meaningful sub-components, like shares for each private business firm, or become worthless.[28]

Essential to the justice and economic success of such privatization would be free trade in these shares. The newly born stock market would quickly expand as emerging specialized entrepreneurs form new businesses and begin, with free capital markets in general, to correctly channel savings into the structure of production and across the structure to various processes for creation of the necessary capital goods without government intervention injecting irrationality into the process.

Money must also be returned to the market by state decrees to end monetary inflation immediately, to make the official currency redeemable in gold (at a rate appropriate to allow redemption of the entire stock of fiat paper for the state's gold stock), and to allow entrepreneurs to freely produce money within the framework of property rights. Returning money to the market is necessary to meaningful economic calculation without which rational social production cannot occur. Allowing the state to maintain control of money, even partial, insures the distortion of entrepreneurial activity as the state uses this power to control spending and capital flows.[29]

Privatization should be instituted simultaneously with a complete dismantling of all forms of government intervention into the ensuing pattern of voluntary exchange and division of labor. This is a necessary condition of permitting private property ownership and of opening the channels for entrepreneurial activity in social production. With no more interference into the contractual conditions of private individuals, e.g., no price controls or occupational licensing, government would be further scaled back, releasing more bureaucrats into the productive private sector.

[28]For a discussion of these alternatives, see Hoppe, "De-Socialization," pp.98–101.

[29]On the gold standard see, Murray N. Rothbard, "The Case for a Genuine Gold Dollar," in Llewellyn H. Rockwell, Jr., ed., *The Gold Standard: An Austrian Perspective* (Lexington, Mass.: Lexington Books, 1985); and idem, "The Case for a 100 Percent Gold Dollar," in Leland Yeager, ed., *In Search of a Monetary Constitution* (Cambridge, Mass.: Harvard University Press, 1962).

Finally, the process of desocialization should be done instantly, following the historic example of the German economic "miracle" begun by Ludwig Erhard on June 24, 1948.[30] Halfway measures will not work since they create secondary problems and the ensuing political pressure to renew controls.[31]

No better example of this principle exists than the tragic plight of the people of the former East Germany who may miss this historic chance for freedom by their apparent acceptance of the West German welfare state instead of a free market.[32] The results so far have been massive transfers of wealth from west to east caused by the artificial overvaluation of the East German mark; unjust property ownership caused by the sale of state assets and the preference in these sales to the politically connected; unemployment caused by the adoption of unemployment "insurance" and minimum wages; inefficient allocation of capital caused by acceptance of social security; inefficiencies and wealth destruction caused by implementation of a West-German-style tax structure and controls interfering with free domestic and international trade. Such a welfare-statist beginning does not bode well for the freedom and prosperity of the German people.

The East Germans would have been far better off traveling a course of complete privatization, not only for themselves, but for the irresistible pressure thereby put on the West German state to follow them down the privatization path. Unfortunately, they, like most people, have a dearth of principled, courageous, and knowledgeable statesmen who would take the initially, politically difficult path. Instead they are led by politicians willing to import the disastrous welfare-statist policies and politicians of West Germany.[33]

Entrepreneurship has no direct role in bringing about the program of desocialization. However, entrepreneurial activity has played a crucial indirect part by subverting the centrally planned system, illustrating to people the benefits of freedom. Those in the political system with the courage to desocialize will face their biggest obstacle in the bureaucracy, entrenched as it is in the status quo. Overcoming this obstacle will be a most difficult political problem; those who will

[30]Consider also the Russian economist Yuri Maltsev's one-day plan for the immediate desocialization of the Soviet Union outlined in, "The Maltsev One-Day Plan," *The Free Market* 8, no.11 (November 1990). A similar, but relatively snail-paced, plan for the United States is outlined by Llewellyn H. Rockwell, Jr. in, "Rockwell's Thirty-Day Plan," *The Free Market* 9, no. 3 (March 1991).

[31]See Mises, *Human Action*, pp. 858–61.

[32]See Hoppe, "De-Socialization," pp. 90–95.

[33]Ibid., pp. 88–97.

take the unpopular course of instant desocialization are not political entrepreneurs but statesmen to whom their countrymen would owe a great debt of gratitude.[34]

Conclusions

Entrepreneurship is the driving force behind improving the ability of all people to attain their ends in cooperation with one another. The future condition of mankind depends on the channels provided within a social system for the functioning of entrepreneurship. To have the greatest amount of entrepreneurship of the highest quality, a social system must be based on the private ownership of property and individual liberty. Only then can the free market emerge incorporating the talents of everyone in a voluntary, cooperative edifice of exchange and production coordinated by entrepreneurship which is made possible by economic calculation. A rare moment in history has come, allowing countries of the world to institute the free market, and thus ensure the prosperity and gratitude of their progeny.

[34]Adherence to the Misesian view of entrepreneurship avoids the paradoxical idea of the "political" entrepreneur. The specialized entrepreneur, by definition, is involved in the wealth-enhancing process of voluntary cooperation within the division of labor where everyone benefits. There can be no "political" entrepreneur since the political process employs coercion resulting in the transfer and destruction of wealth as it distorts the division of labor. There is, however, political entrepreneurship in the sense that in every action the actor must deal with uncertainty. In the political arena this would be akin to the entrepreneurship interest in the actions of the robber and swindler. In both cases, the actor is uncertain concerning how much he can take from the victims and how strong and in what form their resistance might be. For analysis using the concept of a political entrepreneur, see Gordon Tullock, *The Politics of Bureaucracy* (Washington, D.C.: Public Affairs Press, 1965), pp. 99f; and James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1965), pp. 334f.

Review Essay

Aurophobia: or, Free Banking on What Standard?

Murray N. Rothbard*

Gold, Greenbacks, and the Constitution. By Richard H. Timberlake. Berryville, Virginia: The George Edward Durrell Foundation, 1991.

In recent years, disillusionment with the record of central banking has led a number of economists to return to the nineteenth-century concept of "free banking": [t]hat is, free and unregulated banking without a central bank. Unfortunately, this return has not been toward the Currency Principle/Mises tradition of free banking *within* a firm matrix of demand liabilities (notes or deposits) grounded in 100 percent reserves in specie (gold or silver). Instead, this new movement has harked back to the contrasting inflationary credit generated by what used to be known as "wildcat banking." In lauding free banking as akin to a free market in any other good or service, these new free bankers have overlooked two vital defects. First, that a genuine free market must be based on an absence of fraud or theft, whereas issuing demand liabilities in excess of assets is equivalent to a warehouse issuing fraudulent receipts to non-existing assets, and is therefore a species of fraud or embezzlement. And second, the free bankers neglect the insight of Currency Principle men from Ricardo down, that all quantities of money are optimal, and that therefore—in stark contrast to all other goods—increased supplies of money can only be redistributive and can confer no social benefit.[1]

*Murray N. Rothbard is S. J. Hall distinguished professor of economics at the University of Nevada, Las Vegas and editor of the *Review of Austrian Economics*.

[1]With the exception, of course, of increased *non*-monetary benefit from an increase in gold or silver, a gain that cannot accrue from an increase in fiat paper or in fractional-reserve bank credit.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 97–108
ISSN 0889-3047

On the first point, we contend that bank notes or deposits are bailments and not debt, and that therefore an issue of fractional reserve liabilities can only be a violation of the bailment contract. In addition to the pressure of bankers on the law, one of the reasons why the critical court decisions in the nineteenth century ruled the other way is that bailment law was then in an undeveloped state. In the late nineteenth century, and even in the 1930s in the United States, grain warehouses, which, as in the case of banks, issue warehouse receipts to fungible goods, were able to issue, unchecked and unpunished, fraudulent receipts to non-existent wheat, which they loaned out to speculators in the Chicago wheat market. Interestingly enough, this fractional-reserve process generated a local boom-bust cycle in Chicago wheat.[2] In a genuinely free market, absent force or fraud, bank loans or investments would reflect only their own equity or their genuine debt (e.g., bonds or certificates of deposit), which would constitute genuine credit transactions—exchange of a present good (e.g., money) for a future good (e.g., money at a future date). Free marketeers are sometimes in danger of forgetting that fraud or robbery can be committed by private organizations as well as by government. As Mises favorably quoted Thomas Tooke, "free trade in banking is free trade in swindling."[3]

On the second, more narrowly economic point, from Ricardo to Mises and his followers it has been demonstrated that an increase in the money supply can only dilute the effectiveness of each existing money unit, and therefore must be "inflationary" in the sense of raising prices beyond what they would have been otherwise. In addition, we know from Mises's theory of the business cycle that such inflationary bank credit can only lead to a destructive boom-bust business cycle. And it is not true, on Misesian theory, that central banking is necessary in order to generate this cyclical process. Any bank credit expansion in commercial loans is sufficient to generate the business cycle, whether a central bank exists or not. In the Misesian view, however, there will tend to be far more room for bank credit expansion whenever a central bank, with its privileging by

[2]Ours is the view of the losing counsel in the 1816 English case of *Devaynes v. Noble*, who argued that "a banker is rather a bailee of his customer's funds than his debtor . . . because the money in . . . [his] hands is rather a deposit than a debt, and may therefore be instantly demanded and taken up." See J. Milnes Holden, *The Law and Practice of Banking, Vol. 1: Banker and Customer* (London: Pitman, 1970), p. 31; Murray N. Rothbard, *The Mystery of Banking* (New York: Richardson & Snyder, 1983), pp. 87–95.

[3]Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, 1963), p. 446.

government and its role as a lender of last resort, is active in the economy.

The recent free bankers have consisted of a coalition of ex-Misesians (White, Selgin, Glasner), English subjectivists (Dowd), and neo-monetarists or neo-Friedmanites (Yeager, Timberlake). Friedman himself, while not totally committed to free banking, has been indicating his disillusion with the Fed's failure to follow his famed Money Rule (in addition to the increasing monetarist difficulty in figuring out which of the various Ms should be subject to that Rule). Hayek may be added to that list, except that he was never a Misesian on this question, at least since the 1930s.

I do not propose here to rehash the substantial controversy between the modern free bankers and the modern Misesians (Rothbard, Salerno, Hoppe, Skousen, North), much less discuss the older 100 percent tradition (most eighteenth-century British economists, including Hume, except Adam Smith; the Currency school; the Jeffersonians and Jacksonians), or the 100 percent fiat paper reserve tradition of the Chicago school (Fisher, Knight, Simons, Hart, and the early Friedman). What I want to do here is to focus on another vitally important, but neglected, area of the free-banking controversy. Assuming for the sake of argument that banks will be free without restrictions to issue demand liabilities to standard money, *what*, in the view of the free bankers, is that standard money supposed to be? In a sense, this problem is more important and fundamental than the question of the reserve ratio: What is money, and what is going to be the "standard" money, in which these liabilities are supposed to be redeemable on demand?[4]

Oddly enough, the answer to this vital question by the free bankers have been vague, murky, and inconsistent answers that reveal deep and unexamined flaws in the free-banking camp. The recent booklet by Professor Timberlake—in the same vague and murky tradition—provides us with an opportunity to examine the views of modern free bankers on the monetary standard, and on what exactly would constitute the "cash" upon which the banks would be allowed to pyramid as many demand liabilities as they could get away with.[5]

[4]In 1975, at least, Hans F. Sennholz, a former Mises student, had no doubt on the proper answer to this question, as note the title of the book he then edited: *Gold I$ Money* (Westport, Conn.: Greenwood Press, 1975). Since then, however, Sennholz has apparently become an ex-Misesian and joined the free-banking camp.

[5]Hayek's proposal, which can only be considered grotesque, can be dismissed quickly. For Hayek would solve this problem by having each bank create its own fiat paper currency. In short, a Rothbard Bank could issue notes or deposits in 50, 100, and

Professor Timberlake's work is a curious performance. Ostensibly, it is a brief history of the greenbacks and of the judicial controversy over the constitutionality of the greenbacks and of their legal tender powers. Much of Timberlake's discussion of the Legal Tender Cases is indeed illuminating, since Timberlake is squarely opposed to the constitutionality of fiat money. And yet there are curious distortions and overtones, which build to a climax in the concluding chapters when Timberlake reveals his own positive monetary proposals. For one thing, his attack on greenbacks would seem to imply a pro-gold standard position, and yet throughout his analysis there is a subtle but continuing disparagement of gold which becomes evident when he unrolls his own inflationist, fiat money program. Thus, Timberlake states that the gold standard only existed for four decades in the nineteenth century, omitting the crucial point that from time immemorial only two standard moneys existed, gold and silver, with confusion only emerging from the co-existence either of parallel standards, in which gold or silver were free to fluctuate, or bimetallic standards, in which governments attempted to fix the gold/silver at a ratio varying from the market. The fact that gold monometallism existed for only a few decades is beside the point, which is the well-deserved monetary longevity of both gold and silver.

Furthermore, while critically analyzing the judicial defenders of greenbacks, Timberlake manages to focus the issue almost exclusively on the illegitimacy of government power to make greenbacks, or fiat paper, legal tender for private contracts. But the power to make paper legal tender for payments *to government* is left unscathed by Timberlake, which as we shall see seems to fit into his ultimate monetary agenda. This omission contrasts starkly with the magnificently hard-money Jacksonians, who endeavored to end the federal government's power to receive paper or deposits in taxes or fees. The Jacksonians tried, and partially

---

1,000 Rothbards, which would be redeemable in . . . the same amount of paper Rothbard tickets! Such a bank could of course never fail, but it is doubtful if anyone save close friends and relatives could ever be induced to use and hold these notes and deposits, regardless of what grandiose promises about "price stability" Rothbard might wave in front of potential customers. In addition, Hayek's proposal is absurdly "constructivist" on his own methodological terms. It is doubtful that anyone not a Nobel Laureate making such a proposal would be taken seriously. Thus, see F. A. Hayek, *Denationalisation of Money* (2nd ed., 1976; London: Institute of Economic Affairs, 1978). For a critique, see Murray N. Rothbard, "The Case for a Genuine Gold Dollar," in Llewellyn H. Rockwell, Jr., ed., *The Gold Standard: An Austrian Perspective* (Lexington, Mass.: D. C. Heath/Lexington Books, 1985), pp. 2–6.

succeeded, in limiting the government to accepting only specie in payments.[6]

Once curious aspect of Timberlake's anti-gold stance is to embrace Milton Friedman's new-found attachment to bimetallism. Timberlake actually refers to Gresham's Law as demonstrating the gently stablizing effects of bimetallism (pp. 8–9). And yet one of the more valuable insights of monetarism was to demonstrate that fixing of exchange rates inevitably causes distortions by creating shortages of the undervalued, and surpluses of the overvalued, money. From the fourteenth-century French scholastic Nicole Oresme to Ludwig von Mises, Gresham's Law has been seen as the inevitable and unfortunate consequence of maximum price control for the undervalued money and of minimum price control for the overvalued. And yet in pursuit of his lifelong hatred of gold, Milton Friedman seems willing to embrace virtually any alternative, including bimetallism, and Timberlake is willing to follow suit.

Part of Timberlake's problem here is thinness of scholarship. Thus, he discusses the central role of Civil War Secretary of Treasury (and later Chief Justice) Salmon P. Chase, without bothering to mention the national banking system, or Chase's intimate corruptionist connection with the investment banker Jay Cooke. He mentions Chase's ambition, and notes with surprise that Chase wanted to run on the Democratic ticket in 1868, without realizing that Chase was an old Jacksonian Democract, and with slavery defeated there was every reason for him to return to the Democracy. More important, Jay Cooke was an old friend and literal patron of Chase, and Cooke and his influential Ohio journalist brother Henry lobbied the Lincoln Administration heavily and effectively to make their client Chase Secretary of the Treasury. As soon as Chase gained the post, Cooke easily persuaded Chase to grant him the unprecendented power of monopoly underwriter of all government bonds—a monopoly Cooke was able to retain, almost unbroken, until he went bankrupt in the Panic of 1873. Then, Chase went along with Cooke's plan to destroy the decentralized pre-Civil War banking system and to replace it with a quasi-monopoly National Banking System, a system in which the federally chartered national banks

[6]The Jacksonian Democrats, under Van Buren and Polk, were able to impose the Independent Treasury sytem, in which the federal government kept its money only in its own Treasury vaults, and not in any banks. They did not succeed, however, in requiring the government to accept taxes and fees only in specie. See Major L. Wilson, *The Presidency of Martin Van Buren* (Lawrence, Kans.: University Press of Kansas, 1984), pp. 61–121.

had a monopoly privilege to issue notes, and their note issue was based *pro rata* on how many government bonds they might purchase. The bonds, of course, had to be purchased from Jay Cooke, who also managed to have himself granted several national bank charters. And so, when Timberlake refers crossly to Chase's "patent . . . anti-bank prejudice" (p. 21), he neither seems to understand that that "prejudice" stemmed from Jacksonian hard-money principle, nor that Chase stood ready to violate that principle in behalf of his corruptionist patron Cooke and so created the national banking system.

And while Timberlake correctly notes that the Republicans in this era were inflationist while the Democrats favored gold and hard money, he fails to link up these positions with economic interests. One of the major forces in favor of greenback inflation was the iron and steel industry, centered in Pennsylvania. Under the leadership of the Pennsylvania economist and ironmaster Henry C. Carey, the Radical Republicans and iron and steel interests were instructed that falling dollar rates caused by greenback inflation acted as a temporary but welcome extra tariff, discouraging iron and steel imports and encouraging their export. The other major inflationist interest was the big railroads, the major big businesses and incorporated enterprises in the country. Heavily indebted to their bondholders, the railroads saw that inflation would lower the real value of their outstanding debts. Thus, Timberlake correctly notes the significance of the action of the Grant Administration in appointing two Supreme Court Justices to fill vacancies. The Administration was sure these judges would quickly reverse the Legel Tender Cases and declare greenbacks and fiat money constitutional. Timberlake notes that these two swing justices were William Strong and Joseph P. Bradley, but fails to make the important point that Strong had been a top attorney for the Philadelphia and Reading Railroad, and a director of the Lebanon Valley Railroad; and as for Bradley, his connections with the railroad interests were almost as great, having been a director of the Camden and Amboy Railroad and of the Morris and Essex Railroad, both in New Jersey.[7]

One pervading problem is that Timberlake's scholarship is spotty. Thus, on the post-Civil War monetary situation, there is reference to Irwin Unger's *The Greenback Era*, but no mention whatever of the equally important Robert P. Sharkey, *Money, Class and Party: An*

[7]Ron Paul, *The Ron Paul Money Book* (Clute, Texas: Plantation Publishing, 1991), pp. 115–16. On the railroad ties of Strong and Bradley, see Philip H. Burch, Jr., *Elites in American History, Vol. II: The Civil War to the New Deal* (New York: Holmes & Meier, 1981), pp. 44–45.

Economic Study of Civil War and Reconstruction (Baltimore: Johns Hopkins University Press, 1959). Timberlake mentions Bray Hammond's classic *Banks and Politics in America*, but overlooks Hammond's important *Sovereignty and an Empty Purse: Banks and Politics in the Civil War* (Princeton: Princeton University Press, 1970). He uses the splendidly hard-money Don C. Barrett's article in the *Quarterly Journal of Economics* (May 1902), but omits Barrett's fully developed book, *Greenbacks and the Resumption of Specie Payments, 1862–1879* (Cambridge: Harvard University Press, 1931). And how can anyone, as Timberlake does, deal with silver and bimetallism without so much as mentioning the famed revisionist article by Paul M. O'Leary, "The Scene of the Crime of 1873 Revisited: A Note," (*Journal of Political Economy* 68 [1960]: 388–92), or the splendid work by Allen Weinstein, *Prelude to Populism: Origins of the Silver Issue 1867–1878* (Yale University Press, 1970)?

Perhaps the problem is that Professor Timberlake, or his Durrell Foundation editor, John W. Robbins, was anxious to rush past the history to get to the policy conclusions, the monetary agenda which is only loosely based on the preceding historical discussion. In his conclusion, Timberlake brusquely dismisses the gold standard. Gold, he says, has been subject to government manipulation by central banks. Very true, but how about the gold standard that also abolished the central bank? This Misesian solution is not mentioned, nor indeed is the extensive Jacksonian literature to the same effect. Timberlake states as if a new point that under the gold standard government need not have minted gold coins, a theme that has long been part of the Misesian literature. He need scarcely rely for reference on a forthcoming article by J. Huston McCulloch. Timberlake only bothers making two other negative references to justify his dismissal of gold. One, that gold might "shut out technically more efficient systems" (p. 52), whatever they might be, but without pointing out that efficient clearing systems can be and have been based on standard metallic money. His other point is the disingenuous one that even Ludwig von Mises, a champion of gold, admits that gold "introduces an incalculable factor into economic activity" (p. 47). But Timberlake fails to note Mises's very next point: that this incalculable factor, stemming from variations in the supply of gold, has been minuscule compared to the volatility introduced by government and by bank manipulations of the supply of money.[8]

[8]Ludwig von Mises, *The Theory of Money and Credit* (1934; Indianapolis, Ind.: Liberty*Classics*, 1980), p. 27.

What then is Professor Timberlake's proferred alternative, one which he avows would "more effectively constrain the state" than the gold standard (p. 52)? What, in Timberlake's words, "is a market-directed monetary system completely free from any possible government intervention" (p. 62)? Or to return to our earlier question, in Timberlake's proposed world, in what thing would banks liabilities be redeemable? The one cogent note in Hayek's bizarre "denationalized currency" scheme is the pungent clarity of his answer: banks that issue Hayek, Rothbards, and ducats would redeem these paper tickets or open book liabilities in Hayeks, Rothbards, and ducats. Timberlake, unfortunately, is not nearly so clear. He does seem to realize that Americans are stuck with "dollars" as their currency unit and standard, just as Englishmen are stuck with pounds and Germans marks. He does not, however, explain why these countries are necessarily stuck with currency names. Instead, he becomes even murkier by adopting the curious—and grotesquely "constructivist"—plan of Greenfield and Yeager: that the monetary unit of account be totally and ineluctably sundered from the medium of exchange. The monetary unit would still be the dollar, but how then is the "dollar" to be defined? Originally, the dollar, along with every national currency, was simply defined as a definite unit of weight of gold or silver. Before 1933, for example, the "dollar," the monetary standard in the United States, was defined as 1/20 of an ounce of gold. Nowadays, of course, the "dollar" is fiat; it is simply a paper ticket issued by the Federal Reserve System that says, on its face, "one dollar" or "ten dollars."

What would Timberlake do about this; or, following Greenfield and Yeager, how would he proceed to "the practical purpose of getting the government [in the guise of the Federal Reserve System] out of any policy-making role" (p. 60)? By severing the dollar from the medium of exchange. The government would define the "dollar" as equal "to a market price index made up of a limited array of staple, conventional, basic commodities—items that would ideally mirror an all-markets average of prices." But if the government defines the dollar as an overall price index, wouldn't this definition be subjected to political pressure for continually redefining the index; and wouldn't the government almost automatically strive to stabilize the price level as gauged by its precious index? No, because incredibly, according to Timberlake, Greenfield and Yeager, the government would be sternly advised *not* to stabilize its own index. But does anyone in his right mind, anyone at all familiar with our political system, think for one moment that the government would thus keep its hands off its own index?[9]

[9]Professor Timberlake would have done well to heed Mises's insights about index numbers in the passage just before the sentence he yanked out of context: "If it should

And what, too, would be the medium of exchange in Timberlake's system, and would that medium be redeemable in the dollar-index? None of that is clear. If it is redeemable, then presumably people would not be walking around with index market-baskets; if instead, it is to be redeemable in the "purchasing power" of the index, then we are back to stabilizing the price level, and also in *what* would the medium be redeemed, and would that index then become the medium? If not, and if there is to be no redemption whatever, then who is to supply the medium of exchange, and what is to keep the "free" money suppliers from issuing money *ad infinitum*? (In the gold standard, of course, what keeps the banks at least partially in check is the necessity to redeem in gold.) Timberlake is of little help in supplying this crucial answer.[10] At one point he refers to the "medium of exchange [as] the Federal Reserve note" (p. 60)! *That's* getting the government and the Fed "out of any policymaking role?" At another point, he inconsistently "would leave this function [supply the quantity of money] to dealers and arbitrageurs in financial and commodity markets" (p. 60). What is all this supposed to mean? At another point, the confusion is even worse compounded by Timberlake's calling for "privatizing" the government's gold stockpile "and the twelve Federal Reserve Banks" (p. 62). Privatizing the Federal Reserve? What can this mean? In a profound sense, the Federal Reserve, as well as all previous central banks, are already "private"—a government-established and enforced cartel of the private banking

---

be thought that index numbers offer us an instrument for providing currency policy with a solid foundation and making it independent of the changing economic programs of governments and political parties, perhaps I may be permitted to refer to what I have said. . . . on the impossibility of singling out any particular method of calculating index numbers as the sole scientifically correct one. . . . There are many ways of calculating purchasing power by means of index numbers, and every single one of them is right, from certain tenable points of view; but every single one of them is also wrong. . . . Since each method of calculation will yield results that are different from those interests and injure others, it is obvious that each group of persons will declare for those methods that will best serve its own interests." Mises, *Theory of Money and Credit*, pp. 26–27. Also see Mises's scintillating critique of index numbers in ibid., pp. 215–23.

[10]Greenfield and Yeager are not much more helpful either. In contrast to Timberlake's hint about "privatized" Federal Reserve notes still constituting the medium of exchange, Greenfield and Yeager avow the absence of "any dominant" medium of exchange, which seems close to calling for no general medium of exchange at all, and hence a return to some form of barter. Greenfield and Yeager also propose a convenient new criterion for the advance of science: that the burden of proof to clarify and persuade others of a totally new proposal, such as theirs, should rest on the readers bound in their old frameworks rather than on the authors themselves. R. Greenfield and L. Yeager, "Competitive Payment Systems: Comment," *American Economic Review* 76 (Spetember 1986): 848–49.

system. Are we then to be stuck forever with Federal Reserve notes as "dollars," whether or not they are officially defined as such? Privatizing the Fed is about as cogent, and about as genuinely free-market-oriented, as the idea of "privatizing" the Internal Revenue Service. No, it is important to realize that those government operations which supply or monopolize genuine goods and services should be privatized—e.g., carrying the mail, supplying streets and roads, putting out fires. But other government activities, which are counterproductive and destructive to the market—e.g., the IRS, government regulatory commissions, concentration camps for dissenters—should *not* be privatized but abolished. Surely, that massive monopolistic and inflationary engine of legalized and legitimated counterfeiting called the Federal Reserve System should be abolished rather than privatized.

In supporting the idea of sundering the unit of account from the medium of exchange, Timberlake fallaciously refers to the researches into medieval money of the great economic historian Luigi Einaudi.[11] But he fails to realize that in his historical cases, Einaudi was not writing about an abstract unit of account of "imaginary money" that came from the sky or from professors and was never used as a medium of exchange. On the contrary, in all cases, Einaudi was referring to the bimetallic or parallel metallic situation in which units of weight of gold (or silver) was the medium of exchange in a certain country, whereas units of weight of the other precious metal, silver (or gold) functioned as the unit of account. In this situation, both gold and silver originally emerged, on the market, as media of exchange and hence units of account. Not only do Einaudi's cases not constitute historical support for the Timberlake-Greenfield-Yeager scheme; they are precisely the reverse.[12]

[11]In addition to citing Einaudi's article in the Gayer *Festschrift* for Irving Fisher, Timberlake might have momentarily strengthened his case by referring to the impressive article by Luigi Einaudi, "The Theory of Imaginary Money from Charlemagne to the French Revolution," in F. C. Lane and J. C. Riemersma, eds., *Enterprise and Secular Change* (Homewood, Ill.: Richard D. Irwin, 1953), pp. 229–61. The Einaudi article was originally written in *Rivista de storia economica*, 1936, and its English translation by Giorgio Tagliacozzo was approved and added to by Einaudi.

[12]On the theory of parallel standards, see Mises, *The Theory of Money and Credit*, pp. 205–13. For historical examples of parallel standards, see also W. Stanley Jevons, *Money and the Mechanism of Exchange* (London: Kegan Paul, 1905), pp. 88–96. Robert S. Lopez points out that whereas gold coinage was introduced into modern Europe almost simultaneously in the mid-thirteenth century by Florence and Genoa, Florence instituted bimetallism, whereas "Genoa, on the contrary, in conformity to the principle of restricting state intervention as much as possible, did not try to enforce a fixed relation between coins of different metals." Robert S. Lopez, "Back to Gold, 1252," *Economic History Review* (December 1956): 224.

The problem with all these plans, from Greenfield and Yeager to Timberlake to Hayek, is that they ignore one of Ludwig von Mises's most original and profound contributions to monetary theory: the "regression theorem," which demonstrates that no money can originate in any society except as a medium of exchange, and as a medium that arose on the free market as a useful non-monetary commodity, e.g., gold or silver.[13] Hence, the regression theorem explains the fallacy and the dismal prospects for all such constructivist schemes as the magic index or the Hayekian ducat. The reason why we must start with the dollar as the money for Americans, the franc as the money for the French, etc., is that the people of these countries are used to those units of account, and since those units grew originally out of a unit of weight of gold or silver, they were useful non-monetary commodities on the market before they became employed as moneys.[14]

If we really wish, then to separate government from monetary policy or from monetary functions, we must totally divest government of those roles. We must therefore start with reality—the dollar defined as a government paper ticket or Fedeal Reserve note—and proceed to privatize the dollar precisely by ending its relationship to the note, and by redefining it as a unit of weight of gold. How is this to be done? By abolishing the Federal Reserve System. Abolishing that "corporation" means, as in the death of any corporation, liquidating its liabilities, and parcelling out the assets of the liquidated organization to its creditors. Since Federal Reserve notes are legally liabilities of the Fed, and since its assets are the Fed's accumulated gold stock kept in Fort Knox and other Treasury repositories, the gold should be parcelled out *pro rata* to the Fed's creditors (holders of

[13]On the regression theorem, see Mises, *The Theory of Money and Credit*, pp. 129–59; *Human Action*, pp. 408–16.

[14]Greenfield and Yeager, dismissing the relevance of the point that their monetary scheme could never emerge from the market, argue that "dismantling government domination of the existing system will require deliberate policy actions, and the positive actions taken will unavoidably condition the successor system." Greenfield and Yeager, "Competitive Payments Systems," p. 849. But it is precisely because economic history is path-dependent that we don't want to foist upon the future a system that will not work, and that will not work largely because such indices and media cannot emerge "organically" from individual actions on the market. Surely, the idea in dismantling the government and return (or advancing) to a free market is to be as consonant with the market as possible, and to eliminate government intervention with the greatest possible dispatch. Foisting upon the public a bizarre scheme at variance with the nature and functions of money and of the market, is precisely the kind of technocratic social engineering from which the world has suffered far too much in the twentieth century.

Federal Reserve notes and banks that keep demand deposits at the Fed). The dollar would be redefined in units of weight of gold to permit 100 percent liquidation as well as the exchange of gold assets for all liquidated notes and liabilities. As its last monetary function, the Treasury could mint the gold coins out of the deposited bullion to exchange for these notes and deposits. The money supply would then consist solely of gold coins, which could be deposited for warehouse receipts in commercial banks. Federal Reserve notes and deposits would then have disappeared.[15]

One of the few places where I agree with Professor Timberlake's prescription is to "privatize the government's stockpile of gold." But of course legally the gold is owned not by the government *per se* but by the Federal Reserve; and therefore the only way to privatize the gold stock, and at one and the same time to abolish the Federal Reserve and to return from a fiat to a gold standard, would be the plan I have described above: redefinition of the dollar as a unit of weight of gold, and abolition of the Fed and the disgorging of its gold stock, to be exchanged, one for one, for its liquidated liabilities, the Fed's notes and deposits.

I submit that we would then have a gold standard without a central bank, without fiat money, without Federal Reserve notes, and with none of the actualities or even possibilities of government intervention that Professor Timberlake professes to abhor. But for Timberlake, or for Greenfield or Yeager, to adopt such a plan, would require them to abandon once and for all, their flight from gold, that veritable phobia about gold, or "aurophobia," that has marked all respectable schools of economic thought, whether Keynesian or monetarist, for most of the inflationist twentieth century.

[15]What of the government securities that now constitute the bulk of the assets of the Federal Reserve System? An urge for genuine privatization and a decent respect for the taxpayer would require the immediate writing off of these bonds; why should the taxpayer be forced to pay interest and principal when one agency of the federal government owns the bonds of another?

Book Reviews

The Enterprise of Law. By Bruce L. Benson. San Francisco: Pacific Research Institute, 1990.

Many advocates of the free market hold an odd view of that institution's scope. Although economists such as F. A. Hayek and James Buchanan laud the market to the skies and never tire of describing the depredations and stupidities of the state, they reverse themselves at a crucial junction.

They maintain that the market depends on the state for its existence. Unless a government establishes and enforces law, they claim, the market will soon sink from order to chaos. It is the outstanding merit of Bruce Benson to subject this view to withering scrutiny, both theoretical and historical. He argues that people can secure justice through private arrangements and that they have often done so, both now and in the past. Far from being necessary to a just social order, the state is a hindrance.

The book should not be taken as a defense of anarchism, since Benson does not discuss functions other than justice such as national defense usually assigned to the state. But in the contemporary climate of opinion, the work is startlingly radical.

If one characterizes law as a system of enforcible rules of conduct, nothing in the nature of law requires its provision by a state. How law has been provided is a question for historical investigation, not one to be resolved by fiat.

Benson clearly gets off to a good beginning. One might add that many eminent legal scholars, most notably John Austin and Hans Kelsen, have defined law in a question-begging way: They require that law be promulgated by a sovereign. Benson, who relies here principally on Lon Fuller, avoids this pitfall.

On one minor point he seems to me incorrect. Why is it the case that if "law is simply represented by any system of rules . . . then

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 111–115
ISSN 0889-3047

'morality' and 'law' would appear to be synonymous" (p. 11)? In this definition, what is moral would be legal, but it is not necessary that what is legal be moral.

Benson gives an excellent account of the development of law in Anglo-Saxon England. Custom gave birth to the law and sustained it. The state entered *after* the legal system was developed, seizing control of it in order to gain power and money. His description of the history of English law from Anglo-Saxon times through the nineteenth century shows mastery of a wide variety of sources; his presentation is a veritable *tour de force*. I would suggest only two additions. First, in the description of the Magna Carta, its annulment by Pope Innocent III should have been mentioned. Also, in contrast to the earlier situation described by Benson (p. 68), defendants during much of the nineteenth century could not testify.

The author places great stress on the Law Merchant, which during the period 1000–1200 "evolved into a universal legal system through a process of natural selection" (p. 32). Trade among the nations of Europe took place principally in fairs and markets, and merchants traveled from one to another. They devised a system of courts and regulations to handle business disputes; to rely on the varying customs of each nation would have been grossly inconvenient. This system, formed independently of the various states, became the basis of modern commercial law.

Benson, drawing upon a wide array of data, describes many cases of law without the state, ranging from the Kapauku Papuans of Western New Guinea to the American West in the nineteenth century. Contrary to various Hollywood movies, the West was not a series of never-ending gunfights in which outlaws terrorized a cowed populace. Quite the contrary, the West developed a considerable measure of home-grown law and order (pp. 312–21).

Though these facts cannot be denied, some will be inclined to interpose an objection. Before one can have private arrangements to enforce a body of law, do we not require a structure of rights, in particular an assignment of property titles? How can this structure be created by the market, since for the market to operate rights must first exist?

Benson's reply is cogent. Rights are indeed necessary for a market to function, but it by no means follows that they must be established through collective action. By a mutual recognition of one another's claims, people can gradually build up a system of rights. The market does not delay its arrival until the full details of a law code are hammered out; it comes into existence and develops along with the clarification and extension of the system of rights.

However surprising one may find the historical facts, they are exactly what one would expect given elementary principles of economics. In a market system, producers have a strong incentive to give customers what they want; if they do not, they will be replaced by those better able to fulfill consumer demand. Those who succeed in satisfying consumers will profit. This is the mechanism of natural selection mentioned above, and it exerts an inexorable pressure.

The state operates through an utterly different principle. As Benson accurately notes, the principal purpose of the state is the transfer of wealth. Like Franz Oppenheimer and Albert Jay Nock before him, Benson pictures the state as an instrument of coercive interference with free activity. Struggles among the Anglo-Saxon kingdoms, culminating in the Norman Conquest, dealt the non-statist Anglo-Saxon legal system crippling blows. The state took over the Law Merchant and subjected it to rigid restrictions.

The situation remains the same today. The abundant efforts of people to escape from the official legal system, e.g., through arbitration and private police, have been continually shackled by the state, a "jealous God" indeed, fearful and intolerant of all rivals.

Supporters of state provision of justice frequently rely on one weapon to defeat opponents, the famous public-goods problem. Law and its enforcement, it is alleged, generate several public goods. If, for example, police patrol a neighborhood, the benefit of deterrence of crime extends not just to those who pay for the services but to all local residents. Most of these public goods are familiar but some are rather recondite. David Landes and Richard Posner, for expample, maintain that written opinions by judges produce positive externalities, since people other than the parties to the case can use written decisions as guides (p. 279).

Benson has a double line of defense to these criticisms of private law. First, he endeavors to show that the market can internalize the externalities in question. Neighborhood associations, e.g., can require everyone who purchases property in an area to contribute to police protection. (Of course, this must be done not through compulsion but contractually.)

So far as the problem of precedent is concerned, judges do have an incentive to issue written opinions. In a competitive situation, judges need to acquire a good reputation in order to attract customers; no one can compel disputants to use them. To issue opinions that attain widespread respect is obviously one means of doing so. One might add to Benson's discussion that in the Roman Empire many legal scholars or *jurisconsults* gained recognition through their writing.

The second string in Benson's bow is as much an attack as a defense. To think that government has any realistic chance of improving the provision of public goods by the market is fatuous. Government is dominated by bureaucrats, intent on gaining power for themselves. Special interest groups can through concentration of resources gain privileges that worsen the position of others. Benson develops his bleak picture principally through application of public choice economics. He defends it by massive citation of historical and contemporary evidence.

Furthermore, state activities tend to create their own public goods problems. Access to the courts is available to all; people do not have to pay a market price to use the state's legal services. Of course, expenses such as filing fees and attorneys' costs do limit entry, but there is no charge just for access. Overcrowding results; and the governmentally supplied resource is used inefficiently. If the market sometimes underproduces public goods, the state more frequently overproduces them.

Benson concludes that the public goods problem does not strike a fatal blow at a free market legal system. Given the manifest advantages of this system, he accordingly recommends it.

The book's outstanding argument can I think be strengthened at two points. First, the underlying assumptions of Benson's model of public goods are not entirely clear. On one model, "a public good is one that enters two or more persons' utility" (p. 273, quoting Paul Samuelson). Efficiency aims at matching utilities and costs as closely as possible.

I am far from certain, but I think this is the conception of efficiency Benson uses. Although in his hands it leads to results favorable to the free market, it is intrinsically objectionable. If taken as a welfare ideal, a glance will show that this view of efficiency is a variant of utilitarianism, subject to most of the problems of that position. This is not the place to debate ethical theory, but it is uncontroversial that utilitarianism is controversial. It cannot simply be assumed without defense.

Another way of looking at public goods has quite different implications. Here one begins with having people and property rights not subject to coercion. People may find themselves in situations where individual and collective rationality conflict, but the question facing the analyst is entirely different from that of the first model. All solutions must strictly respect property rights.

If one goes one step farther and adds the Austrian demonstrated preference principle, the problem of public goods dissolves. The principle is of course much disputed; but it seems to me that even those

inclined against it ought to adopt a strict view of rights. Had Benson done so, he could not so easily have said: "An ideal and *permanently* limited government might be an improvement" over a complete free market (p. 373).

The second point at which the book's argument might benefit from expansion resembles the first. If efficiency is understood in loose terms as increasing wealth then it seems evident that it is an important value. But it is not the sum and substance of political philosophy, and its relation to other values needs to be examined. How would Benson reply to a defender of government who accepted his argument but claimed that other ethical principles still required a statist legal order?

I cannot guess Benson's response to this question, but of one thing I am sure. It would be a carefully considered answer, based on exhaustive research. *The Enterprise of Law* is a magnificent achievement and I enthusiastically recommend it.

David Gordon
The Ludwig von Mises Institute

Carl Schmitt: Politics and Theory. By Paul Edward Gottfried. New York: Greenwood Press, 1990.

Economists have in recent years extended their distinctive methods of analysis to the state. According to the public choice school, government officials, like everyone else, attempt to advance their own interests. The possession of power changes their situation but leaves untouched their motivation. The state does not differ in its nature from other institutions.

Ludwig von Mises adopted an entirely different approach to the state. The state in his view rests on force. The economic or "catallactic" sphere, based on exchange, does not encompass the state. Quite the contrary, it operates on antithetical principles.

In taking this view of the state, Mises showed his affinity for a conservative tradition whose foremost twentieth-century representative was Carl Schmitt. Mises and Schmitt did not know each other, so far as I am aware, although both knew Max Weber; and Mises speaks disparagingly of Schmitt in *Omnipotent Government*. Nevertheless, the similarities are unmistakable.

Paul Gottfried's brilliant new work elucidates Schmitt's view of the state. As Gottfried stresses, Schmitt rejected the pluralism of Harold Laski, who saw the state as but one of many groups within society. This anti-political view ignored the essence of the state, its monopoly of coercive power.

Schmitt maintained that liberals overemphasized legality: their quest for a precisely organized system of legal rules was a futile effort to avoid political decision. Thus, Hans Kelsen, the leading liberal jurist of the German-speaking world and Schmitt's arch-rival, argued that every legal system stems from a basic rule or *Grundnorm*. From the basic rule, the entire legal system can be logically deduced.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 117–120
ISSN 0889-3047

Schmitt questioned the fundamental basis of Kelsen's Pure Theory of Law. The key to sovereignty lies not in a system of principles, but rather in the power to make exceptions to customary legality in order to deal with emergencies. A state exists not by itself but as one of a group of contending powers. The chief function of the sovereign is to preserve order. Rival states need to be contained and internal factions kept in line.

Kelsen's deductive procedure bears close affinities with Mises's praxeological method in economics. But Mises's theory of the state was nevertheless closer to Schmitt's than to Kelsen's. Like Schmitt, Mises thought that the state had one key duty, the preservation of order. Unlike Schmitt, he did not stress the importance of the exception. But both Mises and Schmitt could say, with de Maistre, "The state rests on the executioner."

As Gottfried ably brings out, Schmitt refused to subordinate order to any "higher" political goals. In spite of Schmitt's reputation as a collaborator with National Socialism, "Schmitt in fact expounded a modified traditionalist view of the state that had little in common with Nazi theory or Nazi practice" (p. 3).

During the final years of the Weimar Republic, Schmitt strongly opposed the Nazis as a manifest threat to political stability. In line with his doctrine of the exception, he urged that a presidential dictatorship be established to contain both the Nazi and Communist threats. His advice was of course not followed, and after Hitler became Chancellor in January, 1933, Schmitt joined the Nazi Party. His period of effective collaboration with the Nazis came to an end in 1936; he was never the "Crown Prince" of Nazi jurists, as leftist writers endlessly repeat.

Schmitt's brand of conservatism differed entirely from the Nazis' emphasis on race and party above the state. He saw himself in the tradition of Jean Bodin and Thomas Hobbes. Bodin sought an end to the domination of French politics by religious warfare. In the *Six Books of the Commonwealth* (1576), Bodin emphasized the imperative need of the sovereign to control religious factions. Although in most cases the ruler should observe the laws and customs of the kingdom, he should be prepared in emergencies to abrogate them. Bodin did not write in an anti-religious spirit, although it perhaps goes too far to call him a "believing Catholic" *tout court* (p. 34). He may have been, but the nature of his religious views has aroused enormous dispute. His main work on the subject, the *Colloquium heptaplomeres*, is difficult to interpret.

Like Bodin, Hobbes saw the state as the sole guarantor of order. Gottfried discusses in detail Schmitt's interpretation of Hobbes,

noting in particular Schmitt's emphasis on the symbolism of Leviathan (pp. 48–49). Hobbes thought it within the power of the sovereign to declare how Christianity was to be interpreted: his ruling bound his subjects in their outward behavior. In his discussion of Schmitt on Hobbes, Gottfried shows superb control of the immense Hobbes literature. He offers an especially valuable discussion of the Warrender thesis, the view that Hobbes was a Christain Scholastic. In addition to the articles he cites critical of Warrender, I would also recommend Thomas Nagel's essay "Hobbes's Concept of Obligation" (*Philosophical Review*, 1959).

A leitmotif of Schmitt's work was his continued efforts to demonstrate how theology gave birth to political ideas. His association of doctrines of the Trinity with imperial assertions of power in the Roman Empire, a thesis that embroiled him in furious controversy with Erik Peterson, is the most famous instance.

Occasionally, Schmitt's search for parallels between theology and politics misfired, as in his discussion of the occasionalists in *Political Romanticism*. Nicholas Malebranche and other occasionalists attributed all causation to God's direct action. Schmitt drew a parallel between this view and the Romantics' tendency to think of themselves as outside the ordinary world. To them, politics was an "opportunity of expressing their inmost selves" (p. 18).

But this misunderstands the occasionalists. Malebranche did not deny fixed order in the world. On the contrary, he saw the world as the scene of constant correlations, anticipating the position of David Hume, who knew his work well. Malebranche taught that God added necessary connection to the fixed order of the world. His philosophy was not an assertion of theological arbitrariness. Incidentally, I do not think that occasionalism has ever been declared heretical (p. 17).

To Schmitt, the analysis of intellectual movements was much more than an academic exercise. He maintained that the "tyranny of values" endangered contemporary political order. Intellectuals in the grip of abstract universals threaten to overthrow political order, principally by perfervid advocacy of democracy. Rather than view the state as the preserver of order, the democratic ideology subjects society to total politicization (p. 80). In this way it bears a close connection with totalitarianism.

Schmitt traced the contemporary "tyranny of values" in part to the ethical universalism of Immanuel Kant, who not coincidentally favored a world federation of nations. Mises did not share this position, although he was decidedly not a Kantian in ethics. But he too stressed the role of maligned intellectual doctrines in the

overthrow of European order. Oddly enough, Mises's most extended treatment of this theme is in *Omnipotent Government*, the book that criticized Schmitt. Further, although Mises supported democracy, he did so strictly on pragmatic grounds. He had no commitment to it as an ideology.

Gottfried applies Schmitt's insights in a fascinating way to neoconservatism. Although supposedly rightwing, the neoconservatives favor total commitment to democracy in the exact fashion stigmatized by Schmitt. Their Wilsonian interventionism and worship of democracy bear no resemblance either to traditional conservatism or libertarianism. Gottfried insightfully compares Allen Bloom's universalist position with Kant's (p. 91).

Paul Gottfried has given us not only a lucid account of Carl Schmitt but also an illuminating analysis of contemporary politics. In both tasks, he displays remarkably wide-ranging and thorough scholarship. Gottfried is clearly an original thinker of high rank.

David Gordon
The Ludwig von Mises Institute

Ingenious Yankees: The Rise of the American System of Manufactures in the Private Sector. By Donald R. Hoke. New York: Columbia University Press, 1990.

Until recent years, the history of technology used to be written, and taught, for its own sake and almost completely isolated from economic and social history. Who among us has not had his eyes glaze over at tedious recitations of the technology of the flying shuttle, or the power loom, or the open-hearth process? The treatment was tedious because treated in isolation; about all we were told of the economic effects was that these machines improved productivity and lowered costs.

This tiresome tradition came to a sudden end with the arrival of the fascinating and crucially important work of David A. Hounshell, *From the American System to Mass Production, 1800–1932* (1984), which created a new paradigm dominating the field of American technological history. Hounshell's achievement was to integrate technological with economic and social history, and bring us, for the first time, a genuine history of the development of mass production. Thus, for example, in his pioneering history of the bicycle industry of the 1890s, Hounshell showed that the bicycle was, in two ways, a critical prelude to the invention and development of the automobile because, (1) the bicycle taught consumers the possibility and the joy of individual, mobile transportation (in contrast to the mass transportation between fixed points essential to the railroad); and (2) it taught bicycle makers the technology of the wheel, the tire, and the axle. It is no accident that the first automobiles were made in bicycle shops.

But there was one troublesome aspect to this new paradigm, one that conspicuously did not fit with an economist's knowledge of the market economy and the way it operates as compared to government. Based on his own work and on the contemporaneous studies of Merritt Roe Smith, Hounshell asserted that the fountainhead of mass production was U.S. government armories. Operated by government

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 121–124
ISSN 0889-3047

and with government as their only customer, the federal armories, beginning particularly in the late 1840s, were able to give full sway to the "technological enthusiasm" of engineers, and, *heedless of cost*, could develop mass production of firearms with perfectly interchangeable parts. This aesthetically pleasing but costly method of manufacture gradually spread its way from the public sector to private mass production. Thus, modern mass production was a creation of government typically heedless of cost rather than of private entrepreneurs functioning in a market economy.

But now comes Donald Hoke, in this exciting and highly significant work, to upset completely the Hounshell-Smith picture of "Armory Practice" as the key to the development of mass production in America. While building upon Hounshell's work, Dr. Hoke stands Hounshell on his head. Hoke makes it clear that he is an old friend and colleague of Hounshell's: both of them emerging from the remarkable economic history and history of technology program of the Hagley Foundation and the University of Delaware. Hoke demonstrates conclusively that, long before Armory Practice, mass production was brought to American industry by the remarkable engineer-entrepreneur, Eli Terry. As early as 1807, Terry, an ingenious Connecticut Yankee, created a wooden movement clock industry, as a mass produced clock with interchangeable parts, completely superseding the old hand crafted clock. In 1814, Terry delivered another shock to the clock industry, by creating the highly successful wooden movement shelf clock, as compared to the "hang-up" clocks previously dominant. In contrast to the highly costly arms manufacture, Terry's clock process was adopted precisely because it drastically *lowered* costs, and could thus be sold at a very low price and create a new mass consumer market for clocks that had previously been a luxury item for the wealthy.

One of the keys to this private mass production, which Hoke shows was to become the rule throughout American industry, was that the parts were not *perfectly* interchangeable, an inordinately rigid and expensive procedure. Instead, the wooden clocks and private manufacturing in later industries, were *designed* to be not "perfect" but adjustable, with built in adjustable elements such as screws, which allowed the parts to be fitted in each unit at the final assembly. Thus, interchangeability was not "perfect," but as much as necessary. This built-in flexibility allowed mass production to cut costs; for, in contrast to government operation, the emphasis by Terry and later private producers, was on cutting costs of manufacture and on easy use by the consumer. Hence, Terry and his successors were driven, not just by technological enthusiasm, but by such enthusiasm

intimately combined with a continuing quest to make products more cheaply and to render them more usable by the consumer. All this development was made possible by close cooperation between engineers and entrepreneurs; in this way, technology was always advanced in close collaboration with private, profit-seeking entrepreneurs for the benefit of the mass of consumers.

The next great case of mass production was the axe handle industry, developed in the 1830s and 1840s, also in Connecticut, by the creative engineer, Elisha K. Root, in collaboration with the far-seeing entrepreneur, Samuel W. Collins. Once again, the key was profit-seeking and cutting costs, and in the case of Root, in an integrated, systems approach. And rather than this mass production being influenced by Armory Practice, it was the Colt armory that hired Root, eminent from his development of axe handle factories, to manage its arms production at the end of the late 1840s. Thus, the major influence was, contrary to Hounshell, not so much from Armory Practice to private industry, as the other way around.

Donald Hoke goes on to study two other prominent cases beginning around the Civil War and also relatively neglected by historians: the intricately precise typewriter industry, and watch manufacturing as established by the Waltham Watch Company at Waltham, Massachusetts. In all cases he found the same pattern: emphasis on profit-seeking through cost-cutting and the development of a mass market; adjustable rather than "perfect" interchangeability; and collaboration between engineers and entrepreneurs. Not only that: In each and every case, Hoke found that not only was the industry private, but that there was virtually no reliance on government subsidies, or even on government contracts or purchases. The American System of mass production was private and market-oriented through and through.

Why have David Hounshell and other previous historians missed the boat so badly? Why, in particular, was the great pioneer Eli Terry virtually unknown before resurrected by Donald Hoke? Hoke's hypothesis is that Hounshell and the others have been deficient as antiquarian engineers: that is, they work solely from documentation and never from close study of the three-dimensional, old *objects* themselves. Hoke shows that Hounshell shows pictures of the objects produced in the nineteenth century only to illustrate his story, not as objects of study themselves. Hence, Hounshell and the others get the story wrong. Hoke, steeped in antiquarian engineering and in its journals, and therefore in close study of the objects themselves, was able to avoid this error.

In sum, *Ingenious Yankees* is a superb book, providing a new paradigm of American technological history consonant with sound

economics, based on thorough scholarship and a deep study of the produced objects themselves. It combines sparkling writing, bursting with the excitement of his paradigm discovery, with meticulous detail on the specific engineering innovations and their broader significance. There are also fascinating nuggets of insight that I hope Hoke or others will pursue further. Thus, Hoke finds absolutely no labor strife in these private mass production industries, despite their often rapid technological change. This harmony contrasts, for example, with the bitterness of many craftsmen working in the Harpers Ferry Armory. It is very possible that the technological force-feeding of government operation created more resentment than the cost- and customer-conscious collaboration between entrepreneurs and engineers. Hoke also notes the fundamental error of those historians who wail about mass-production workers being reduced to skillless machine operatives, deprived of the high skills of their craftsmen-fathers. Hoke replies that, not only did mass production create many more jobs, but that the new mass production required and developed many *new* skills, including invention, production, maintenance, and repair. The new skills were different from those of craftsmen, but the skills were still extensive.

Hoke also makes some telling points about later periods in American history. He shows that even Henry Ford was engaging in misleading bravado when he proclaimed that there were "no fitters" in this mass production; on the contrary, even automobiles needed adjustments and fitting. Even on Hounshell's own turf of the bicycle industry, Hoke shows that Alexander Pope's bicycle factory was not nearly as Armory Practice oriented as Hounshell claims, that his machine tools were adjustable rather than "perfect" and that Pope's increasingly successful competitors after the mid-1880s were even farther removed from Armory Practice.

With the appearance of *Ingenious Yankees*, the history of technology has become more deeply scholarly, focusing at last on the profound study of the actual three-dimensional technological objects, and at the same time, becoming integrated with social and economic history as well as with the teachings of economic theory. In his preface, Hoke quotes the eminent historian of medieval technology Lynn White, Jr. that "the history of technology is, emphatically, fun." In the hands of Donald Hoke, at least, it certainly is.

Murray N. Rothbard
University of Nevada, Las Vegas

The Limits of Government. By David Schmidtz. Boulder, Colorado: Westview Press, 1991.

David Schmidtz's illuminating new book subjects to careful examination a key argument used to justify governmental intervention into the free market. Some economic goods, it is alleged, the market cannot produce efficiently. Roughly speaking, goods will be produced if the gains expected by their producers exceed the costs involved in their manufacture. Some goods, e.g., national defense, have features that skew the market from an approach to efficiency. The goods in question, termed public goods, are characterized by jointness of supply and nonexcludability.

If produced, they are available to everyone within a given area. If, e.g., a drive-in movie is visible from the street, anyone who passes by may watch it, not just those who bought tickets to it. If, for example, some of the passersby would have been willing to purchase tickets had the film been otherwise unavailable, then (so it is claimed) a problem exists.

The movie is underproduced. The owner of the theater takes into account only the gains from those who pay admission; he receives nothing from passersby who free ride. Private cost and public benefit in public goods diverge. To expunge the gap, various remedies have been proposed, most of which involve resort to the state.

Schmidtz begins his assessment of the public goods problem by discussing several fundamental issues of political theory.

He first analyzes the nature of justification, finding two basic sorts of reason by which political institutions can be supported. The first is teleological justification: here the institution has a feature or promotes a goal which counts as a reason for establishing or maintaining it. An emergent justification, by contrast, claims that the manner in which an institution has been established justifies it.

The Review of Austrian Economics, Vol. 6, No. 1 (1992): 125–135
ISSN 0889-3047

Many political theorists claim that the state promotes civil peace, welfare, etc., better than alternative arrangements. Others argue that if a state arises by popular consent, it holds power rightfully. The first of these claims is a teleological justification; the second, an emergent. Schmidtz cogently argues that these two patterns constitute the principal sorts of justification for the state. As he notes, the two forms are not the only conceivable types of justificatory argument: Besides his own example, a theory that required the state to be justified both teleologically and emergently would fit neither type alone. Though neither mutually exclusive nor exhaustive, the two types are of great importance.

Schmidtz uses his classification scheme to make an intriguing claim about a style of argument popular in recent political thought. Some writers maintain that institutions are justified by what people under given conditions would rationally find it in their interests to accept. Schmidtz maintains that the apparent form of the argument masks its true character. It is not an emergent argument but rather a teleological one, since its "consent" is hypothetical. More radically, Schmidtz avers that to grasp the true force of a hypothetical consent argument, one must cast aside the imaginary story in which it is cloaked. The consent that would occur, e.g., in Rawls's original position, comes about for certain reasons. It is these reasons that bear the brunt of the argument.

Schmidtz states the essence of his case with characteristic lucidity: "The hypothetical story adds nothing whatsoever. It certainly does not add consent, for the story is only hypothetical" (p. 6). I am not sure that Schmidtz's provocative argument succeeds. Why cannot a teleological justification claim that an institution has the following good-making feature: it would be agreed upon by persons under stated hypothetical conditions?

Perhaps this sort of teleological argument always fails, and I certainly have no wish to defend it. An advocate would need to show why the feature in question added to the moral value of the institution having it. But in form, at least, I can see nothing wrong with the argument. The good-making feature is not the reason the hypothetical actors consent: it is rather their hypothetical consent itself. Schmidtz is surely correct that reasons need to be advanced in defense of the claim that consent would occur; but I cannot see that this always suffices to show the hypothetical consent does no work.

Schmidtz now turns to a subject of concern to everyone interested in libertarian theory: the Lockean Proviso. In one of its forms, this principle has seemed impossible to satisfy; it requires initial appropriators of property to leave "as much and as good" as they take for others.

Suppose that a parcel of land is divided into one hundred lots, identical in all qualities. Further, assume that there are one hundred settlers who use the land in common. If someone takes one of the lots, he has left ninety-nine lots for everyone else. Has he left "as much and as good" for others? On one reading of the Proviso, he has not; by removing one lot, everyone else has one fewer choice available.

The problem of satisfying the Proviso becomes even more severe if one takes into account future generations. One must now leave as much and as good for those who will come into existence. Schmidtz finds it plausible to extend the Proviso in this way, although he does not specify how many generations need to be considered.

Schmidtz seems on the surface to have painted himself into a corner. He has presented a version of the Proviso which seems on its face to rule out the initial acquisition of property; yet he wishes to defend property acquisition. With a bold stroke, Schmidtz extricates himself from the difficulty; the Proviso actually mandates the acquisition of property. "*Leaving goods in the commons fails to satisfy the Proviso.* In fact, leaving goods in the commons practically insures their ruin" (p. 21, emphasis in original).

The argument Schmidtz deploys is straightforward. If land is worked in common, then individuals have little incentive to conserve resources. Persons do not bear the full cost of their actions; if, e.g., someone grazes cattle on common land in a wasteful manner, most of the ensuing costs will be borne by others. The upshot will be what Garrett Hardin has famously called a "tragedy of the commons." Since property rights have not been established, the available resources will quickly sink to nothing.

If so, Schmidtz ingeniously contends, the Proviso mandates establishment of a system of property rights. The erstwhile irremovable bar to property rights has become their chief support. If it is objected that individuals who arrive on the scene later than the original appropriators can no longer themselves acquire unowned property, Schmidtz has a ready response. The Proviso requires that future generations have resources to use, not to appropriate. They are not harmed by having to acquire property from others.

Schmidtz's brilliant discussion will be a must for all future work on the Lockean Proviso. A few clarifications and objections, however, require mention. First, a point I think Schmidtz recognizes, he has not argued that the Proviso is morally required. It is not at all obvious why original appropriators must leave as much and as good for others: if one holds a strong labor-mixture theory of original acquisition, e.g., the limitation imposed by the Proviso will seem implausible.

It might be objected that Schmidtz has given an argument for the Proviso. Unless it is satisfied disaster will ensue through a tragedy of the commons. Is this not a very strong reason for accepting the Proviso as Schmidtz construes it? But what Schmidtz's point shows is that a society ought to have a system of property rights rather than allow unrestricted common use of resources. One need not fulfill the Proviso to meet this requirement. A system that requires individuals to bear the cost of their own waste of resources will prevent a tragedy of the commons, even if it leaves some people worse off than they would have been before the system was established. Suppose, e.g., that a few people in a society are totally denied any access to resources. The rest maintain a standard free-market system. There is no tragedy of the commons, but the Proviso is not satisfied.

Further, it is not apparent why Schmidtz deems it obvious that the Proviso must be extended to future generations. Why is it irrational to hold that one's obligations extend only to actual persons, not to persons who do not now exist? I do not argue that Schmidtz is wrong: it just is unclear why he thinks the issue requires no discussion.

To turn now to the substance of his argument; does the Proviso in fact require that property be removed from the commons? Schmidtz is of course correct that land is not being used efficiently in the situation he depicts. But it does not follow at once that a tragedy will ensue; this depends on circumstances. How much of a deviation will there be from efficient use? If the deviation is not substantial, then how strong is the requirement that enough and as good be left for others? It seems implausible that we are morally obligated to install a system providing for the highest possible degree of efficiency. If the use of land does not prevent successors from doing about as well as current users, why is there cause for complaint? (Perhaps if one took into account many future generations, however, a sorties problem might reinstate the Proviso.) It may well be, though, that Schmidtz is correct about most real-world situations, in which case his argument has outstanding practical importance.

One more difficulty needs to be treated, but this fortunately can easily be remedied. Suppose that common use does in fact result in rapid impoverishment of everyone. Has the Proviso been violated? No, since as stated it restricts only those who appropriate property; by hypothesis, there are none in the present case. But the modification of the Proviso which Schmidtz requires to meet this minor point is obvious and will be left "as an exercise for the reader."

Schmidtz continues with more provocative and insightful analysis in his third chapter; there the subject is the right of punishment.

His surprising conclusion is that "a state can acquire an exclusive right to punish even if individuals also have a right to punish and even if they do not relinquish that right" (p. 34).

Although Schmidtz developed his view of punishment as a response to a problem in Robert Nozick's treatment of risk, he approaches matters in a very different way from Nozick. The risk that concerns Schmidtz is danger to innocent bystanders—presumably when someone tries to enforce a sentence upon a recalcitrant offender. Although Schmidtz avoids postulating a right not to be put at risk, he does assume that one has no right to impose unnecessary risks on others. If the state can reduce risks to innocent bystanders below the level prevalent in self-help enforcement, then people are no longer at liberty to punish those who have injured them.

To reiterate, Schmidtz does not contend that one forfeits the right to punish in these circumstances. Rather, one cannot exercise one's right, since an alternative exists less liable to place bystanders at risk.

Once again, Schmidtz's ingenuity compels admiration. He again and again comes up with original ideas that challenge and instruct. But should we accept his argument? I am inclined to think not. First, an analogous point to one raised in the discussion of the Proviso emerges here as well. Why should we be required to maximize safety to innocent bystanders? So long as private enforcement does not place innocent bystanders at substantially more risk than does state enforcement, why should one insist on the least possible risk (consistent with having sentencing at all)? As will later be apparent, Schmidtz himself uses the distinction between "good enough" and "best possible" in his later discussion of public goods; does it not also apply here?

Further, why does Schmidtz think it likely that private enforcement will be riskier to bystanders than state enforcement? Perhaps he has in mind something like this: I attempt to take back my wallet from a thief. He sees no reason to return it to me, and in the ensuing struggle, people are injured. Had the police dealt with the thief, the bystanders could breathe a sigh of relief. Although on occasion criminals "shoot it out" with police, resistance is much less likely to occur.

No doubt matters often take place in the way just described. But it does not follow from this that individual enforcers need abandon their activities. They need only choose their opportunities carefully. They can, e.g., take care to have sufficient force to deter the criminal from resisting. One way to do this is to hire a private protection agency to enforce judgment: If the agency were sufficiently powerful, resistance seems an unlikely prospect for the same reason that

relatively few people resist arrest by the police. Another possibility is to pick one's spots carefully so that no innocents stand in danger.

Suppose, however, that Schmidtz's picture perfectly matches reality: A single dominant protection agency is vastly less liable to expose bystanders to danger than any combination of independents. Have we obtained a state? I cannot see that we have. It might be the case that the single agency able to enforce sentences could do nothing else. The mandate for punishment would always come from an independent. I do not claim this possibility is more likely to arise than the one Schmidtz envisions, but only that his argument does not exclude it.

A strong point of Schmidtz's work is that he attempts to meet in advance objections to his argument. One such objection suggests, following Guido Calabresi and A. Douglas Melamed, that injury to innocent bystanders be handled differently from Schmidtz's approach. Instead of prohibiting independents from enforcement, why not compensate innocents who are injured?

To this Schmidtz replies that the bystanders are being subject to pointless risks. Thus, the case should be governed by a property rather than a liability rule, to use Calabresi's terms: Prohibition rather than compensation is the indicated course.

Schmidtz's supposition of pointless risk does not cover all relevant cases. What if the state does not impose exactly the same punishment as the independent would have done? What if the state finds the criminal innocent, or fails to take up the case at all? Here one cannot say the risk is pointless—even if Schmidtz's argument were otherwise acceptable, it would not apply to independents in these circumstances. But what of instances in which Schmidtz's account exactly fits? I am not sure that even in this type of case, the risk is pointless: what if someone values protecting his own rights? But what if the risk *is* pointless? Schmidtz gives no argument that prohibition rather than compensation is the proper course to follow. But I have no argument to offer that he is wrong.

Schmidtz introduces the principal topic of his book, the provision of public goods, with an excellent analysis of the Prisoner's Dilemma. Many writers view the supply of public goods as raising the same problem as the classic Dilemma: supplying the good is collectively rational; but, for each person, refusal to cooperate in its supply dominates contributing. Since no person's actions will substantially affect supply of the good, everyone individually seems better off refusing to contribute, regardless of what others do.

Schmidtz very usefully divides the difficulty of securing cooperation into two parts. On the one hand, the familiar free-rider problem arises: Although everyone is better off if the public good is supplied,

for each person refusal to contribute dominates contributing. On the other hand, the free-rider problem, as Schmidtz convincingly shows, does not exhaust the difficulty of the Dilemma. He draws attention to the assurance problem: People willing to contribute do not wish their contributions to go to waste by failure to secure enough donors to produce the good.

Does the problem of supplying a public good, analyzed as a Prisoner's Dilemma, require forcible intervention for its resolution? Schmidtz does not think so; he shows that voluntary agreement suffices. His solution accents the assurance problem. A universal contract will suffice to prevent contributions from being forfeited without result. The terms of such an assurance contract provide that everyone agrees to contribute to the provision of the public good, if and only if everyone else does. Further, with a unanimous agreement, the remaining obstacle to a cooperative solution also dissolves. There are no free riders, and individual rationality now coincides with what best secures the welfare of the group (p. 57).

One might at first object that Schmidtz has by his assurance contract merely pushed back the difficulty. How is compliance with the contract to be secured? Will this not in turn generate another Prisoner's Dilemma, this time to be resolved only by force? To this difficulty Schmidtz has a response: Contract enforcement is not a public good since it is not characterized by jointness of supply. Those who do not purchase this good will not secure the enforcement of their contracts.

If it is now objected that contract enforcement depends upon force, Schmidtz once more has an ingenious reply. Signers of a contract cannot rightfully complain if they are compelled to observe its terms, since they have agreed to do so. The agency that in fact enforces contractual arrangements cannot then be legitimately questioned, since it might have arisen voluntarily.

But what if it did not? Schmidtz now produces the ingenious counter just mentioned. Even if the enforcement agency has not arisen through voluntary agreement, its activities do not depend on its having arisen through the use of force. The reason for this is just that an enforcement agency might have arisen voluntarily: How the agency arose does not affect the legitimacy of its present activities. (How it arose may of course affect whether it, rather than some other group, is best entitled to perform these activities.)

Thus Schmidtz has virtually completed his case. Public goods can be produced voluntarily, and nothing in the means required to do this need violate rights. This part of Schmidtz's argument seems to me eminently successful. One point that might require further

development has to do with the existence of individual property rights, necessary for a free market to function. To fully complete his case, Schmidtz needs to show that these rights do not depend essentially on the use of force for their establishment. I see no reason to think that this cannot be done.

A unanimous assurance contract by no means puts paid to all problems about public goods. Not all public goods can be analyzed as a Prisoner's Dilemma game, the players of which are a society's entire population. Some people may not regard the public good as desirable at all: Opponents of United States foreign policy, e.g., will not wish to purchase the "public good" of national defense. Others may rate certain public goods as worth less to them than the contribution required through an assurance contract.

Why not then confine the assurance contract to those who do think the public good worth securing? In Schmidtz's view, this solution generates a further problem. Some people may actually want the good; but, knowing that those who do not are not required to contribute, they may disguise their true wishes. Falsely pretending to be genuine holdouts, they hope by their strategic behavior to gain the good for nothing. The free-rider problem reemerges.

A further difficulty complicates the public goods problem even more. Unanimous consent is in practice intolerably cumbersome to achieve: It is likely that the market solution will consist of an assurance contract of fewer than the total number of those who want the good. The number required will vary with the minimum number needed to produce the good (unanimous consent will presumably still be required for a pure public good, in which no coalition suffices for its production). Once more free riders threaten.

Schmidtz suggests several principles to aid in the solution of these problems. He sets forward conditions under which he thinks people stand under an obligation to contribute to the provision of public goods they want. But obligation does not generate by itself liability to be coerced by others, should one fail to fulfill one's duty. Because of the tendency of government officials to advance their own interests, abundantly documented by public choice economists, it is highly unlikely that government intervention will bring about a better state of affairs than the free market. On the contrary, it is a safe bet that the government will worsen things. Schmidtz accordingly holds that the government should stay out of public goods provision, except in emergencies in which immediate action is required to prevent the destruction of society.

Schmidtz does not confine himself to a purely speculative account of how the market might produce public goods. He describes several

experiments, some of which he helped to design himself, which have endeavored to determine how people might handle public goods provision. The experiments provide some evidence for the view that people will voluntarily agree to produce public goods, although their behavior does not conform to theoretical models of rational choice. To those who object that the experiments are artificial, not genuine tests of market behavior, Schmidtz has a clever answer.

Theories of public goods production should, if correct, apply to experimental situations, since these fall within the scope of the theories' postulates. The experiments Schmidtz describes thus are more than simulation of actual market behavior: they are themselves "real-life" tests.

Austrians may be inclined to look on experimental economics with a jaundiced eye, but I think Schmidtz escapes danger from this front. He does not claim that he has an airtight model, deductively derived from self-evident axioms, specifying when it is rational for persons to contribute to public goods. He need not be taken as committing himself to the view that all economic theory requires empirical verification.

On another point, though, Schmidtz's analysis sharply contrasts with a Misesian position. On the "demonstrated preference" view, only persons' actual choices are counted as genuine preferences. Counterfactual preferences are banned from praxeological analysis. As one can readily imagine, this has quite drastic consequences for the public goods problem; Hans Hoppe, most notably, has used demonstrated preference in an attempt to undermine standard accounts of public goods.

I strongly suspect that Schmidtz thinks this view mistaken. I wish he had spent at least a short time discussing the issue, as the question is of concern to many philosophers and economists of free-market orientation. But given the wide range of topics Schmidtz does cover, I am no doubt unfair in my complaint.

To return from Austrianism to Schmidtz, his skepticism about the role of government in the supply of public goods seems eminently justified. His careful distinction between obligation and liability to coercion is particularly excellent.

On one point, however, Schmidtz might usefully have extended his skepticism. He assumes that free riding, and perhaps certain other kinds of strategic behavior, are morally questionable. Thus, he holds that if one benefits to a sufficient extent from a public good, one ought to contribute to its production. Further, though I may be mistaken, I think he finds morally problematic pretending for strategic reasons to be a holdout.

Though most philosophers interested in this area agree with Schmidtz, I do not think it at all obvious that something is wrong with free riding. *Prima facie*, the free rider (or strategic bargainer) is acting to secure his own interests: what exactly is his moral offense?

It might be said that free riding prevents a group from maximizing its collective welfare. But why is this a reason to hold the practice morally wrong? Is one under an obligation to avoid interfering with the use of resources to maximize collective welfare? On certain consequentialist views, the answer is yes; but these positions cannot simply be assumed as given.

Schmidtz might reply that this objection underestimates the force of the considerations against the free rider. It is not only the group that will benefit if no one free rides: With an assurance contract, everyone, including potential free riders, will be better off than if each person is free to act as he pleases. But this at most shows that one would be irrational (or not rational in Schmidtz's sense [p. xvi]) in refusing to sign an assurance contract. An additional premise is needed to generate a moral obligation.

Schmidtz, as one might expect, knows this full well and has just the moral premise that will do the trick. His feedback theory of morality tests moral norms by the question: "Is this norm conducive to a cooperative society's success, given how people will react both to it and to agents guided by it" (p. 153)?

Granted that social cooperation is a *conditio sine qua non* of human happiness and survival, does it follow that one must take maximizing cooperation as the test of morality? Why is it not sufficient to secure some threshold of cooperation, after which this value might find itself in competition with other values? This point generalizes a criticism made earlier about Schmidtz's discussion of the Proviso. From "x is good," the further statement "maximize x" does not follow. Of course, I have not shown that one should *not* aim to maximize social cooperation: The point, rather, is that the matter is more controversial than Schmidtz allows.

The case against the free rider suffers from a more fundamental flaw. The argument against him, very roughly, is that cooperation is desirable; free riding impedes cooperation; therefore, free riding is *prima facie* objectionable. A problem with this argument emerges if one considers once more Schmidtz's convincing analysis of the Prisoner's Dilemma.

In that analysis, two problems produce the Dilemma: besides the free rider difficulty, there is also an assurance problem. If free riding is objectionable just because it impedes cooperation, why is there no similar objection to someone wishing assurance that his contributions

will not be wasted? Schmidtz does not call for the curtailment or reduction of the desire for assurance; instead, he caters to this desire through the assurance contract. Why the difference? The objection to free riding cannot *just* be that it blocks cooperation. What then is it?

I fear that I have gone on too long, but this is an endlessly fascinating book. Many of its themes I have had to omit: I think particularly of the illuminating discussion of what Schmidtz terms the concatenated Prisoner's Dilemma (pp. 101–02)[1] and the use of his feedback theory to derive a rule of reciprocity in cooperative ventures.

The Limits of Government is an outstanding work, manifesting the remarkable philosophic talent of its author.

David Gordon
The Ludwig von Mises Institute

[1]Schmidtz suggests, following David Kreps, that someone playing an iterated or concatenated Dilemma with an opponent having an established reputation for reciprocity ought rationally to cooperate rather than use the backward induction paradox to justify noncooperation. But might the paradox interfere with developing such a reputation?

THE REVIEW OF AUSTRIAN ECONOMICS

Volume 6, Number 2

The Review of Austrian Economics

Murray N. Rothbard, Editor
University of Nevada, Las Vegas

Walter Block, Co-Editor
College of the Holy Cross

Steve H. Hanke, Associate Editor
The Johns Hopkins University

Judith F. Thommesen
Managing Editor

Editorial Board

Martin Anderson
Hoover Institution
Stanford University
Dominick T. Armentano
University of Hartford
Roger Arnold
California State University, San Marcos
Charles W. Baird
California State University, Hayward
Don Bellante
University of South Florida
James T. Bennett
George Mason University
Olufur Bjørnsson
University of Iceland
Samuel Bostaph
University of Dallas
J. B. Bracewell-Milnes
Surrey, England
Yale Brozen
University of Chicago
Alfred G. Cuzan
University of West Florida
Thomas J. DiLorenzo
Loyola College
Richard M. Ebeling
Hillsdale College
Robert B. Ekelund, Jr.
Auburn University
Joseph Fuhrig
Golden Gate University
Lowell Gallaway
Ohio University
Fred R. Glahe
University of Colorado
David Gordon
Ludwig von Mises Institute
Henry Hazlitt
Fairfield, Connecticut
Robert F. Hébert
Auburn University
Robert Higgs
Seattle University
Ole-Jacob Hoff
Tjøme, Norway
Randall G. Holcombe
Florida State University
Hans-Hermann Hoppe
University of Nevada Las Vegas
Edward Kaplan
Western Washington University
Lord Harris of High Cross
Institute of Economic Affairs, London, England
Kurt Leube
Hoover Institution
Stanford University
Stephen O. Littlechild
University of Birmingham England
Naomi Moldofsky
University of Melbourne Australia
Thomas Gale Moore
Hoover Institution
Stanford University
John C. Moorhouse
Wake Forest University
David O'Mahony
University College Cork, Ireland
David Osterfeld
St. Joseph's College
E. C. Pasour, Jr.
North Carolina State University
William H. Peterson
Washington, D.C.
W. Duncan Reekie
University of the Witwatersrand South Africa
Morgan O. Reynolds
Texas A & M University
Charles K. Rowley
George Mason University
Joseph T. Salerno
Pace University
Arthur Seldon
Institute of Economic Affairs, London, England
Sudha Shenoy
University of Newcastle Australia
Mark Skousen
Rollins College
Gene Smiley
Marquette University
John W. Sommer
Urban Institute
University of North Carolina, Charlotte
T. Alexander Smith
University of Tennessee
Thomas C. Taylor
Wake Forest University
Richard K. Vedder
Ohio University
Leland B. Yeager
Auburn University
Albert H. Zlabinger
Carl Menger Institute Vienna, Austria

THE REVIEW OF AUSTRIAN ECONOMICS

Volume 6, Number 2

Edited by
Murray N. Rothbard
University of Nevada, Las Vegas

Co-edited by
Walter Block
College of the Holy Cross

LUDWIG VON MISES INSTITUTE

Auburn University

Kluwer Academic Publishers
Boston/Dordrecht/London

The Review of Austrian Economics

SUBSCRIPTION RATES

The subscription price for 1992, Volume 6 (2 issues) is:
For institutions Dfl. 213.00/US $108.50 including postage and handling.

ORDERING INFORMATION / SAMPLE COPIES

Subscription orders and requests for sample copies should be sent to:

Kluwer Academic Publishers Group
P.O. Box 322
3300 AH Dordrecht
The Netherlands

or

Kluwer Academic Publishers
101 Philip Drive
Assinippi Park
Norwell, MA 02061, USA

or to any subscription agent

All requests for further information concerning *The Review of Austrian Economics* should be sent to:

Kluwer Academic Publishers
101 Philip Drive
Assinippi Park
Norwell, MA 02061, USA

or

Kluwer Academic Publishers
P.O. Box 163
3300 AD Dordrecht
The Netherlands

Photocopying. *In the U.S.A.:* This journal is registered at the Copyright Clearance Center, Inc., 27 Congress Street, Salem, MA 01970. Authorization to photocopy items for internal or personal use, or the internal or personal use of specific clients, is granted by Kluwer Academic Publishers for users registered with the Copyright Clearance Center (CCC) Transactional Reporting Service, provided that the base fee of $5.00 per copy per article is paid directly to CCC. For those organizations that have been granted a photocopying license by CCC, a separate system of payment has been arranged. The fee code for users of the Transactional Reporting Service is 0889-3047/92/$5.00.

Authorization does not extend to other kinds of copying, such as that for general distribution, for advertising or promotional purposes, for creating new collective works, or for resale.

In the rest of the world: Permission to photocopy must be obtained from the copyright owner.

Copyright © 1993 by The Ludwig von Mises Institute.

ISSN 0889–3047

Printed on acid-free paper.

The Review of Austrian Economics has two broadly conceived objectives: (1) to promote the development and extension of Austrian economics and (2) to promote the analysis of contemporary issues in the mainstream of economics from an Austrian perspective.

Correspondence relating to submissions, articles, book reviews, permission to quote, and back issues through volume 3 should be addressed to: *Review of Austrian Economics,* Ludwig von Mises Institute, Auburn University, Auburn, Alabama 36849.

Papers submitted for consideration should be double-spaced, include three copies of the manuscript, and an abstract of not more than 250 words to assist the referees. There is no submission fee. Articles that are accepted will be requested on an IBM format diskette, when possible.

The opinions expressed in this volume by the authors in their respective articles are their own and *The Review of Austrian Economics* assumes no responsibility for these views.

Dedication

Volume 6, number 2, of the *Review of Austrian Economics* is dedicated to the Members of the Ludwig von Mises Institute, whose generosity makes such projects possible, and in particular to O. P. Alford, III, Thomas K. Armstrong and the Armstrong Foundation, Everett Berg and EBCO Enterprises, Eugene W. Bluemly, Jr., Franklin M. Buchta, Samuel O. Campbell, Christopher P. Condon, Guy Curtis and the Alta Hier Estate, Robert T. Dofflemyer, Michael L. Keiser, Robert D. Kephart, Hugh E. Ledbetter, Peter K. Martin, Ellice McDonald, Jr., James M. Rodney, Sheldon Rose, Leland W. Schubert and the AHS Foundation, Mrs. Somers von Behren, Frederick G. Wacker, Jr., and Dallas R. Wolf.

The Review of Austrian Economics would like to thank the following referees for their help:

Charles W. Baird

Donald J. Boudreaux

David Gordon

Robert F. Hébert

Robert Higgs

Randall G. Holcombe

Joseph T. Salerno

Richard K. Vedder

THE REVIEW OF AUSTRIAN ECONOMICS

Articles

Larry J. Eshelman
Ludwig von Mises on Principle 3

Bruce L. Benson
The Impetus for Recognizing Private Property and Adopting Ethical Behavior in a Market Economy: Natural Law, Government Law, or Evolving Self-Interest 43

Donald J. Boudreaux and Thomas J. DiLorenzo
The Protectionist Roots of Antitrust 81

Review Essays

David Gordon
Toward a Deconstruction of Utility and Welfare Economics 99

Joseph T. Salerno
Mises and Hayek Dehomogenized 113

Book Reviews

Tibor Machan, *Capitalism and Individualism*
Reviewed by David Gordon 149

Henry B. Veatch, *Swimming Against the Tide in Contemporary Philosophy*
Reviewed by David Gordon 153

VOLUME 6, NUMBER 2 **1993**

Articles

Ludwig von Mises on Principle

Larry J. Eshelman*

Ludwig von Mises was one of this century's most principled and uncompromising defenders of laissez faire. He was also an outspoken advocate of utilitarianism and the doctrine of social expediency, and a critic of any kind of objective ethics such as natural law or natural rights. This raises the obvious question as to how successful Mises was in turning the sow's ear of social expediency into the silk purse of laissez faire.

Murray N. Rothbard's answer is that Mises was not successful—that no one, not even Mises, could accomplish such a feat (1982, pp. 205–13). Henry Hazlitt (1964) and Leland Yeager (1992), on the other hand, have argued that utilitarianism really is not the sow's ear that its critics have made it out to be—or at least not the brand of utilitarianism that they attribute to Mises: indirect utilitarianism. Furthermore, they argue that only utilitarianism, properly understood, can provide a moral foundation for laissez faire.

While I agree with Rothbard that utilitarianism, whether direct or indirect, cannot provide a principled defense of laissez faire, I shall argue that Mises's method of justifying laissez faire has more in common with the natural rights approach of Herbert Spencer and Auberon Herbert than the utilitarianism of Bentham and Mill. It should be stressed that I am not disputing the easily documented fact that Mises proclaimed himself to be a utilitarian, and was highly critical, even scornful of natural law and natural rights doctrines (Rothbard 1980). One can dredge up quote after quote where Mises defends utilitarianism and social expediency and attacks natural law and natural rights theories. On the other hand, one cannot ignore Mises's "apparent use of natural law–type constructs, in spite of his explicit rejection of natural law" (Tucker and Rockwell 1991, p. 48).

*Larry J. Eshelman is an independent scholar living in New York.

The Review of Austrian Economics Vol.6, No. 2 (1993): 3–41
ISSN 0889-3047

In trying to understand Mises's relationship to the natural law tradition, one should keep in mind, as Mises pointed out, that the natural law tradition is made up of a "bewildering diversity of doctrines" (1957, p. 45). The same can be said of utilitarianism. Defenders, as well as critics, of these traditions rarely agree as to what constitutes their defining criteria. For example, if one believes that the essence of the natural law tradition is the fusion of the "ought" and the "is," or the doctrine that Nature has a purpose and morality consists in following Nature's intentions, then clearly Mises stands opposed to that tradition. There are, however, other important features of the natural rights tradition, especially with regard to methodology, that generally distinguish it from the utilitarian tradition.

In the next three sections I distinguish three different senses in which one may be properly labeled a utilitarian: (1) a nonmoral *functionalist* sense concerned with whether means are efficient; (2) a moral sense concerned with *social harmony*; and (3) a methodological sense in which alternative institutions and actions are *compared* with regard to how well they promote utility. It is my contention that Mises was a utilitarian in only the first two senses, and that his criticism of the natural rights tradition is aimed mainly at what he conceived to be its irrational, nonfunctional aspects—i.e., its appeal to intuition. In the remaining sections I argue that Mises's methodological approach to morality is more akin to the principled (or *categorical*) stance taken by defenders of the natural rights tradition rather than the *comparative* stance taken by utilitarians such as Bentham and Mill.[1]

Functionalism versus Intuitionism

It is important to begin by clarifying what Mises means by utilitarianism, and this can best be done by understanding what he was contrasting utilitarianism with. For Mises the alternative to utilitarianism is an appeal to "intuition" (1922, p. 360; 1966, p. 883; 1957, pp. 53, 58), to an "inner voice" (1933, p. 41; 1957, p. 53), to

[1]I am not claiming that these three senses of utilitarianism are explicit in Mises's writings, but only that they help resolve the apparent conflict between Mises's principled stance toward liberty and his professed belief in social expediency. My approach to Mises's utilitarianism is similar to that taken by Hans-Hermann Hoppe with regard to Rothbard's natural rights: "my approach . . . seems to be more in line with what Rothbard actually does when it comes to justifying the specific norms of libertarianism than the rather vague methodological prescriptions of the natural rights theorists" (Hoppe 1988, p. 61). I hope to show that in spite of his professed utilitarianism, Mises takes a principled approach to ethics that has much in common with the approach taken by Rothbard and Hoppe.

"considerations hidden to the human mind" (1966, p. 148), to "arbitrary laws imposed upon man by a tyrannical Deity with which man has to comply without asking any further questions" (1962, p. 105). For the intuitionist moral laws are viewed as "instruments by means of which God or Nature directs human action according to inscrutable design" (1945, p. 223). Mises places natural law and natural rights in the intuitionist camp, and therefore rejects them as irrational and arbitrary.

Although I think that this turns the natural law tradition into a straw man, it must be admitted that there have been strong intuitionist elements within the natural law and natural rights tradition. For example, Aquinas postulated the special faculty of synderesis as the source of our knowledge of principles of natural law, and Locke's principal argument for natural rights seems to hinge on the premise that God is our Maker (1988, p. 271). What makes Bentham's utilitarianism appealing to many rationalists, including Mises, is that Bentham swept away the remaining intuitionist vestiges of natural law. Unfortunately, Bentham threw out more than the murky bath waters of intuitionism.

To avoid stacking the deck against the natural law and natural rights traditions by identifying utilitarianism with reason and natural law with intuition, I suggest that we re-label this contrast as "functionalism" versus "intuitionism." As Hayek pointed out, if we refer to "any critical examination of such rules and of institutions with respect to the function they perform in the structure of society" as utilitarianism, then "every one who does not regard all existing values as unquestionable but is prepared to ask why they should be held would have to be described as a utilitarian. Thus Aristotle, Thomas Aquinas, and David Hume, would have to be described as utilitarians" (1976, p. 17). What Aristotle, Aquinas, Hume, Bentham, Mill, and Mises have in common is not some appeal to "the greatest happiness for the greatest number," but a belief that morality serves some earthly social function and can be understood by reason, as opposed to something "imposed on mankind by mysterious powers" (1933, p. 42).

Although the term "utilitarianism" has become identified with Bentham's doctrine of "the greatest happiness for the greatest number," i.e., with the maximization of utility or social welfare, one must keep in mind that when Mises advocates utilitarianism he is often simply advocating that we ask what the purpose of a policy, institution, etc. is and judge it by how well it achieves this purpose. As such, functionalism is not a moral doctrine, although it can be applied to morality. In the next section I will examine functionalism as it relates

to morality, but here I am concerned with generic, nonmoral functionalism.

The functionalist judges acts (or policies) in terms of how adequate (or efficient) they are as means for accomplishing a given end. In other words, all "oughts" are hypothetical or conditional and are of the form: "If you want to accomplish *E*, then you ought to do *M*." The end or goal is not judged. Only the means are judged as to whether or not they are appropriate to the given end. Even if one considers the goal evil, one can still judge certain means as more appropriate for accomplishing that goal, and thus good, relative to the goal. Thus Mises, as a functionalist, says, "if there were people who consider it as the ultimate end of their endeavors to destroy civilization . . . , then we could not help applying to their doctrines the standard of their ultimate end" (1949b, p. 300). (There remains the question as to whether it would be ethical to give helpful advice to someone who is intent upon destroying civilization.)

This is the brand of utilitarianism with which Mises, like most economists, feels most comfortable. He can make judgments without abandoning the value-free stance of the economist. Mises speaks (1966, p. 764) as a nonmoral functionalist when he asserts, "Economics does not say that . . . government interference with the prices of only one commodity . . . is unfair, bad, or unfeasible. It says . . . that it makes conditions worse, not better, *from the point of view of the government and those backing its interference*." Rothbard (1982, p. 206) quotes this passage and asks, "[H]ow does Mises know *what* the advocates of the particular policy consider desirable?" But I do not think this criticism hits the mark. Mises's point is simply that such policies will not accomplish their proclaimed goals. Those who advocate a minimum wage, for example, may really want to make nonunion labor uncompetitive, but their *proclaimed* goal is that they want to help the poor. By showing that certain policies will have the opposite effect from that proclaimed, the functionalist can undermine the arguments used in support of these policies.

If people's goals were so diverse that hardly any two people shared the same goals, the functionalist would not have much to contribute. But Mises contends that most people share certain goals. In particular, he asserts that most "people prefer life to death, health to sickness, nourishment to starvation, abundance to poverty" (1966, p. 154). In so far as the socialist or interventionist argues that his policy will make people more prosperous, he is subject to criticism from the functionalist standpoint (1927, pp. 7–8; 1966, p. 183). It should be stressed that Mises is not giving any *moral* relevance to the fact that the majority prefers prosperity to poverty. For the

generic functionalist such facts concerning majority preferences have only practical relevance—i.e., arguments concerning appropriate means will be relevant to more people than if only a minority shared this goal.

In order for nonmoral functionalism to be an appropriate mode of argument, however, it is not enough that everyone agree upon the end in question. While it may be true that most people value prosperity and abundance, it is not true that these are their only goals (Rothbard 1982, p. 209). Almost any policy purporting to achieve a particular end will affect other ends as well. The functionalist cannot ignore these other ends. Suppose, for example, most people are willing to trade off some prosperity for increased economic equality. The functionalist's argument that certain alternative policies lead to greater prosperity is no longer relevant if these policies cause greater inequality. In fact, Mises recognizes this weakness in the functionalist argument. He suggests that the socialist might reply to the argument that there is greater prosperity under capitalism as follows: "Granted that each individual will be worse off under socialism than even the poorest under capitalism. Yet we spurn the market economy in spite of the fact that it supplies everybody with more goods than socialism. We disapprove of capitalism on ethical grounds as an unfair and amoral system. We prefer socialism on grounds commonly called noneconomic and put up with the fact that it impairs everybody's material well-being" (1966, p. 679). Mises's comment is, "If no other objections could be raised to the socialist plans than that socialism will lower the standard of living of all or at least of the immense majority, it would be impossible for praxeology to pronounce a final judgment" (1966, p. 679).[2]

Another problem with nonmoral functionalism is that it is not very useful for making a case against forms of statist intervention that have little effect upon prosperity, e.g., oppression of the majority against a small minority (Rothbard 1982, p. 211). In order to attack these forms of statist intervention, the laissez-faire liberal needs a stronger argument than nonmoral functionalism—he needs some kind of moral argument. As we will see in the next section, Mises indeed does resort to a form of moral functionalism when defending laissez-faire liberalism. I will argue in the subsequent sections, however, that his moral functionalism is not the moral utilitarianism of Bentham and Mill.

[2]Mises believes, however, that a "final judgment" can be made, because economic calculation is not possible under socialism, and so socialism is not a realizable system.

Social Harmony

The functionalist approaches morality by first determining the function or end of morality, and then assessing various moral rules according to how well they serve this function. For Mises, as for most moral functionalists, the function of morality is the preservation of the social order: "Everything that serves to preserve the social order is moral; everything that is detrimental to it is immoral" (1927, p. 34). "The ultimate yardstick of justice is conduciveness to the preservation of social cooperation. Conduct suited to preserve social cooperation is just, conduct detrimental to the preservation of society is unjust" (1957, p. 54). If man were not a social being, he would not need morality. "Morality consists in the regard for the necessary requirements of social existence that must be demanded of each individual member of society. A man living in isolation has no moral rules to follow" (1927, p. 33). Throughout Mises's writings the stress is on the "preservation of society" (1966, p. 149), the "preservation of peace" (1966, p. 149), and the "preservation of social cooperation" (1962, p. 105). For Mises, "Human society is an association of persons for cooperative action" (1927, p. 18), and cooperation presupposes peace. "Society has arisen out of the works of peace; the essence of society is peacemaking" (1922, p. 59). "The goal of liberalism is the peaceful cooperation of all men" (1944, p. 50).[3]

To avoid the ambiguities associated with "utilitarianism" as a moral theory and to avoid begging the question against "natural rights," I suggest we call anyone who views the primary aim of justice to be the "securing a peaceful living together" a *social harmonist*.[4] A moral rationalist, in the sense of a social harmonist, is someone who believes that a society of morally rational individuals would exist in a state of social harmony. In other words, it would be a peaceful society with no need for coercion. Societies only have to resort to coercion because not everyone is rational in this social sense. Mises explicitly states that social harmony is the ideal and is possible: "The ultimate ideal envisioned by liberalism is the perfect cooperation of all mankind, taking place peacefully and without friction" (1927, p. 105). "If all men were able to realize that the alternative to peaceful social cooperation is the renunciation of all that distinguishes Homo sapiens from the beasts of prey, and if all had the moral strength always to act accordingly,

[3]This paragraph and many similar observations throughout this essay concerning Mises's social theory owe much to Joseph Salerno's essay, "Ludwig von Mises as Social Rationalist" (1990).

[4]I am borrowing the label "harmonist" from Mises, although giving it a somewhat wider connotation (1957, p. 40).

there would not be the need for the establishment of a social apparatus of coercion and oppression" (1962, p. 98).

Mises's stress upon preserving social peace certainly fits in with the utilitarian tradition of J. S. Mill. When discussing justice, Mill stresses social peace: "It is their observance [of the rules of justice] which alone preserves peace among human beings; if obedience to them were not the rule, and disobedience the exception, everyone would see in everyone else an enemy against whom he must be perpetually guarding himself" (Mill 1971, p. 54).

It should be pointed out, however, that this stress upon social harmony, although part of the utilitarian tradition, is not unique to that tradition. Herbert Spencer, for example, describes his theory of justice as an "attempt to find a definite expression for the fundamental principle of harmonious social order" (Spencer 1978, p. 66). Given that some utilitarians have claimed Spencer as a fellow-traveler, it should be noted that Lysander Spooner, who has never been mistaken for a utilitarian, states that the natural law is "the science of peace; and the only science of peace; since it is the science which alone can tell us on what conditions mankind can live in peace, or ought to live in peace, with each other" (Spooner 1982, p. 5). Along these same lines, Locke wrote that the law of nature "willeth the Peace and *Preservation of all Mankind*" (Locke 1988, p. 271).

More generally, according to A. P. D'Entrèves, one the foremost scholars of natural law, the primary focus of much of the natural law tradition has been on the preservation of society:

> No doubt natural law, as a moral precept, extends to "all acts of virtue." But human laws cover only those aspects of human behavior which imply a coordination with other men. Thus, properly speaking, the laws of men do not primarily aim at virtue, but only at securing a peaceful living together: they do not forbid all that is evil, but only that which imperils society. (D'Entrèves 1970, p. 84)

Thus, we must include as social harmonists not only utilitarians such as Bentham and Mill but also modern natural rights theorists such as Locke and Spencer and most ancient and medieval natural law theorists. If there are any natural law theorists who really advocate the principle, "let justice be done, though the world perish," as opposed to, "let justice be done, lest the world perish," then they are not social harmonists.

But if the debate between natural law theorists and utilitarians is not over utility as defined in terms of social harmony, then what is it about? I suggest that the basic difference is one of methodology.

This difference has been succinctly summarized by another modern defender of natural law, Paul Sigmund, as follows:

> For natural law theorists . . . utility is a result of the observance of natural law principles, whereas for utilitarians the principles of justice are an indication or codification of long-run utility. Both take account of the same moral experience and both often come to the same conclusions, but one emphasizes the *a priori* and universal character of our moral conclusions about man in society, and the other emphasizes the basis for these conclusions in human desires and in a posteriori effects which follow their adoption. (1971, p. 152)

Among classical defenders of natural rights, Herbert Spencer most clearly articulated this methodological distinction in order to distinguish his moral theory from the utilitarianism of Bentham and Mill. Spencer did not reject the label "utilitarianism," since he too saw happiness as the "ultimate end" (1989, p. 109) or "creative purpose" (1970, p. 61). What he objected to was making happiness "the rule of human conduct" (1970, p. 60) since the idea of the greatest happiness was "capricious" (1970, p. 27). Instead of trying to estimate the empirical consequences of an action or a policy, morality should be concerned with ascertaining "the *conditions* by conforming to which this greatest happiness may be attained" (1970, p. 61). Spencer did not object to being called a utilitarian, provided this label was qualified with the word "rational" to distinguish his doctrine from the "empirical utilitarianism" of Bentham and Mill (Spencer 1978, p. 494).[5]

Utilitarians have tended to either dismiss or misinterpret Spencer's point about method (in so far as they have paid any attention to Spencer at all). J. S. Mill is typical in this respect. Mill, in reply to Spencer's criticism of utilitarianism, asserted that there was no essential disagreement between Spencer and himself (and Bentham), dismissing Spencer's stress upon necessary consequences as not very important (Mill 1971, p. 56). Others have taken Spencer's methodological point more seriously but have interpreted it as being the distinction between direct (act) utilitarianism and indirect utilitarianism. According to John Gray,

> Indirect utilitarianism may be defined as that species of utilitarian theory in which a strong distinction is marked between the critical and practical levels of moral thought, and in which the principle of

[5]Locke, who wrote before utilitarianism had been developed as a distinct theory, made a similar methodological distinction: "Utility is not the basis of the law or the ground of obligation, but the consequence of obedience to it" (Sigmund 1971, p. 93).

> utility is evoked, solely or primarily, at the critical level. Utilitarian appraisals apply, not to conduct, but to the considerations which govern conduct—not only social rules, but the whole body of sentiments, attitudes and dispositions which lead us to one thing rather than another. (Gray 1989, p. 122)

Gray classifies both J. S. Mill and Spencer as indirect utilitarians.

Although it is true that Spencer believed that direct utilitarianism would lead to social "confusion" (1970, p. 16), his objection was much deeper than this. What Spencer mainly objected to in the utilitarian philosophy was its lack of principle, i.e., its stress on expediency. Now this may seem to be consistent with Gray's point about indirect utilitarianism: "Indirect utilitarianism is distinct from a sophisticated act-utilitarianism view, then, because it requires that certain practices and conventions be accorded enough weight for their claims to be able to *resist erosion* by utilitarian appraisals" (Gray 1989, p. 130, italics added). Spencer thought, however, that if anything, it was "incomparably less difficult" to "trace out the consequences a given act will entail" than to do so for "some public measure," but that in neither case could one make "trustworthy inferences" (1970, p. 73). Ironically, in one of the key texts that is supposed to provide evidence that Mill was an indirect, and therefore, a principled utilitarian Mill states, "All persons are deemed to have a *right* to equality of treatment, except when some recognized social expediency requires the reverse" (Mill 1971, p. 56). A little later he says, "Thus to save a life, it may not only be allowable, but a duty to steal or take by force the necessary food or medicine, or to kidnap and compel to officiate the only qualified medical practitioner" (Mill 1971, p. 57). (Perhaps this is a utilitarian's ideal of resisting "erosion," but to nonutilitarians it looks more like a mud slide.)

Of course Mill's failure to take a principled stance should not be used to convict all indirect utilitarians. I argue in the next section, however, that what I call the comparative–categorical contrast better captures the distinction Spencer was trying to make than the direct-indirect contrast. The direct–indirect distinction is a question of what one should compare. The direct utilitarian compares acts, choosing those whose consequences provide more utility. The indirect utilitarian compares rules, institutions, policies, sentiments, choosing those whose consequences provide more utility. In both cases, a *comparative* approach is taken. The distinction between direct and indirect utilitarianism is based on a distinction between what is being compared. Spencer, on the other hand, rejects the comparative approach, taking instead a *categorical* approach to social harmony.

Comparative versus Categorical Harmonists

The comparative harmonist compares the alternatives, whether they be acts, rules, institutions, etc. and picks the best from among these alternatives. Comparative harmonists differ as to how to choose among alternatives. Some argue that happiness should be maximized, others that pain and suffering should be minimized. Others argue for maximizing liberty instead of happiness. Still others, like Hayek, argue for maximizing expectations or "chances of anyone selected at random" (Hayek 1976, pp. 129–30). Some, like Bentham, presuppose that happiness can be quantified and summed, whereas others resort to devices such as taking the stance of an impartial spectator or making decisions behind a veil of ignorance. But in all cases these doctrines assume a moral framework in which the moral theorist chooses the best from among the alternatives. Thus the comparative harmonist can be described as a maximizer, although it should be stressed that this means choosing the best among known alternatives, not the best among all possible alternatives.

The categorical harmonist, on the other hand, believes there are only two moral alternatives: social harmony or social chaos, the way of reason or the way of the beasts.[6] As Cicero put it, "There are two types of conflict: one proceeds by debate, the other by force. Since the former is the proper concern of man, but the latter of beasts, one should only resort to the latter if one may not employ the former" (Cicero 1991, p. 14). The categorical harmonist views those who are not rational, i.e., who seriously imperil social harmony, as enemies of the social order and thus subject to coercion. Whereas for the comparative harmonist the primary moral relationship is maximization, for the categorical harmonist it is reciprocity—social harmony is possible only among those who are committed to social harmony.

The categorical harmonist separates people into two general classes—those within the law and those outside. Those who by their actions demonstrate that they either have contempt for the social order or are incapable of acting in accordance with social harmony are declared outlaws and treated accordingly. Thus Locke writes, "In transgressing the law of nature, the offender declares himself to live by another rule than that of *reason* and common equity" (1988, p. 272). Furthermore, by putting oneself outside the reach of reason, one forfeits one's right to be treated as a reasonable being: "[O]ne may destroy a man who makes war upon him, or has

[6]Or to use Murray Rothbard's apt phrase, the categorical harmonist adopts a "polar analysis" (1970, p. 264).

discovered an enmity to his being, for the same reason that he may kill a wolf or a lion; because such men are not under the ties of the common law of reason, have no other rule, but that of force and violence" (1988, p. 279).[7]

The comparative harmonist, on the other hand, does not automatically declare those who disregard the conditions for social harmony to be outlaws. His moral world is not so black-and-white, and for this reason gives the illusion of being more humane and tolerant. Since the underlying principle of morality for the comparative harmonist is to maximize utility (or happiness or social welfare), the fact that an individual is behaving irrationally—acting in ways that are harmful to the social welfare—does not exclude this individual from being included in the utility calculus.

This basic difference in moral outlook is reflected in how the categorical and comparative harmonist justify punishment. For both the categorical and the comparative harmonist, there is a presumption against the use of physical force. This is what distinguishes social harmonists from social nihilists—those who believe that might is right. Categorical and comparative harmonists differ, however, concerning what overrides this presumption against the use of force. For the categorical harmonist, force is justified only against someone who shows a disregard for social harmony. (The nihilist, by declaring through his actions that he believes that might is right, can hardly complain when we use force against him.) For the comparative

[7]In another passage Locke states, "a criminal, who having renounced reason, the common rule and measure, God hath given to mankind, hath by the unjust violence and slaughter he hath committed upon one, declared war against all mankind, and therefore may be destroyed as a *lion* or a *tiger*, one of those wild savage beasts, with whom men can have no society nor security: And upon this is grounded the great law of nature, *who so sheddeth mans blood, by man shall his blood be shed*" (1988, p. 274). Auberon Herbert takes a similar stance: "My justification [in knocking a thief down] was, that he had established between himself and the rest of society the force relation, and therefore I had to deal with him as I should have dealt with a wild beast that had attacked me" (Herbert 1978, p. 101). "The men who do so restrain their neighbor, . . . are men who disallow this universal law [against aggression], and therefore lose the rights which they themselves possess under it" (p. 141). This same reciprocity based moral framework is presupposed by Rothbard's discussion (in the context of animal rights) of what he calls the "Martian problem": "If we should ever discover and make contact with beings from other planets, could *they* be said to have the rights of human beings? It would depend on their nature. If our hypothetical 'Martians' were like human beings—conscious, rational, able to communicate with us and participate in the division of labor, then presumably they too would possess the rights now confined to 'earth-bound' humans. But suppose, on the other hand, that the Martians also had the characteristics, the nature, of the legendary vampire, and could only exist by feeding on human blood. In that case, regardless of their intelligence, the Martians would be our deadly enemy and we would not consider that they were entitled to the rights of humanity" (Rothbard 1982, p. 156).

harmonist, on the other hand, force is justified only by showing that the consequences outweigh the intrinsically negative utility of the use of force. Thus, for a categorical harmonist punishment is viewed primarily as restitutional and retributive, whereas for a comparative harmonist punishment is viewed primarily as a deterrent and for reforming the criminal. The former is backward looking and proper to a nomocratic social theory where justice is measured against one's relationship to law and the need to preserve social harmony. The latter is forward looking and proper to a teleocratic social theory where justice is measured against a goal—the maximization of utility.

In a society based on a categorical moral framework, if someone disturbs the order of society, he is expected to restore the order—to make restitution. If he refuses to be bound by that order, he, in effect, declares himself an enemy of that order and becomes an outlaw and is no longer protected by the law (or more precisely, not protected by the law to the extent of, and in proportion to, his disregard for social harmony). In a society based on a comparative moral framework, on the other hand, punishment is justified only if it positively contributes to the overriding purpose of maximizing utility. The murderer's happiness counts just as much as everyone else's, including his potential victims. (This is a logical consequence of the principle that "equal amounts of happiness are equally desirable, whether felt by the same or different persons" [Mill 1971, p. 56].) The reason the murderer can be justifiably restrained and punished is that the resulting pain and suffering caused to the murderer (and, indirectly, to his mother, friends, etc.) is outweighed by the pain prevented to the rest of society. Punishment is justified only if the pain inflicted by punishment is outweighed by the expected social benefits. Likewise, punishing someone who has not done anything that threatens the peace of society is justified if the pain inflicted is outweighed by the social benefit. Admittedly, comparative harmonists can come up with plausible rationales why punishing the innocent would rarely maximize utility. The point is, however, that, unlike the categorical harmonist, the comparative harmonist has to do this in a roundabout and rather tenuous manner, making some rather strong assumptions about future consequences and the interpersonal comparison of utilities.

Both the similarities and the differences between the comparative and categorical harmonists are illustrated by how their defenders attempt to justify these two moral frameworks. Both begin with the individual's desire for happiness, but even here there is a subtle difference in emphasis. Whereas the comparative harmonist stresses the individual's desire to maximize his own happiness, the categorical

harmonist tends to stress the universal law of self-preservation. Many categorical harmonists go so far as to argue that each individual has a duty to preserve himself. Locke, for example, attempted to ground this obligation by arguing that men are the "workmanship of one omnipotent, and infinitely wise maker" (1988, p. 271), and so are ultimately the property of God. Others, such as Aristotelian rights theorists, have argued that the duty of self-preservation follows from man's inherent nature. But the categorical harmonist is not necessarily committed to justifying a duty to preserve oneself—i.e., he need not be committed to the strong assumption that a person who fails to defend himself is irrational and violates his nature or God's trust, and so should be condemned. What distinguishes the categorical harmonist is that he starts with the fact that it is reasonable to expect most people to try to preserve themselves (whether they have a duty to or not), and, in particular, to defend themselves from attack.

It is in the next step of the argument, the move from the individual's desire for happiness to the derivation of the basic principle of morality, that the comparative and categorical harmonists most radically differ. The comparative harmonist's argument is always some version of Mill's notorious inference from the fact that each individual desires his own happiness to the desirability of the general happiness (1971, p. 37). The categorical harmonist, on the other hand, asks: Given the nearly universal law that people will defend themselves when attacked, under what conditions is social harmony possible? The prototypical answer is given by Spencer. After noting that the desire for self-preservation applies to all creatures, and thus lacks an ethical quality, he takes the next step:

> Ethical character arises only with the distinction between what the individual *may* do in carrying on his life-sustaining activities, and what he *may not* do. This distinction obviously results from the presence of his fellows. Among those who are in close proximity, or even some distance apart, the doing of each are apt to interfere with the doings of others; and in the absence of proof that some may do what they will without limit, while others may not, mutual limitation is necessitated. The non-ethical form of the right to pursue ends, passes into the ethical form, when there is recognized the difference between acts which can be performed without transgressing the limits, and others which cannot be so performed. (Spencer 1981, p. 150)

Auberon Herbert makes a similar move. Beginning with the premise that "Underneath all life lies the great law of self-preservation," he

notes that this is "a law which we may fulfill either by using force as the animals do, or by universally accepting the reasonable relation which, forbidding force, guarantees equal freedom to all" (Herbert 1978, p. 101).

In brief, although the comparative harmonist shares with the categorical harmonist the goal of preserving society, this is seen only as a first step, albeit a necessary one, toward a more ambitious goal. The comparative harmonist judges the institutions of a society as inadequate, no matter how peaceful that society may appear on the surface, if these institutions can be modified so as to increase the total social welfare. Of course, one must weigh the costs of making any modification against future gains, and in practice a comparative harmonist may be very conservative in weighing these costs, as Bentham was, but in principle any institution is always subject to revision since someone may come up with a new alternative that is even better than any of the previous alternatives that have been considered in the past. In essence the comparative harmonist is always a social tinkerer.

Mises and Maximization

We can now address the question of whether Mises was a utilitarian in the maximizing, comparative sense or whether he was a categorical harmonist. In this section I argue that the evidence clearly indicates that he was not a maximizer, and in the next section I take up the question of whether he can more properly be classified as a categorical harmonist.

Now it may seem that when Mises says that laissez-faire liberalism promises "the most abundant possible satisfaction of all those desires that can be satisfied by the things of the outer world" (1927, p. 4), he does not leave much doubt that he is a moral utilitarian of the maximizing variety. But as was pointed out in the first section, when the issue is an agreed-upon policy goal, e.g., prosperity, then Mises can as a value-free economist recommend certain liberal policies as the best means for accomplishing this goal. In any case, one should not read too much into such statements. After all, natural rights liberals also believe that laissez faire will lead to a better world. More relevant are statements such as "the only yardstick that must be applied to [law and legality, the moral code and social institutions] is that of expediency with regard to human welfare" (1966, p. 147). Here Mises leaves no doubt that he is advocating a moral doctrine, not functionalism in general, and this moral doctrine seems to imply the maximization of social welfare. But compare this passage to a very similar passage: "The ultimate yardstick of justice

is conduciveness to the preservation of social cooperation. Conduct suited to preserve social cooperation is just, conduct detrimental to the preservation of society is unjust" (1957, p. 54). No categorical harmonist would have problems with this passage. Furthermore, in the former passage the very next sentence reads, "The utilitarian economist does not say: *Fiat justia, pereat mundus.* He says: *Fiat justia, ne pereat mundus.*" This is one of Mises's favorite points: the utilitarian rejects "Let justice be done, though the world perish" for "Let justice be done, lest the world perish." The contrast is between destroying and preserving the social order, not between maximizing and failing to maximize utility. Or consider the following passage, "The policy of liberalism is the policy of the common good, the policy of subjecting particular interests to the public welfare" (1922, p. 456). Taken out of context, this is the kind of statement that one would typically attribute to a social harmonist concerned with maximizing utility. Mises immediately adds, however, that this is "a process that demands from the individual not so much a renunciation of his own interests as a perception of the harmony of all individual interests" (1922, p. 456). What Mises clearly means is that in order for social harmony to be possible, individuals cannot completely ignore other individuals. This is fully consistent with the categorical harmonist's argument for rights.[8]

It becomes even more difficult to attribute a maximizing interpretation to these passages in the light of other statements made by Mises that seem to explicitly reject a maximizing view of utilitarianism. These statements can be divided into two categories that parallel the two major objections that critics have raised against utilitarianism: (1) Utilitarianism demands that individuals be willing to sacrifice themselves to the greater good, but why should any individual agree to do this? (2) Utilitarianism presupposes that interpersonal comparisons of utility can be made; yet, this presupposition is highly dubious, if not incoherent.[9]

Mises employs both these objections against moral doctrines that he rejects. With regard to the first objection, Mises's major criticism of "anti-utilitarian" doctrines, in addition to his rejection of their

[8]Compare Herbert: "Man is predestined to find his complete happiness, as Mr. Spencer teaches, only when the happiness of others becomes to him an integral part of his own; but this development of his nature cannot take place unless he is living under those true conditions which belong to a free life" (Herbert 1978, pp. 116–17).

[9]See, for example, Narveson (1988, pp. 150–153). In addition to these two fundamental objections, critics have also argued that utilitarianism has certain counter-intuitive implications—e.g., the punishment of the innocent under certain circumstances.

appeal to intuition, is that they require self-sacrifice. According to Mises, one of the contributions of "utilitarianism" is that the "dualism of motivation assumed by most ethical theorists" was overthrown (1922, p. 357). "Utilitarian philosophy . . . reduced these apparent antagonisms [selfishness vs. altruism, economics vs. ethics, individual vs. society] to the opposition of short-run and long-run interests" (1957, p. 55). This may be true of Mises's brand of "utilitarianism," as it is true of those categorical doctrines of social harmony that stress reciprocity, but it is not true of any maximizing doctrine of social harmony.

It is instructive to contrast Mises with Henry Hazlitt on this point. Although Hazlitt, who describes himself as a utilitarian, believes that "for 99 percent of the people 99 percent of the time, the actions called for by enlightened self-interest and morality are identical" (1964, p. 124), "[t]here remains the rare case when the individual must be called upon to make a 'genuine' sacrifice" (p. 125). He cites Bentham's argument that we can be forced to help in Good Samaritan situations if the cost to us is not too great, and as an example he mentions forcing a doctor to "attend a patient suffering from a contagious disease" or to aid victims of an epidemic (p. 111). In these cases there is a conflict between long-term self-interest and social utility, and the maximizing-utilitarian sides with social utility. Mises, on the other hand, never admits to such a conflict, but repeatedly claims, as we have seen, that one of the major discoveries of "utilitarianism" is that there is no such conflict.[10]

With regard to the second objection to utilitarianism, given that Mises believes that only ordinal comparisons of utility can be made and that interpersonal comparisons of utility make no sense, it would be surprising if he were then to try to base his moral theory upon the maximization of utility. In fact, he is explicitly critical of any such doctrine:

> Some economists believe that it is the task of economics to establish how in the whole of society the greatest possible satisfaction of all people or of the greatest number could be attained. They do not realize that there is no method which would allow us to measure the

[10]Even Mises's defense of conscription (one of his few lapses from a pure libertarian position) is not cast in terms of maximizing utility, but as a condition that may sometimes be necessary in order to preserve society from "ruthless oppressors" (1966, p. 282). Underlying his argument is the assumption that defense is a public good. This assumption met with little resistance, even among categorical harmonists (Spencer, for example, makes a similar case for conscription [1978, p. 87]), until the public goods argument itself was challenged by Rothbard (1962, pp. 883–90; 1970, ch. 1).

> state of satisfaction attained by various individuals. They misconstrue the character of judgments which are based on the comparison between various people's happiness. While expressing arbitrary value judgments, they believe themselves to be establishing facts. (Mises 1966, p. 242)

He then adds, "The reformers searching for the maximum of general satisfaction have told us merely what state of other people's affairs would best suit them" (1966, p. 243). In another context he raises the question, "Is society, people asked, merely a sum of individuals or is it more than this and thereby an entity endowed with independent reality? The question is nonsensical. Society is neither the sum of individuals nor more nor less. Arithmetical concepts cannot be applied to the matter" (1957, pp. 251–52).[11]

It should be emphasized that a comparative harmonist cannot escape Mises's objection against making judgments based on interpersonal comparisons of utility by resorting to such devices as assuming the role of an impartial spectator or making decisions behind a veil of ignorance. In fact, Mises explicitly criticizes the "old liberals" for assuming the stance of a "perfect king" whose only objective is to make his citizens happy (a precursor to the impartial spectator):

> [T]he economists compare this hypothetical system [embodying their own value judgments], which in their eyes embodies the moral law itself, with the market economy. The best they can say of the market economy is that it does not bring about a state of affairs different from that produced by the supremacy of the perfect autocrat. They approve of the market economy only because its operation, as they see it, ultimately attains the same results the perfect king would aim at. (Mises 1966, p. 691)

Mises contends that the fiction of the "perfect king" contributed to the modern notion of a godlike state.

Although one can find passages where Mises quotes Bentham's "greatest happiness" principle without comment (e.g., 1966, p. 175), on other occasions he is rather dismissive. For instance, he characterizes it as expressing "not very aptly" the view that laissez-faire liberalism does not favor any special group (1927, p. 7). In another passage he interprets it as simply meaning that social man "must adjust his conduct to the requirements of social cooperation and look upon his fellow men's success as an indispensable condition of his

[11]Contrast Mill's statement that "the truths of arithmetic are applicable to the valuation of happiness, as of all other measurable quantities" (Mill 1971, p. 56).

own" (1966, p. 833). He goes on say that "if we interpret welfare in this manner, the concept is void of any special significance. It can be invoked for the justification of every variety of social organization. . . . A principle that is broad enough to cover all doctrines, however, conflicting with one another, is of no use at all" (1966, p. 834).[12]

In summary, Mises believed, like Spencer and Herbert, that it was legitimate to speak of the general welfare as the ultimate goal of morality, but also like Spencer and Herbert, he did not believe that one could give this principle any operational content. Its main value is that it distinguishes the social harmonist from the moral intuitionist, but there is always the danger that it will be used as a cover for special interests. As Mises stresses, "No decent man likes to be so rash as to raise objections against the realization of welfare"; however, "in the mouths of the welfare propagandists the notion of welfare has a definite meaning. They intentionally employ a term, the generally accepted connotation of which precludes any opposition" (1966, p. 834). Although Mises does not believe that an appeal to the general welfare can provide a definite guide to policy, he does not want to play into the hands of the welfare propagandists by being misinterpreted as being opposed to the general welfare.

Freedom is Indivisible

Having argued that Mises is not a comparative harmonist, but actually an astute critic of any maximizing moral framework, we must now consider whether he can more properly be described as a categorical harmonist. This brings us back to the central question with which we began: How could Mises be both a principled defender of laissez faire and a defender of the doctrine of social expediency? Our argument so far has been that the passages where Mises explicitly defends social expediency can be interpreted as defending the functionalist doctrine that morality is concerned with preserving society and attacking any appeal to mysteriously intuited principles. The question remains as to whether Mises's principled approach to laissez faire is a categorical approach.

[12]Mises made a similar statement in his final book: "That every human action has to be judged and is judged by its fruits or results is an old truism. It is a principle with regard to which the Gospels agree with the often badly misunderstood teachings of utilitarian philosophy. But the crux is that people widely differ from one another in their appraisal of the results. What some consider as good or best is often passionately rejected by others as entirely bad. The utopians did not bother to tell us what arrangement of affairs of state would best satisfy their fellow citizens. They merely expounded what conditions of the rest of mankind would be most satisfactory to themselves" (1962, pp. 96–97).

As we have seen, for the categorical harmonist social harmony is not a relative, i.e., comparative matter, but a black-and-white, i.e., categorical matter. In Auberon Herbert's words, "It must be the battle of principles—the principle of liberty against the principle of force" (Herbert 1978, p.51); "force and reason . . . are the two opposite poles" (p. 91). "Force—whether disguised or not under the forms of voting—has but one meaning. It means universal confusion and strife" (p. 335). Mises in very similar words contrasts the "principle of violence" and the "principle of peace": "Violence and law, war and peace, are the two poles of social life" (1922, p. 34). "History is a struggle between two principles, the peaceful principle, which advances the development of trade, and the militarist-imperialist principle, which interprets society not as a friendly division of labor, but as the forcible repression of some members by others" (1922, p. 268). Furthermore, the principle of violence cannot form the basis of a social coherent theory: "Try to realize completely the principle of violence, even only in thought, and its anti-social character is unmasked. It leads to chaos, to the war of all against all. No sophistry can evade that. All anti-liberal social theories must necessarily remain fragments or arrive at the most absurd conclusions" (1922, p. 37). "It is impossible to defend honestly the case for violence against the case for peaceful cooperation. Thus the advocates of violence are resorting to the trick of calling the methods of violence and threat of violence to which they resort 'nonviolence'. . . . The fundamental antagonism between the realm of mutual peaceful agreement and that of compulsion and coercion cannot be eradicated by idle talk about two 'sectors' of the economy, the private and the public. There is no conciliation between constraint and spontaneity" (1968, p. 37).

For Mises the sole justification for force is social preservation:

> Society welcomes as members all who can see the benefit of peace and social collaboration in work. It is to the personal advantage of every individual that he should be treated as a citizen with equal rights. But the man who, ignoring the advantages of peaceful collaboration, prefers to fight and refuses to fit himself into the social order, must be fought like a dangerous animal. It is necessary to take up this attitude against the anti-social criminal and savage tribes. Liberalism can approve of war only as a defense. For the rest it sees in war the anti-social principle by which social cooperation is annihilated. (1922, p. 284)

Note that Mises, like Locke and other categorical harmonists, compares the anti-social individual to a dangerous animal. Likewise, for

Mises, "[a]n unbridgeable gulf separates man from all those beings that lack the ability to grasp the meaning of social cooperation" (1962, p. 105). Unfortunately, not every member of our species can cross this gulf, for "[t]here have always been people who were emotionally unfit to conceive the fundamental principle of cooperation under the system of the division of tasks" (1962, pp. 88–89).[13]

Mises's categorical approach is perhaps best represented by his claim that "freedom is indivisible" (1957, p. 376), and his rejection of a middle way between socialism and capitalism (1950b). "The liberal program is an indivisible and indissoluble whole, not an arbitrary assembled patchwork of diverse components. Its various parts condition one another. The idea that political freedom can be preserved in the absence of economic freedom, and vice versa, is an illusion" (1949a, p. 38). The same principle is appealed to when Mises argues against interventionism: "There is no middle way. Control is indivisible" (1949c, p. 55).[14]

[13]Mises has very little to say about the justification of punishment. On a number of occasions he does say that force must be used to protect society, e.g., "In order to preserve peaceful cooperation, one must be ready to resort to violent suppression of those disturbing the peace" (1950a, p. 303). He does note that, "To punish criminal offenses committed in a state of emotional excitement or intoxication more mildly than other offenses is tantamount to encouraging such excesses" (1966, p. 16). This might be taken to mean that he holds a deterrence theory of punishment. This does not mean, however, that his position is one of maximization. Categorical harmonists recognize that punishment has a deterrence effect, but they typically believe that this must be subject to proportionality—i.e., one must not punish a person more severely than his anti-social act would merit. According to Locke, one "may bring such evil on any one, who hath transgressed that Law, as may make him repent the doing of it, and thereby deter him, and by his Example others, from doing the like mischief," but one may do so "only to retribute to him . . . what is proportionate to his Transgression" (Locke 1988, p. 272). At least twice Mises mentions the possibility of considering criminals to be mentally ill, but he does so for the sake of argument, not because he agrees with this premise: "We may agree that he who acts antisocially should be considered mentally sick and in need of care. But as long as not all are cured . . . . some provision must be taken lest they jeopardize society" (1966, p. 149; 1944, p. 48).

[14]Herbert likewise argued that freedom is indivisible: "The nature of man is indivisible; you cannot cut him across, and give one share of him to the state and leave the other for himself" (1978, p. 140). The view that there is no middle way is common to the natural rights tradition. As we have seen, Locke contrasted the "common law of reason" with the "rule . . . of force and violence" (1988, p. 279). He was just as explicit in his *Letter on Toleration*: "There are two sorts of contests amongst men; the one managed by law, the other by force: and they are of that nature, that where the one ends, the other always begins" (Locke 1991, p. 45). Lysander Spooner also makes use of a similar "no middle ground argument": "There is . . . no middle ground between absolute communism, on the one hand, which holds that a man has a right to lay his hands on any thing, which has no other man's hands upon it, no matter who may have been the producer; and the principle of individual property, on the other hand, which says that each man has an absolute dominion, as against all other men, over the products and acquisitions of his own labor, whether he retains them in his actual possession, or not" (Spooner 1855, p. 88).

Although he does not explicitly distinguish them, Mises has two arguments against a middle way.[15] The first argument is the "tar-baby" argument. Like Br'er Rabbit and the Tar Baby, each act of intervention creates more problems than it solves and leads to new interventions. This process escalates until one has created such a mess that it is almost impossible to extract oneself. This argument is especially applicable to economic policies such as price controls (Mises 1950b, pp. 22–24), but it can also be applied to "social" policies such as drug controls (Thornton 1991).

Mises's other argument against a middle way is the the "slippery-slope" argument. He argues, for example, that government intervention *implies* socialism:

> All these champions of interventionism fail to realize that their program thus implies the establishment of full government supremacy in all economic matters. . . . Thus the doctrine and the practice of interventionism ultimately tend to abandon what originally distinguished them from outright socialism and to adopt entirely the principles of totalitarian all-round planning. (Mises 1966, pp. 723–24)

Mises is not saying that the slide to totalitarianism is inevitable. No one can predict the outcome. The slide down the slope may be slow or it may be fast, and it may be halted before descending all the way to the bottom. But assuming, as Mises does, that the social world is ultimately ruled by ideas, then to sacrifice principle for the sake of social expediency is to kick over the intellectual prop which has prevented descent down the slide to totalitarianism. Mises makes this quite clear when arguing against the regulation of drugs:

> [O]nce the principle is admitted that it is the duty of government to protect the individual against his own foolishness, no serious objections can be advanced against further encroachments. . . . And why limit the government's benevolent providence to the protection of the individual's body only? Is not the harm a man can inflict on his mind and soul even more disastrous than any bodily evils? . . . The mischief done by bad ideologies, surely, is much more pernicious, both for the individual and for the whole of society, than that done by narcotic drugs. (Mises 1966, pp. 733–34)

[15]Note, however, that when discussing "why all men should receive equal treatment under the law" (1927, p. 28), Mises does explicitly distinguish two arguments that parallel the distinction I make above. The first is an economic argument concerning the conditions for prosperity, the second, a moral or social harmonist argument concerning the conditions for social peace.

For Mises the issue is one of principle: "We see that as soon as we surrender the principle that the state should not interfere in any questions touching on the individual's mode of life, we end by regulating and restricting the latter down to the smallest detail" (1927, p. 54).

The slippery-slope argument has played a central role in the categorical defense of rights.[16] Unlike comparative harmonists, categorical harmonists are not moved by the purported fact that an exception will have certain positive consequences. They see this as the first step down a slippery slope. Although comparative harmonists may recognize the value of a principled approach and the danger of allowing exceptions, they argue that the absolutist, categorical approach implied by the slippery-slope argument is too extreme. They may admit that intervention often has negative consequences that outweigh any positive benefits, but insist that this must be established case by case.

Such an attitude is exemplified by Yeager in a panel discussion on utilitarianism and natural rights: "I do not know for sure what position to take on things. I do not have an infallible pipeline to the truth" (Shah 1988, p. 9). When questioned as to what position he takes with regard to insider trading his response is: "I cannot take a firm position for or against insider trading. If I were to study the actual factual details of particular cases, I do not know whether I would come out condemning it or not" (p. 5). Rothbard, another panelist, is quick to point out that Yeager's answer "shows the difference between viewing liberty and the free market as an organic tendency versus holding it as an absolute principle" (i.e., between what I have been calling a comparative and a categorical approach), and adds, "I am in favor of saying that there is nothing wrong with insider trading except for breach of contract" (p. 5).

It seems to me that there is little doubt that Mises, in spite of his professed utilitarianism, would have sided with Rothbard on this issue. It is because Mises takes such a principled stance with regard to government intervention that he is often perceived as "dogmatic." Critics ask how Mises can dismiss the middle way of intervention in such an *a priori* fashion? For the comparative harmonist one must weigh the evidence in each case—any *a priori* claim to the contrary is a veiled appeal to intuition or "an infallible pipeline to the truth."

[16]Herbert, for example, argues in response to those who do not see a sharp dichotomy between the principle of force and the principle of peace and who want to "judge each case on its merits" that "apart from any fixed principle, the merits will be always determined by our varying personal inclinations. It is all slope, ever falling away into slope, with no firm level standing place to be found anywhere" (Herbert 1978, p. 281).

Liberty of Conscience

The charge that the categorical harmonist must fall back on intuition has some historical justification. As we have seen, the categorical harmonist's stance is that force is only justified against those who are not reasonable—i.e., when rational interaction breaks down. The problem has always been deciding when this happens. Clearly, if one person uses force against another person who is amenable to reason, then the user of force is the one who has opted out of rational discourse. But this still leaves the problem of determining when the other party is or is not amenable to reason. The fact that my opponent does not agree with me may only mean that I have not given him a good reason to agree.

Up until the sixteenth century, categorical harmonists, as represented by natural law theorists, still relied heavily upon our supposed common religious and moral intuitions to determine what is reasonable. But in the context of the religious wars of the sixteenth century, social theorists started to face the fact that people's intuitions differed. Whereas during the Middle Ages the foundation for society had been considered to be "peace and unity," it was realized by a few social theorists in the sixteenth century, such as Sebastian Castellio, that coerced unity was the major cause of strife. This became the central insight of the seventeenth century defenders of toleration, e.g., Roger Williams, Henry Robinson, and the Levellers. The argument was summarized by Locke at the end of the seventeenth century: "It is not the diversity of opinions, which cannot be avoided; but the refusal of toleration to those that are of different opinions, which might have been granted, that has produced all the bustles and wars, that have been in the Christian world, upon account of religion" (Locke 1991, p. 52).

The major theme of these social theorists was that any defense of toleration must be a principled defense. In discussing the question of a state sanctioned church, Locke asks which church are we to choose? He notes that it "will be answered, undoubtedly, that it is the orthodox church which has the right of authority over the erroneous or heretical." To which he scornfully replies, "This is, in great and specious words, to say just nothing at all. For every church is orthodox to itself; to others, erroneous or heretical. Whatsoever any church believes, it believes to be true; and the contrary thereupon it pronounces to be error" (Locke 1991, p. 24). Nor can we allow the prince to choose, for "the religion of every prince is orthodox to himself. . . . If it be once permitted to introduce anything into religion, by the means of laws and penalties, there can be no bounds put to it; but it will, in the same

manner, be lawful to alter everything, according to that rule of truth which the magistrate has framed unto himself" (Locke 1991, p. 37). In other words, there is no middle ground.

It should be stressed that Locke's insight that "every one is orthodox to himself" (Locke 1991, p. 14), did not imply relativism. Locke believed that there was "but one truth, one way to heaven" (Locke 1991, p. 19). His point was that men disagreed about what this truth was, and that it was intellectually dishonest to assume away this disagreement. Diversity of opinion must be our starting point—it is implied by each man's uniqueness, his fallibility, and the scarcity of time. No one has "the leisure, patience, and means, to collect together all the proofs concerning most of the opinions he has. . . . And yet we are forced to determine ourselves on the one side or the other. The conduct of our lives, and the management of our great concerns, will not bear delay" (Locke 1933, p. 382). Any moral theory that ignores scarcity (including that of time) and diversity (including that of opinions) fails to apply to the world as it is.

Thus if there is to be social harmony, there is no alternative but to tolerate each other. Quoting Locke again:

> Since therefore it is unavoidable to the greatest part of men, if not all, to have several opinions, without certain and indubitable proofs of their truth; and it carries too great an imputation of ignorance, lightness, or folly, for men to quit and renounce their former tenets presently upon the offer of an argument, which they cannot immediately answer, and show the insufficiency of: it would methinks become all men to maintain peace, and the common offices of humanity and friendship, in the diversity of opinions; since we cannot reasonably expect, that anyone should readily and obsequiously quit his own opinion, and embrace ours with a blind resignation to an authority, which the understanding of man acknowledges not. (1933, p. 382)

Later natural rights theorists realized that this argument for religious tolerance could be generalized to apply to all opinions and practices. Spencer, for example, argued that just as "[t]he advocate of religious freedom does not acknowledge the right of any council, or bishop, to choose for him what he shall believe or what he shall reject[,] [s]o the opponent of a poor law, does not acknowledge the right of any government, or commissioner, to choose for him who are worthy of his charity, and who are not" (Spencer 1981, p. 197). Herbert applied this same argument against public education (1978, p. 73) and compulsory taxes. In the case of the latter he argued,

> Because free countries have affirmed many years ago that a compulsory church rate is immoral and oppressive, for the sake of the burden laid upon individual consciences; and in affirming this truth they have unconsciously affirmed the wider truth, that *every tax or rate, forcibly taken from an unwilling person, is immoral and oppressive*. The human conscience knows no distinction between church rates and other compulsory rates and taxes. The sin lies in the disregarding of each other's convictions, and is not affected by the subject matter of the tax. (Herbert 1978, pp. 393–94)

Note that this general argument against coercion is basically the same argument that Locke used against religious intolerance—given that people disagree about the best course of action, on the one hand, and the necessity of action (and the impossibility of waiting until there is agreement), on the other hand, the only peaceful solution is toleration, i.e., the mutual respect of each other's rights. This argument was also the basis for Spencer's case against utilitarianism: Given all the conflicting alternative proposals advocated under the banner of utility, if nothing were "to be done till all agreed upon them, we might stand still to the end of time." On the other hand, "[i]f each man carried out, independently of a state power, his own notions of what would best secure 'the greatest happiness of the greatest number,' society would quickly lapse into confusion" (1970, p. 16). To avoid this dilemma, the utilitarian has to fall back upon an "umpire," i.e., the government, for without the authority of government "such a morality must ever remain inoperative" (p. 16). Consequently, "Let but rulers think, or profess to think, that their measures will benefit the community, and your philosophy stands mute in the presence of the most egregious folly, or the blackest misconduct" (Spencer 1970, p. 4). Once we clear away all the euphemisms, the stark reality of the comparative approach (whether direct or indirect) stares us in the face: whoever can gain control of government is who decides. Once the decision as to what is and is not permitted is given to government, then as Locke asserted, "there can be no bounds put to it" (Locke 1991, p. 37).

Central to Spencer's argument is the insight that utilitarianism as a moral doctrine is "inoperative" and has to fall back upon the authority of the government. In other words, utilitarianism fails to satisfy the requirement that a moral principle be "praxeologically realizable" or "operational," to use Hans-Hermann Hoppe's terminology (1988a, p. 261).[17] This was also Spencer's objection against

[17]As Hoppe explains, "it must be possible for us, who invariably must act and employ resources, to actually implement such a criterion and consistently act upon it." Given

proposals for a "right to a maintenance":

> One party says that a bare subsistence is all that is implied. Another, that the applicant can demand all the comforts usually enjoyed by those in his station. Another, that he may as fairly claim the luxuries of life as those above him. And the extreme party will be content with nothing short of the socialist principle, of community of property. Who is to say which of these is the true expression of the right? The gradations are infinite, and how can it be decided where the claim begins and where it ends? Who can tell the rate-payer how much of his property can be justly demanded by his fellow creature? Who can tell the pauper when he asks for more pay, that he receives just as much as he is entitled to? or can explain to him why he has a right to what he already receives, but no right to anything more? And yet, if this were really a right, ought it not be capable of such a definition? (Spencer 1981, p. 205)

This inherent indeterminacy was what Herbert had in mind when he said that no one can draw a "force line," i.e., a line between the legitimate (apart from self-defense) and illegitimate uses of force (1978, p.89). In response to the suggestion that we "allow society . . . to decide such matters as we are all pretty well agreed should be so decided," Herbert replies, "[t]here never can be agreement amongst men as to what these matters are" (p. 131). Ultimately, one ends up "sanctioning not only the right of some men to coerce others, but their right to decide how and when and for what purposes they shall coerce others. It is the power holders, freed from any general principle that controls and directs them, who have to decide as to the limits and application of their own power. For who else can do so?" (pp. 131–32). The argument is not that it is difficult to draw a line between the proper and the improper use of force. Anyone can draw a line. The problem is that no two people agree where this line should be drawn. There are only two stopping points—the doctrine that force can only be used in self-defense and the doctrine that might is right. The point that Herbert continually stresses is that when the issue is seen as where to draw this "force line," i.e., the attempt to find a middle way somewhere between these two points, the decision will always be

---

some criterion such as the greatest happiness or the stance of an impartial spectator, Hoppe asks, "what if [we] . . . do not choose the same but incompatible societies—the criterion of maximum average utility has already done its work—but there is still disagreement" (Hoppe 1988a, p. 262). Elsewhere Hoppe notes that "in advocating a consequentialist position, utilitarianism is strictly speaking no ethic at all when it fails to answer the all-decisive question 'what am I justified in doing now?'" (1988b, p. 54).

made by those who have the most power, i.e., the question will ultimately be decided in favor of might.[18]

This brings us to the most misunderstood part of the categorical harmonist's argument—the appeal to *equal* rights. In Spencer's words, quoted earlier, the crucial move was that "in the absence of proof that some may do what they will without limit, while others may not, mutual limitation is necessitated" (Spencer 1981, p. 150). Note the similarity between Spencer's argument and Locke's with regard to toleration. After arguing that all churches are orthodox to themselves, Locke concludes, "So that the controversy between these churches about the truth of their doctrines, and the purity of their worship, is on both sides equal" (Locke 1991, p. 24). The point is not that the doctrines are equally good, but that there is no evidence that anyone on earth has been given the prerogative to decide. As Herbert asks, "Who shall decide between us? There is no moral tribunal before which you can summon unlimited power" (1978, p. 312).

Mises's Categorical Defense of Liberty

In an earlier section we saw that Mises takes a principled stance to liberty, and how this is in line with the categorical moral tradition. In this section I argue that the basis for his principled stance is the same as that developed by Locke (and others before him) and generalized by Spencer and Herbert.

First, note that with regard to the critical issue of toleration, Mises takes a principled approach:

> Liberalism demands tolerance as a matter of principle, not from opportunism. It demands toleration even of obviously nonsensical

[18]This is a common theme running throughout Herbert's writings: "Admit that any one . . . may restrain by force the exercise of the faculties of others, and in what sea of moral confusion you are at once plunged. Who is to decide which is the better man or the more civilized race, or how much freedom is to be allowed or disallowed. To settle this question men must sit as judges in their own case; and this means that the strongest will declare themselves the most civilized, and will assign such portions of freedom as they choose to the rest of the nation or the rest of the world as the case may be. Are you prepared for this?" (1978, p. 98). "Once admit that force is right in itself, and then you cannot pick out any special sect or party, confer special privileges upon them, and declare that they alone, and nobody else are entitled to use force. That would be a mere arbitrary and fanciful selection, as arbitrary and fanciful as picking out certain opinions, and declaring that these are orthodox, and that all other opinions are heterodox. If force is good in the hands of some men, it is good in the hands of other men; if it is a good instrument to serve some causes, it is good to serve other causes" (p. 231). "[U]ntil they have found some law by which they can distinguish the right from the wrong use of power, by which they can justly satisfy not only their own minds but the minds of others, they are simply leaving in suspension the greatest matter that affects human beings" (pp. 132–33).

> teachings, absurd forms of heterodoxy, and childishly silly superstitions. It demands toleration for doctrines and opinions that it deems detrimental and ruinous to society and even for movements that it indefatigably combats. For what impels liberalism to demand and accord toleration is not consideration for the content of the doctrine to be tolerated, but the knowledge that only tolerance can create and preserve the condition of social peace without which humanity must relapse into the barbarism and penury of centuries long past. (Mises 1927, pp. 56–57)

It should be emphasized that Mises's defense of toleration is "utilitarian" only in the sense that every categorical harmonist's argument is utilitarian—it is concerned with the conditions that make social harmony possible. It is only because most comparative harmonists abandon their comparative approach when it comes to the question of toleration and take a principled approach that this is not noticed.

Second, Mises, when discussing toleration, draws on the same insight expressed by Locke's slogan "everyone is orthodox to himself" (Locke 1991, p. 14): "Mere opportunists excepted, everyone is convinced of the rightness of his opinions. But, if such a conviction by itself were a justification for intolerance, then everyone would have a right to coerce and persecute everyone else of another way of thinking. . . . In such a case there must always be war and enmity between men" (1922, pp. 166–67). According to Mises, one of the major "blunders" of rationalism was its "neglect of the problem of erroneous thinking. Most of the rationalist philosophers failed to see that even honest men, sincerely devoted to the search for truth, could err. . . . A doctrine of which they disapproved could in their opinion have been prompted only by purposeful deceit" (1957, p. 270). Mises is here simply applying the insight of Locke concerning religious disagreements to rationalism.

Third, Mises, like Locke and Spencer, objects to the uniformitarian assumption that underlies most moral systems: "One of the motives that impel men to search for an absolute and immutable standard of value is the presumption that peaceful cooperation is possible only among people guided by the same judgments of value" (1957, p. 51). According to Mises, rationalists made a similar mistake, which is their other major blunder: "[T]hey assumed that all men are endowed with the same power of reasoning" (1957, p. 270). The fact of the matter is that there is diversity of opinion. Postulating immutable standards of value, even if true, will not make this diversity of opinion go away, nor will a faith in the rationality of man. The great insight of laissez-faire liberalism is that a free society "can function

in spite of the fact that its members disagree in many judgments of value" (1957, p. 61; 1966, p. 693).

Finally, Mises, like Spencer and Herbert, sees the case for liberty as a generalization of the case for religious toleration. The socialist is just as blind as the religious fanatic to the insight that everyone is orthodox to himself:

> No socialist author ever gave a thought to the possibility that the abstract entity which he wants to vest with unlimited power . . . could act in a way which he himself disapproves. A socialist advocates socialism because he is fully convinced that the supreme dictator of the socialist commonwealth will be reasonable from his—the individual socialist's—point of view, that he will aim at those ends of which he—the individual socialist—fully approves, and that he will try to attain these ends by choosing means which he—the individual socialist—would also choose. Every socialist calls only that system a genuinely socialist system in which these conditions are completely fulfilled; all other brands claiming the name socialism are counterfeit systems entirely different from true socialism. (Mises 1966, pp. 692–93)

In another passage Mises is even more explicit in identifying socialism with intolerance and fanaticism:

> It is customary to call the point of view of the advocates of the welfare state the "social" point of view as distinguished from the "individualistic" and "selfish" point of view of the champions of the rule of law. In fact, however, the supporters of the welfare state are utterly anti-social and *intolerant zealots*. For their ideology tacitly implies that the government will execute what they themselves deem right and beneficial. They entirely disregard the possibility that there could arise disagreement with regard to the question of what is right and expedient and what is not. (Mises 1922, pp. 520–21; italics added)

The parallels between Mises's case for a principled, categorical approach to social harmony and that of Locke, Spencer and Herbert is somewhat obscured by Mises's unfortunate insistence that all values are arbitrary. It should be stressed, however, that Mises's argument in no way depends upon this premise, and in fact would be strengthened without it. The fundamental premise is not that ultimate ends, unlike means, are arbitrary and not amenable to rational argument. The starting point for social philosophy, rather, is that people disagree with regard to both means and ends. Even if ultimate ends were totally arbitrary, as Mises asserts, there would be no

problem if everyone happened to agree on these ends. On the other hand, even if questions of means are in principle rationally determinable, insofar as we have not yet resolved which means are best and thus come to an agreement, we are faced with a moral problem of what to do in the meantime. In fact, in spite of Mises's stress on the arbitrariness of ends and the rationality of means, he admits that we often disagree about means (1966, p. 692; 1957, p. 174). He also points out that the distinction between ends and means is not always straightforward—that what are ends for some people may be means for others (1957, p. 37).

One must be careful to not let Mises's assertions about the arbitrariness of values cause one to miss his main point. When Mises attacks absolute values, he almost always has in mind the belief that such values are handed down from Providence (1922, p. 35) and are independent of society (1966, p. 720). Such "heteronomous doctrines" (1966, p. 883) are antithetical to Mises's methodological individualism: "The rejection of methodological individualism implies the assumption that the behavior of men is directed by some mysterious forces that defy any analysis and description" (1962, p. 82). Furthermore, when Mises asserts that all value judgments are personal (1957, pp. 14, 59), usually what he is attacking is the belief that one has the right to impose these absolute values on others. This may not be apparent to the reader because of an ambiguity in Mises's writings between "personal" in the sense of "arbitrary" or a "matter of taste" (like ice cream), and "personal" in the sense of "not to be imposed on others." Although Mises is not careful to distinguish these two senses of "personal," clearly it is only the latter with which he is concerned. This is illustrated by the following passage: "If a man assigns a higher value to the concerns of the collective than to his other concerns, and acts accordingly, that is his affair. So long as the collectivist philosophers proceed in this way, no objection can be raised. But they argue differently. They elevate their personal judgments of value to the dignity of an absolute standard of value" (1957, p. 59). As Mises makes clear a few pages later, he is not insisting that the collectivist admit that his beliefs are arbitrary; what he is attacking is coercion: "There is, of course, but one way to make one's own judgments of value supreme. One must beat into submission all those dissenting" (1957, pp. 60–61).

Finally, although I agree with Rothbard that Mises's sweeping statement that all values are arbitrary is itself arbitrary (Rothbard 1982, p. 212; see also Tabarrok 1990), it seems to me that a coherent and plausible case can be made for Mises's nonjustificationist stance with regard to social harmony. The categorical harmonist's argument

for rights presupposes a commitment to social harmony. Unlike many natural rights and natural law theorists, Mises believes that it is impossible to give any ultimate reason why one should be committed to peaceful cooperation. Instead, he treats this commitment as a hypothetical imperative: "Praxeology and economics do not say that men should peacefully cooperate within the frame of societal bonds; they merely say that men must act this way if they want to make their actions more successful than otherwise" (1966, p. 883). When face to face with the social nihilist, i.e., someone who believes that might is right, it is not clear what the social harmonist could say that would be relevant. This is not to say that one's commitment to social harmony is arbitrary. Mises *argues* that we can ignore those who have no regard for social harmony—e.g., such exceptional cases as Caligula—because of "their tendency to be self-destructive" (1933, p. 38). That is, we can give reasons for ignoring such cases. What we cannot do, however, is provide arguments that would convince the Caligulas of this world. The problem is that argument presupposes that conflict-free interaction is possible (Hoppe 1988a, p. 63; 1989, p. 132), whereas such interaction is precisely what the nihilist rejects. He may use words in ways that resemble, and are parasitic upon, argument, but he is not committed to resolving anything by argument. Argument for the nihilist is simply an expedient, an ammunition-savings measure. The most appropriate response to the nihilist (who has demonstrated by his actions that he really is a nihilist) is to reach for our clubs and hit him over the head. Given that he believes that might is right, he can hardly file a moral complaint against us for such actions.

The real intellectual challenge to the social harmonist comes not from the overt nihilist, but the righteous nihilist—the person who claims that he is committed to social harmony, but uses force against anyone who disagrees with him on the grounds that they are being irrational. It is the righteous nihilist (or "theocrat" [1966, p. 151; 1962, p. 107; 1949a, p. 43]) who is the target of Mises's charge of arbitrariness, just as he was the target of Locke, Spencer, and Herbert. And it is in this light, I believe, that we should read Mises's repeated attacks on absolute and immutable ethical principles. In fact, in this regard Mises often uses language that is reminiscent of that used by Herbert. For example, just as Mises sarcastically speaks of "those individuals to whom, by the mysterious decrees of some mysterious agency, the task of determining the collective will and directing the actions of the collective has been entrusted" (1962, p. 107), Herbert characterizes the socialist (and other users of force) as trying to persuade us "that there exists a mysterious

dispensation given from some unknown quarter in his own special favor" (Herbert 1978, p. 232).

Natural versus Conventional Property Rights

If Mises really is a categorical harmonist, then this should be reflected in his defense of private property. For the most part this is the case. Social cooperation under the division of labor, peace, and property are so closely tied together for Mises that he uses them interchangeably when talking about the nature of society and the goal of liberalism: "That Liberalism aims at the protection of property and that it rejects war are two expressions of one and the same principle" (1922, p. 59). "The basis and starting point of social cooperation lie in peacemaking, which consists in the mutual recognition of the 'state of property'" (1922, p. 467). "The program of liberalism, therefore, if condensed into a single word, would have to read: *property*, that is, private ownership of the means of production. . . . All the other demands of liberalism result from this fundamental demand" (1927, p. 19).

But what are we then to make of Mises's statement that private property "is a human device" and is "not sacred" (1966, p. 683)? Even more troublesome is his statement that if liberals "considered the abolition of the institution of private property to be in the general interest, they would advocate that it be abolished, no matter how prejudicial such a policy might be to the interests of property owners" (1927, p. 30).

The first statement is problematic only if we take it metaphorically to mean that property rights are arbitrary conventions. However, Mises is simply asserting, as the next sentence makes clear, that private property was not conferred on man by God or Nature, but is a human discovery which has a definite history. Although some natural rights theorists might disagree with this, Herbert Spencer would not be one of them. I believe the second statement (about his willingness to abolish property if it were in the general interest) should be taken with a rhetorical grain of salt. What Mises is stressing is that his defense of private property is not based on some special intuition, but upon the fact that private property is intrinsically linked with the very conditions for social harmony.

There is no question that Mises rejects the idea that private property is arbitrary. His major complaint against most moral philosophers was their conviction that "there was in the course of social events no such regularity and invariance of phenomena as had been found in the operation of human reasoning and in the sequence of natural phenomena. They did not search for the laws

of social cooperation because they thought that man could organize society as he pleased" (1966, p. 2). And he explicitly states that capitalism "is the only possible social system. One may undertake to modify one or another of its features as long as in doing so one does not affect the essence and foundation of the whole social order, viz., private property" (1927, p. 88).

The only question at issue is whether Mises's defense of property rights is a pragmatic defense of the status quo—i.e., a defense of currently existing titles regardless of how they were acquired. There are several passages that seem to suggest this: "The basis and starting point of social cooperation lie in peacemaking, which consists in the mutual recognition of the 'state of property.' Out of *de facto having*, maintained by force, arises the legal concept of ownership" (1922, p. 467). "Law is a *settlement*, and end to strife, and avoidance of strife" (1922, p. 34; italics added). "Possession is protected even though it is, as the jurists say, no title. Not only honest but dishonest possessors, even robbers and thieves, may claim protection for their possessions" (1922, p. 34).

If these passages are interpreted to mean that possession is the whole of the law, not nine-tenths, then one can argue that Mises does not provide a principled but only a pragmatic, *ad hoc* defense of property. As Rothbard points out, any ethic relying upon such an *ad hoc* defense of property rights, "pushed to its logical conclusion, must also defend every criminal in the property that he has managed to expropriate," and is thus "ethically nihilistic" (Rothbard 1982, p. 52). Such a doctrine would imply that if A steals X from B, then A, being in possession of X, has a right to X. But it would also imply that if B "steals" X back from A, then B has a right to X. In other words, whoever can retain possession of X has a right to it—i.e., might is right.

Given the incoherence of such a doctrine, however, we should first look for an alternative interpretation before attributing such a viewpoint to Mises. I believe that the key is to be found in a passage a few pages later where he notes that under "the domination of the principle of violence," which he contrasts with the principle of peace, there can be "no peace; at best there [can be] a truce" (1922, p. 58). Here it would seem he is explicitly rejecting the *ad hoc*, pragmatic doctrine of property as a mere "truce." The question, then, is what is the difference between a "settlement" (of the earlier passage) and a "truce"?

If we look at the context of Mises's statement that "even robbers and thieves, may claim protection for their possessions," we see that Mises is concerned to refute those who argue that since existing

property titles have "sprung illegally from arbitrary acquisition and violent robbery" in the distant past, they are not legitimate (1922, p. 34). Again it is illuminating to compare Mises's argument with a similar passage from Spencer. When faced with a related argument—in this case the right of the poor to be maintained by the rich because of the past transgressions of the rich—Spencer does not deny that there were past transgressions, nor does he assert, in an *ad hoc* fashion, that such transgressions are irrelevant. Instead, he insists that the burden of proof is upon those who advocate the right to maintenance (Spencer 1981, p. 201). In particular, "when it can be shown that our poor are the children of the oppressed, and those who have to pay poor rates are the children of the oppressors, then the validity of the objection will be admitted; but that until this is shown to be the truth, or an approach to the truth, the objection may be disregarded" (1981, p. 192). The issue is one concerning on whom the burden of proof falls. Spencer's (and I believe, Mises's) position is not that existing property rights cannot be challenged, but that the burden of proof must fall on the challenger of *de facto* property rights. Only this position is praxeologically operational. Those who place the burden of proof on the *de facto* owner, and demand that he justify his right to use and dispose the object in question, implicitly assume that we can somehow take a disembodied stance, hovering above the physical world until all questions of rights have been satisfactorily decided.[19]

As we have seen, any coherent, operational ethical theory that is to apply to the world as it is, not as it is imagined to be in the dreams of the philosophers, must take into account two facts—scarcity, including scarcity of time, and diversity, including the diversity of opinions. In particular, it needs to recognize that people are never going to agree on how various resources ought to be used. Given that consensual joint control is impossible, the only peaceful alternative is divided control, i.e., private property rights. Furthermore, any coherent, operational ethical theory needs to recognize that people

[19]Mises's assertion that the notion of justice "makes sense only when approving or disapproving concrete conduct from the point of view of the valid laws of the country" (1966, p. 721) might seem to imply that all rights, including property rights, are those defined by the legal system. Such a legal positivist interpretation, however, conflicts with what Mises says elsewhere. For example, when discussing the natural law, he is critical of its "arbitrary prepossessions" but praises it for rejecting "legal positivism" and substituting the "idea that every valid law of a country was open to critical examination by reason" (1957, p. 48). I believe Mises's statements to the effect that there is "neither right nor wrong outside the social nexus" should be interpreted as attacks upon intuitionist critiques that are not grounded in the realities of society rather than appeals to the legal status quo.

are never going to agree on how resources ought to be (optimally) divided up, any more than they are going to agree on how they ought to be used. Since man is a physical being who needs to use resources to survive and who at the very least needs a place to stand, the only peaceful alternative is to make a presumption in favor of current property holdings. This does not mean that robbers have the right to their plunder. The concept of a "presumption" in favor of current property rights only makes sense if it is coupled with the right to have restored property that has been taken.

This theory of rights, combining a presumption in favor of the *de facto* owner with the principle of restitution, might be appropriately labeled a *concrete* theory of rights. I believe that it is equivalent, at least in most essentials, to the Lockean *abstract* theory of rights. In particular, the libertarian homesteading axiom can be directly derived. Any ethic, if it is to be praxeologically operational—if it is to recognize the facts of scarcity and diversity—must start with the existing property distribution. Furthermore, if it is to really qualify as an ethical principle, providing a basis for conflict-free interaction and not be equivalent, for all practical purposes, to might is right, it must also provide for a principle of restitution. The *de facto* owner's presumptive right can only be challenged by showing that a prior right is being restored. By chaining this argument backwards until we reach the first user, the homesteading principle is established—the first user of something cannot have his possession challenged since there is no prior right to be restored. We are far removed from the Lockean state of nature, and there is little doubt that the chain of transfers from there to our current set of property titles has been broken by a large number of illicit acts. This often gives the (false) impression that according to the Lockean view we do not have any grounds to stand on. By starting with a presumption in favor of the current, *de facto* owner, and shifting the burden of proof to the challenger, hypothetical but unprovable past acts of usurpation are clearly seen as irrelevant. Although the passage of time does not turn crimes into venerable institutions, the passage of time does make the burden of proof for the challenger more and more difficult.

Finally, in passing, it should be noted that the right of the first user can be said to be an eternal right. Although Mises rejects all theories of eternal rights, what he is mainly concerned with attacking is the view that rights were somehow self-evident to everyone from the beginning of time. Property rights, however, are eternal in a different sense—they are not conventional. At no point in time did, or can, someone establish property rights willy-nilly. I cannot take your property, for example, and then declare that we will from now

on observe property rights. If I am serious about property rights, then I must make restitution. Even if the concept of property rights has not previously occurred to either of us, once it does, in order for us to observe these rights, we must be willing to make restitution for (recognized) past wrongs. Otherwise, our professed belief in property rights cannot be taken seriously. It is in this sense that property rights can be said to be eternal—they extend backward indefinitely in time.

Conclusion

Mises's utilitarianism is the exception that proves (i.e., tests) the rule, in this case, Rothbard's rule that utilitarianism cannot provide a principled defense of laissez-faire liberalism. Of course, Mises, like almost all defenders of laissez faire, used utilitarian (i.e., nonmoral functionalist) arguments to defend the unhampered market. But he also used moral arguments. My main purpose throughout this paper has been to show that Mises's moral "utilitarianism," in spite of his repeated attacks on natural law and natural rights, owes more to the principled, categorical moral framework of Spencer and Herbert, than to the maximizing, comparative moral framework of Bentham and Mill. Mises equated natural law and natural rights with intuitionism, and for this reason rejected them, but he did not reject the categorical moral framework that underlies much of that tradition. On the contrary, it was the comparative moral framework of utilitarianism that he rejected. Furthermore, the essential premises for his moral defense of laissez faire is not the arbitrariness of all values, but the facts of scarcity (including scarcity of time) and diversity (including diversity of opinion concerning values *and means*)—two facts that play an essential role in his praxeological methodology. Any coherent moral theory concerning the conditions for social harmony, as well as any coherent theory of economics, must take these two facts into account. It is this insight, articulated by Locke, that Mises turns into a powerful moral argument against socialism and in favor of laissez faire.[20]

[20]Mises's arguments for laissez faire and against socialism can be usefully divided into three classes: (1) nonmoral functionalist arguments concerning the best policies for promoting prosperity; (2) the economic calculation argument that socialism leads to social chaos; and (3) moral arguments concerning the conditions for social harmony. There is an interesting parallel with St. Thomas Aquinas's three arguments for preferring private property to communal property: (1) communal property undermines the incentive to work; (2) communal property leads to social confusion; and (3) communal property undermines social peace (Aquinas 1959, p. 169 [*Summa Theologica* II-II 66 2]). In his book on the economics of the late-scholastics Alejandro A. Chafuen notes that Mises's defense of property is similar to that of the late-scholastics (1986, p. 155).

References

Aquinas, St. Thomas. 1959. *Selected Political Writings*. A. P. D'Entrèves, ed. Oxford: Basil Blackwell.

Chafuen, Alejandro A. 1986. *Christians for Freedom: Late-Scholastic Economics*. San Francisco: Ignatius Press.

Cicero, Marcus Tullius. 1991. *On Duties*. M. T. Griffin and E. M. Atkins, eds. New York: Cambridge University Press.

D'Entrèves, A. P. 1970. *Natural Law: An Introduction to the Philosophy of Law*. London: Hutchinson University Library.

Gray, John. 1989. *Liberalisms: Essays in Political Philosophy*. New York: Routledge.

Hayek, F. A. 1976. *Law, Legislation, and Liberty: The Mirage of Social Justice*. Chicago: University of Chicago Press.

Hazlitt, Henry. [1964] 1988. *The Foundation of Morality*. Lantham, Maryland: University Press.

Herbert, Auberon. 1978. *The Right and Wrong of Compulsion by the State and Other Essays*. Indianapolis: Liberty*Classics*.

Hoppe, Hans-Hermann. 1988a. "From the Economics of Laissez Faire to the Ethics of Libertarianism." In Walter Block and Llewellyn H. Rockwell, Jr., eds., *Man Economy and Liberty: Essays in Honor of Murray N. Rothbard*. Auburn, Ala: The Ludwig von Mises Institute. Pp. 56–76.

——. 1988b. "Utilitarians and Randians vs. Reason." *Liberty* 2, no. 2 (November): 53–54.

——. 1989. *A Theory of Socialism and Capitalism*. Norwell, Mass.: Kluwer Academic Publishers.

——. 1990. Review of *Man, Economy and Liberty: Essays in Honor of Murray N. Rothbard*. *Review of Austrian Economics* 4: 249–63.

Locke, John. 1933. *An Essay Concerning Human Understanding*. Selections in Edwin A. Burtt, ed. *The English Philosophers: From Bacon to Mill*. New York: The Modern Library. Pp. 238–402.

——. 1988. *Two Treatises of Government*. Peter Laslett, ed. New York: Cambridge University Press.

——. 1991. *A Letter Concerning Toleration*. John Horton and Susan Mendus, eds. New York: Routledge.

Mill, John Stuart. 1971. *Utilitarianism: With Critical Essays*. Samuel Gorowitz, ed. New York: Bobbs-Merrill.

Mises, Ludwig von. [1922] 1981. *Socialism: An Economic and Sociological Analysis*. Indianapolis: Liberty*Classics*.

——. [1927] 1985. *Liberalism: In the Classical Tradition*. Irvington-on-Hudson, New York: Foundation for Economic Education.

——. [1933] 1976. *Epistemological Problems of Economics*. New York: New York University Press.

——. [1944] 1969. *Omnipotent Government: The Rise of Total State and Total War*. New Rochelle, New York: Arlington House.

——. [1945] 1990. "Economics as a Bridge for Interhuman Understanding." In *Economic Freedom and Intervention: An Anthology of Articles and Essays by Ludwig von Mises*. Bettina Bien Greaves, ed. Irvington-on-Hudson, New York: Foundation for Economic Education. Pp. 223–35.

——. [1947] 1981. *Planned Chaos*. "Epilogue." In *Socialism*. Indianapolis: Liberty*Classics*. Pp. 481–540.

——. [1949a] [1952] 1980. "Laissez Faire or Dictatorship." In *Planning for Freedom*. South Holland, Ill.: Libertarian Press. Pp. 36–49.

——. [1949b] 1990. "The Role of Doctrines in Human History." In *Money, Method, and the Market Process: Essays by Ludwig von Mises*. Richard M. Ebeling, ed. Norwell, Mass.: Kluwer Academic Publishers. Pp. 289–302.

——. [1949c] 1990. "The Why of Human Action." In *Economic Freedom and Intervention: An Anthology of Articles and Essays by Ludwig von Mises*. Bettina Bien Greaves, ed. Irvington-on-Hudson, New York: Foundation for Economic Education. Pp. 51–56.

——. [1950a] 1990. "The Idea of Liberty is Western." In *Money, Method, and the Market Process: Essays by Ludwig von Mises*. Richard M. Ebeling, ed. Norwell, Mass.: Kluwer Academic Publishers. Pp. 303–12.

——. [1950b] [1952] 1980. "Middle-of-the-Road Policy Leads to Socialism." In *Planning for Freedom*. South Holland, Ill.: Libertarian Press. Pp. 18–35.

——. [1952] 1980. *Planning for Freedom*. South Holland, Ill.: Libertarian Press.

——. [1957] 1985. *Theory and History: An Interpretation of Social and Economic Evolution*. Auburn, Ala.: The Ludwig von Mises Institute.

——. [1961] 1990. "On Equality and Inequality." In *Money, Method, and the Market Process: Essays by Ludwig von Mises*. Richard M. Ebeling, ed. Norwell, Mass.: Kluwer Academic Publishers. Pp. 190–201.

——. [1962] 1978. *The Ultimate Foundation of Economic Science: An Essay in Method*. Kansas City: Sheed, Andrews and McMeel.

——. 1966. *Human Action: A Treatise on Economics*. 3rd rev. ed. Chicago: Henry Regnery.

——. [1968] 1990. "The Market and the State." In *Economic Freedom and Intervention: An Anthology of Articles and Essays by Ludwig von Mises*. Bettina Bien Greaves, ed. Irvington-on-Hudson, New York. Pp. 36–39.

——. 1990a. *Economic Freedom and Intervention: An Anthology of Articles and Essays by Ludwig von Mises*. Bettina Bien Greaves, ed. Irvington-on-Hudson, New York: Foundation for Economic Education.

——. 1990b. *Money, Method, and the Market Process: Essays by Ludwig von Mises*. Richard M. Ebeling, ed. Norwell, Mass.: Kluwer.

Narveson, Jan. 1988. *The Libertarian Idea*. Philadelphia: Temple University Press.

Rothbard, Murray N. [1962] 1970. *Man, Economy, and State*. Los Angeles: Nash Publishing.

——. [1970] 1977. *Power and Market*. Kansas City: Sheed, Andrews and McMeel.

——. 1980. "Ludwig von Mises and Natural Law: A Comment on Professor Gonce." *Journal of Libertarian Studies* 4, no. 3 (Summer): 289–97.

——. 1982. *The Ethics of Liberty*. Atlantic Highlands, N.J.: Humanities Press.

Salerno, Joseph T. 1990. "Ludwig von Mises as Social Rationalist." *The Review of Austrian Economics* 4: 26–54.

Shah, Parth. 1988. "On the Ethical Foundation of Public Policy: Utilitarianism, Natural Rights, or Argumentation Ethics?" *Austrian Economics Newsletter* 9, no. 2: 4–9.

Sigmund, Paul E. 1971. *Natural Law in Political Thought*. Cambridge, Mass.: Winthrop Publishers.

Spencer, Herbert. 1970. *Social Statics*. New York: Robert Schalkenbach Foundation.

——. 1978. *Principles of Ethics 2*. Indianapolis: Liberty*Classics*.

——. 1981. *The Man Versus the State*. Indianapolis: Liberty*Classics*.

——. 1989. Letter to J. S. Mill. In *Liberalism: Essays in Political Philosophy*. New York: Routledge. P. 109.

Spooner, Lysander. [1855] 1971. "The Law of Intellectual Property." *The Collected Works of Lysander Spooner*, vol. 3. Weston, Mass.: M & S Press, 1971.

——. [1882] 1971. "Natural Law." *The Collected Works of Lysander Spooner*, vol. 1. Weston, Mass.: M & S Press.

Tabarrok, Alexander. 1990. "Subjective Value Theory: A Reformulation." *Austrian Economics Newsletter* 12, no. 1 (Fall): 5–9.

Thornton, Mark. 1991. *The Economics of Prohibition*. Salt Lake City: University of Utah Press.

Tucker, Jeffrey A. and Llewellyn H. Rockwell. 1991. "The Cultural Thought of Ludwig von Mises." *Journal of Libertarian Studies* 10, no. 1 (Fall): 23–52.

Yeager, Leland B. 1992. "Mises and His Critics on Ethics, Rights and Law." In *The Meaning of Ludwig von Mises: Contributions in Economics, Sociology, Epistemology, and Political Philosophy*. Jeffrey Herbener, ed. Norwell, Mass.: Kluwer. Pp. 190–210.

The Impetus for Recognizing Private Property and Adopting Ethical Behavior in a Market Economy: Natural Law, Government Law, or Evolving Self-Interest

Bruce L. Benson*

I. Introduction

Mises (1949, p. 725) convincingly argues that, *given* the existence of the long-run objectives instilled by private property rights, cooperation in the form of division of labor and trade emerge naturally; and therefore, under these circumstances, "there is no need to enforce cooperation by special orders or prohibitions." His explanation is clear: when private property rights are defined and enforced, the

> reason why the market economy can operate without government orders telling everybody precisely what he should do and how he should do it is that it does not ask anybody to deviate from those lines of conduct which best serve his own interests. What integrates the individual's actions into the whole of the social system of production

*Bruce L. Benson is distinquished research professor of economics at Florida State University.

This paper was prepared for consideration for a Ludwig von Mises prize to be awarded at the Mises Institute's 10th anniversary conference, October 9–11, 1992. The paper draws from and expands upon a manuscript entitled "The Evolution of Values and Institutions in a Free Society: The Underpinnings of a Market Economy," prepared for the International Conference on the Unity of Sciences, held in Seoul, Korea in August of 1992. It is also part of an ongoing research project on "The Evolution of Law: Custom Versus Authority" which has been supported by the Earhart Foundation with Fellowship Research Grants for the summers of 1991 and 1992.

The Review of Austrian Economics Vol.6, No. 2 (1993): 43–80
ISSN 0889-3047

> is the pursuit of his own purposes. In indulging in his "acquisitiveness" each actor contributes his share to the best possible arrangement of production activities. (Mises 1949, pp. 725–26)

But where do the property rights come from? Some suggest that there is a "natural law," perhaps given by some superhuman power (or by the conscience of wise and decent men) which also has entrusted authority into the hands of enforcement institutions. Another answer, legal positivism in the tradition of Hobbes and Austin, typically identifies law with observed legal institutions: generally the state. This view assumes that without a monopoly in police and/or military power by a coercive centralized authority, anarchy characterized by continual conflict will exist, and that whatever the state defines as law is "law." Thus, the state is the necessary prerequisite to the establishment of the fundamental ethical behavior that supports a free market: Presumably individuals will not respect private property, fulfill obligations, or recognize contracts unless a coercive authority forces them to do so. In fact, legal positivism is closely related to the natural law. As Mises (1985a, p. 11) suggests, "A new type of superstition has got hold of people's minds, the worship of the state."

Mises correctly rejects the natural law doctrine. For example, he (1949, p. 720; also see p. 146; 1985b, pp. 44–49, 82) explains that rules and laws are made by people for specific purposes: there is "no such thing as a perennial standard of what is just and what is unjust. . . . All moral rules and human laws are means for the realization of definite ends. There is no method available for the appreciation of their goodness or badness other than to scrutinize their usefulness for the attainment of the ends chosen and aimed at." In a market economy, the ends are the gains from trade that arise given recognition of private property, and the resulting long-run increases in wealth for those involved. And as Mises says:

> there is nothing inhuman or mystical with regard to the market. The market process is entirely a result of human actions. Every market phenomenon can be traced back to definite choices of the members of the market society. The market process is the adjustment of the market society to the requirements of mutual cooperation. (1949, p. 258)

Mises also rejects parts of the legal positivist view. In fact, he (1985b, pp. 47–48) suggests that "[t]he chief accomplishment of the natural law idea was its rejection of the doctrine (sometimes called legal positivism) according to which the ultimate source of statute law is to be seen in the superior military power of the legislator who

is in a position to beat into submission all those defying his ordinance. . . . it is an illusion to deny that the best system of laws cannot be put into place unless supported and enforced by military supremacy." There clearly are, in Mises's mind, appropriate and inappropriate laws (e.g., see 1985a, pp. 46–50). For instance, he emphasizes (1985a, p. 58) that "[g]overnments have always looked askance at private property. . . . It is the nature of the man handling the apparatus of compulsion and coercion . . . to strive at subduing all spheres of human life to its immediate influence." And he maintains that one function of the "law" is to constrain the discretionary application of coercive powers by officeholders and bureaucrats (1983, p. 76). Yet, Mises does not take the final step and reject all of tenets of legal positivism. He accepts the view that a state's authority is essential for controlling individual's tendencies toward unethical behavior:

> The state is essentially an apparatus of compulsion and coercion. The characteristic feature of its activities is to compel people to behave otherwise than they would like to behave. . . . With human nature as it is, the state is a necessary and indispensable institution. The state is, if properly administered, the foundation of society, of human cooperation and civilization. (Mises 1985a, pp. 46–47)[1]

Without the state, Mises (1985a, p. 48) expects that anarchy à la Hobbes will prevail. In fact, despite recognizing that the state is always a threat to property rights, Mises (1949, p. 725) maintains that it is also the source of those rights, or at least of their protection: "Beyond the sphere of private property and the market lies the sphere of compulsion and coercion; here are the dams which organized society has built for the protection of private property and the market against violence, malice, and fraud. . . . here are rules discriminating between what is legal and what is illegal, what is permitted and what is prohibited."

The Hobbesian jungle is not the only alternative to the state, however. Indeed, there is another possible source of property rights and behavioral rules, which a direct extension of Mises's analysis of self-interest incentives for cooperation under private property can explain. Thus, the purpose of the following presentation is to extend, to a more fundamental level, the theoretical explanation offered by Mises as to "why the market economy can operate without government orders telling everybody precisely what he should do and how he should do it," by demonstrating that the same reasoning also

[1]Also see Mises (1983, p. 18; 1985a, pp. 48–50), and footnote 13.

applies to incentives for cooperation in establishing, recognizing, and enforcing private property rights.[2] Given long-run goals rather than short-run concerns, individuals have incentives to enter into cooperative arrangements in order to reduce their costs of defending possession claims and to enhance the property's value by increasing the potential for mutually beneficial interaction, including division of labor and market exchanges. As Rothbard (1970, p. 3) contends, "no State or similar agency contrary to the market is needed to define or allocate property rights. This can and will be done by the use of reason and through market processes themselves; any other allocation or definition would be completely arbitrary and contrary to the principles of the free society." Section II of the following presentation explains why and how self-interested individuals within a particular group will voluntarily adopt the behavioral rules and develop the basic institutional framework that underlies and facilitates a free market, as well as other mutually beneficial interactions. The fact is that even though the concept of a perennial "natural law" is erroneous, "customary law" can evolve naturally or spontaneously, just as Adam Smith described the evolution of markets: "as if guided by an invisible hand." Section III examines the various competitive and cooperative relationships that can arise between groups which facilitate the spread of customary law. It is not contended that the voluntary evolution of the ethical behavioral rules and institutions of customary law *must* arise, however. Rather, the point is that they *can* and *do* arise without a coercive centralized authority. Thus, the concluding section considers the issue of why a centralized coercive authority appears to be the source of law in most modern societies. The fact is that the voluntary rules and

[2]Recognize with Mises (1985a, p. 14), that in order to "understand the present state of political affairs [we] must study history," and note that the literature on legal history reveals a substantial amount of evidence which makes "clear that property and contract were . . . functioning social institutions before state-made laws existed or were even conceived of" (Fuller 1981, p. 174). Many predominantly voluntary arrangements for internal order have been described by anthropologists, historians, and scholars studying modern groups and associations (e.g., see [Hoebel 1954, 1967; Barton 1967; Popisil 1971; Goldsmidt 1951; Peden 1971; Friedman 1979; Berman 1983; Trakman 1983; Umbeck 1981; Berman and Dasser 1990]). Nonetheless, while some economists (e.g., Rothbard [1970]; Friedman [1973]) recognize the logical contradiction between a voluntary, decentralized free market and a centralized, coercive authority for law, an observation made by Leoni (1961, p. 90) still generally applies: The fact is that even Mises and others "who have brilliantly defended the free market against the interference of the authorities have usually neglected the parallel consideration that no free market is really compatible with a law-making process centralized by authorities." Thus, a theoretical presentation using the game-theoretic jargon of "modern" economics seems appropriate.

institutions are not universally observable because conflicting incentives also exist which are more effectively served by authoritarian institutions and laws. Indeed, the evolution of law in most societies is actually shaped by the ebbs and flows of the natural conflict between customary and authoritarian institutions and norms within and between groups, a conflict that Mises clearly recognizes (1985a, pp. 58, 104, 240). The examination of this conflict emphasizes that the expanding scope of centralized authority does not reflect its superiority in preserving and protecting private property or in facilitating voluntary interactions such as those which characterize a market economy.

II.
The Evolution of Ethics and Law Within a Cohesive Group

As Mises explains, cooperation in a market process generates long-run benefits for everyone (1985b, p. 236), but if some individuals focus on short-run considerations, long-run benefits may not be achieved. The question is, under what circumstances are incentives tied to short-run considerations? In the jargon of game theorists: if every potential market exchange between people involves a discrete, simultaneous one-shot game, then mutually beneficial interaction is unlikely in the absence of some threatened sanction by a coercive power. Short-run concerns dominate potential long-run benefits. While this argument applies to cooperative exchange, it also applies to cooperation in the form of collective recognition and compliance with a set of ethical values. An individual, person *A*, who bears personal costs from adopting some type of conduct that constrains him in some way (e.g., respecting someone's private property rights and therefore not using that property without permission, perhaps involving a payment for the use) will get nothing in return if the other individual, *B*, does not adopt a similar set of values and cooperative behavior (e.g., if *B* does not recognize *A*'s property rights). Uncertainty about the behavior of *B* in the resulting one-shot prisoner's dilemma-type situation induces non-cooperative behavior by *A*, and vice-versa. This prisoner's dilemma scenario does not characterize many kinds of social interactions, however (Tullock 1985). Individual's choices regarding interaction with others are part of a continuous process, with each unique decision representing only one link in a long-time chain of interaction. For example, most businessmen expect to be active for a long time and to be involved in interactions with other businessmen and consumers over and over. Their focus is long run, not short run.

A more appropriate characterization of many interactions might be as multi-contact or repeated games. Indeed, in a repeated game

setting with a finite uncertain horizon, cooperation becomes possible (à la Luce and Raiffa [1957] and Axelrod [1984]), although it clearly is not certain.[3] This includes the potential for ethical behavior. For instance, Fuller (1964, pp. 23–24) suggests three conditions which make mutually recognized duties or obligations clear and acceptable to those affected. First, the relationship of reciprocity from which the behavioral obligations arise "must result from a voluntary agreement between the parties immediately affected; they themselves 'create' the duty." Second, the reciprocal acceptance of the duties must be equitable in the sense that both parties must expect to gain: the exchange cannot be one-sided so that one person gains and another loses, once again emphasizing the paramount role of self-interest motives. Third, the parties must expect to interact on a fairly regular basis because the relationship "must in theory and in practice be reversible." That is, given reciprocal gains in a repeated game situation, recognition of common behavioral norms becomes likely as each individual recognizes that the long-term benefits of remaining on good terms with the other party by doing so are likely to be greater than the immediate benefits of not cooperating (e.g., taking another person's possessions, committing fraud).

Even a repeated game involves weaker incentives to recognize a common set of behavioral norms than those which exist in many situations (Tullock 1985). In particular, each individual chooses to enter into several different games with different players. Thus, refusal to behave ethically within one game can affect the person's reputation and limit his ability to enter into other games to the extent that reputation travels from one game to another. When players value ongoing relationships with other reliable players more than the potential benefits associated with refusing to follow accepted behavior in any single game, then the potential for cooperation in the form of recognition of standard behavioral norms is even greater than in simple repeated games (Schmidtz 1991, p. 102). Tullock (1985, p. 1073) refers to this combination of multiple games over time with reputation effects using Adam Smith's phrase: "the discipline of repeated dealings." The incentives to cooperate that arise from repeated games are effectively reinforced, because anyone who chooses a non-cooperative strategy in one game will have difficulty finding a partner for any future game (Tullock 1985, pp. 1075–76). Therefore, in order to maintain a reputation for fair dealings or "high moral standards," each player's dominant strategy is to behave ethically

[3]Actually, the solution still depends on payoffs and other considerations (Tullock 1985, p. 1073).

throughout each game, whether repeated or one shot. And as a consequence, in Mises's words:

> social cooperation becomes for almost every man the great means for attainment of all ends. An eminently human common interest, the preservation and intensification of social bonds, is substituted for pitiless biological competition . . . Man becomes a social being. . . . Other people become his fellows. . . . For man, until the optimum size of population is reached, it means rather an improvement than a deterioration in his quest for material well-being. (1985b, p. 56)

Property rights under "customary law"

Recognition of private property rights and the rights of individuals (rules against violence, malice and fraud) are likely to constitute the most important of the voluntary and mutually recognized duties or obligations when interactions arise out of reciprocity and reputation (Benson 1989b; 1990).[4] After all, individuals must expect to gain as much or more than the costs they bear from voluntarily constraining their behavior in light of common behavioral norms. Indeed, voluntary adoption of commonly accepted behavior (and participation in the institutions that develop to support those values, as noted below) is likely to arise only when substantial benefits from doing so can be internalized by each individual. Recognition by others of a person's possessions as that person's private property is a very attractive benefit.[5] Therefore, individuals have incentives to reciprocate and recognize other individuals' property rights in order to reduce their own costs of defending possession claims, and to enhance the property's value by increasing the potential for mutually beneficial interaction, including market exchanges. From an individual's perspective, such behavioral norms involve both rights and obligations

[4]It should be emphasized that there is no distinction between criminal and tort law in a customary legal system. However, a large proportion of the offenses which appear in a modern criminal code are still illegal (e.g., see Hoebel [1954, 1967]; Barton [1967]; Benson [1989a, 1990, 1991b, 1992b]; Popisil [1971]; Goldsmidt [1951]; Peden [1971]; Friedman [1979]). Indeed, the primary concern of such a voluntary system is protection of private property, including prevention of theft and violence.

[5]Indeed, private property is a key characteristic of all societies wherein reciprocity and reputation is the primary impetus for recognition of behavioral norms or values (Benson 1990). In such a setting, there does not even appear to be any viable reason for voluntary cooperation that does not involve a relative increase in the degree of privatization of rights to property for the group. Individuals with no existing claims to property might conceivably cooperate in order to take property out of the commons and restrict others' access to it, for example; but the result, if the group is successful, is that access and use rights to the property and claims to the benefits from such use become internalized by the group (i.e., privatized relative to what they were).

(recognition of other individual's rights), of course. Indeed, "all such relationships entail domination and submission" (Leach, 1977, p. 19). In some cases an individual's rights dominate, but in other cases the individual must submit to the interests of someone else: " 'the law', by which I here mean the customary rules of society, . . . says who must submit to whom and in what context" (Leach 1977, p. 19). The use of "customary rules" is appropriate here. Recognition of property rights becomes a customary obligation. Indeed, even today, as Hayek (1973, pp. 96–97) explains, many issues of law are not "whether the parties have abused anybody's will, but whether their actions have conformed to expectations which other parties had reasonably formed because they corresponded to the practices on which the everyday conduct of the members of the group was based. The significance of customs here is that they give rise to expectations that guide people's actions, and what will be regarded as binding will therefore be those practices that everybody counts on being observed and which thereby condition the success of most activities."

Property rights are more a matter of economic value than of legal definition. That is why Mises's (1949, pp. 725–26) arguments about the reasons for cooperation in a market readily extend to explain cooperation in rights formation. The fact that the potential for long-run gains implies that self-interest incentives to cooperate in market activities arise given recognition of private property rights also implies that incentives can exist to cooperate in the establishment of such rights, given that individuals have long-run objectives.

Similar incentives motivate the development of legal institutions; and when a system of behavioral obligations is backed by institutions for resolution of disputes and enforcement of obligations, the result is a legal system (Fuller 1964; Benson 1990). If a legal system develops from the bottom up through voluntary arrangements, as suggested here, it can be referred to as "customary" law (Fuller 1964). A customary legal system is based on individual decisions reflecting individual self-interest, because each individual finds it beneficial to obey certain rules (even though each probably recognizes that these rules may occasionally work to his disadvantage) and to contribute to the costs of enforcement, in anticipation that the long term benefits will exceed the costs.

Institutions for Adjudication and Enforcement of Customary Behavioral Rules

When a group of frequently interacting people is sufficiently small and stable so that reputations are well-known and trust relationships are strong, there is little need for a formal institutional

arrangement, perhaps beyond the institution of the immediate family. The self-interest impetus for new institution formation can arise when the potential for beneficial interaction expands to a larger and/or less stable group than one in which everyone knows everyone else's reputations well enough to establish individual trust relationships. As the group expands or becomes more dynamic (e.g., perhaps because of increasing potential for specialization and division of labor), individuals will want to interact with increasing frequency and/or with growing numbers of other individuals with whom reciprocities and reputation effects may not be firmly established. Such interaction, while desirable, also increases the potential for dealings with someone who in fact does not behave as expected, which in turn creates the potential for a disagreement as a result of theft, deliberate fraud, malicious slander, or some other form of taking of property rights. Therefore, for such expansion to occur, each party's commitments to accept commonly expected norms of behavior must be credible.

One way to unilaterally try to insure credible commitments by another party to fairly resolve disputes is "self-help" (Nader and Todd 1978, p. 10): that is, accumulation of human or mechanical assets for inflicting violence in order to threaten retaliation if the other party does not behave as expected. This should reduce the probability of an intentional offense against the individual, and increase the probability that the individual can make a property rights claim stand. However, this can also be quite costly. Furthermore, when the threat of violence is not sufficient and a dispute arises, the relevant institution for dispute resolution is the "feud" or vengeance (Leach 1977, p. 24).

Unilaterally, an individual in a dispute has only two options besides violence. He can simply decide that the cost of pursuing the claim is too high, and drop it, while continuing to interact with the perceived offender, or he can choose not to pursue the claim, *and* to discontinue interactions with the other individual. The relative costs and benefits of these options will be weighed if an individual unilaterally makes a choice; and if the property rights are expected to be more valuable than continuing the relationship, violence will be chosen (Nader and Todd 1978, pp. 10 and 18). Both individuals face similar alternatives, however; so in combination, they actually have a fourth option. They can negotiate a peaceful solution (Nader and Todd 1978, p. 10). In doing so, they attempt to delineate previously undefined property rights or reestablish the rights that have been intentionally taken. Personal strength still plays a role in negotiation, of course, in that it can establish a bargaining advantage. Furthermore, direct negotiation may not be successful, so violence or loses due to acquiescence are still threatened.

The high cost of either unilateral actions in maintaining personal strength or of bearing losses due to acquiescing is an important source of the incentives that individuals with mutual interests in long-term interaction have to form groups or associations for mutual support, even when feuding is still intended to be the ultimate means of dispute resolution. Transactions costs fall through organization and institutions for mutual support. That is, the benefits of negotiation (violence avoidance and maintenance of long-term relationships) are increased. Backing by a combined threat from the group reduces the probability of an intentional offense, reduces the costs for member individuals of large personal investments in the tools of violence, reduces the probability that an individual will have to defend his property relative to what it would be in the absence of such an organization, reduces the likelihood that violence will have to be employed to resolve a dispute, and increases the probability that negotiation will be successful. Furthermore, when negotiation fails, the costs of violent dispute resolution are now shared by the group (e.g., as in a "blood feud"). As feuding begins to create costs for others in the group, incentives arise to offer lower cost means of non-violent dispute resolution than direct negotiation. Indeed, mutual support groups are particularly attractive if group members are obligated to (1) act as or provide access to third parties that mediate or arbitrate any dispute between members, (2) assess judgments to make sure that they are just and consistent with existing property rights, and if necessary, (3) help enforce the dispute's resolution (Benson 1990).[6]

If a dispute between group members arises, for instance, pressure might be brought to bear by the group as a whole (the nature of such pressure is examined below) to induce mediation, leading to a settlement viewed to be "fair" by the group at large. A mediator acts as a disinterested go-between who assists the disputants in their negotiations. This may allow the parties to remain apart, thereby avoiding potentially dangerous direct confrontations. Another low

[6]Note that the mutual support group may have many functions besides its legal role. Primitive kinship groups, for example, might have been primarily concerned with cooperative production of food, shelter, protection from outside threats (or taking of wealth from outsiders, as noted below), and/or religious functions. Even though they also developed a system of customary law to maintain internal order, they may not have fully recognized the importance of this function for facilitating interaction, attributing the results instead to some mystical source. As Mises (1985b, p. 240) notes, "Where people did not know how to seek the relation of cause and effect, they looked for a teleological interpretation. They invented deities and devils to whose purposeful action certain phenomena were ascribed. A god emitted lightning and thunder. Another god, angry about some acts of man, killed the offenders. . ." Also see footnote 8 and related discussion.

transactions cost alternative may be a mutually acceptable arbitrator, with an agreement by the disputants to accept the arbitrator's decision. As Leach (1977, p. 24) notes, however, "even then, the function of the arbitrator is simply to restore peace; it is not part of his duty to adjudicate about the rights and wrongs of the conflict or to inflict penalties." Given this function, it is not surprising that in primitive or religious societies an arbitrator can be supernatural (Nader and Todd 1978, p. 11): "When both parties agree to perform an ordeal or divination and accept the outcome as a decision, the third party in the arbitration is a nonhuman agent."

Rather than assisting in negotiations, the arbitrator considers the issue and proposes a solution which, *ex ante*, the parties have agreed to abide by (a superhuman arbitrator reveals a decision by the failure of one of the parties to survive the ordeal unharmed). The parties involved must expect the benefits from resolving the dispute peacefully (clarifying rights or, in the case of an intentional offense, reestablishing the old right) to outweigh the cost of resolving the dispute in that manner, or they would not take it to the arbitration (or mediation) system: for instance, if arbitration is perceived to involve more costs than other methods of dispute resolution (e.g., violence, direct negotiation), perhaps because the arbitrator is expected to be arbitrary or biased, then arbitration will not be pursued. Indeed, if one party in the dispute perceives a high cost arising from a peaceful settlement (e.g., because he knows he is guilty), he can still resort to violence. Therefore, the "borderline between law and war" is not fixed (Leach 1977, p. 25), and depending on the individual's perception of relative costs and benefits, any of the resolution mechanisms discussed here (violence, acquiescing, negotiation, mediation, and arbitration) can be observed. Of course, when members of a group are affected by a violent dispute they have strong incentives to raise the cost of violence for group members, *and* to lower the cost of non-violent dispute resolution.

In order to raise the cost of violence, acceptance of non-violent dispute resolution will become a customary obligation that is required for group membership. Customary rights and obligations that induce non-violent dispute resolution can include such things as family loyalty, obligations for past care, honor (or reputation) and the shame that comes with disrupting the social order or invoking the wrath of some supernatural arbitrator. Indeed, resort to violence without first trying to achieve a non-violent solution will result in ostracism by the group. That is, refusal to behave according the accepted rules of conduct, including acceptance of non-violent dispute resolution, can be "punished" by boycott (i.e., exclusion from some or

all future interaction with other members of the group). This is possible because customary law is tightly bound with all other aspects of life. Fear of this boycott sanction reinforces the self-interest motives associated with maintenance of reputation and reciprocal arrangements. It also deters intentional offenses. In other words, because each individual has made an investment in establishing himself as part of the community (e.g., establishing a reputation), that investment can be "held hostage" by the community, à la Williamson (1983), in order to insure that the commitment to cooperate is credible.

Furthermore, the costs of non-violent dispute resolution will naturally fall as the institution evolves. After all, since the arbitrator/mediator must be acceptable to both parties in the dispute, "fairness" becomes embodied in the dispute resolution process. As Buchanan emphasizes (1975, p. 68), "Players would not consciously accept the appointment of a referee who was known to be unfair in his enforcement of the rules of the game or at least they would not agree to the same referee in such cases. 'Fairness' or 'justice' may emerge, therefore, in a limited sense from the self-interest of persons who enter into an enforcement contract."

The arbitrator or mediator will have no vested authority to impose a solution on disputants (Leach 1977, p. 24). They are not "adjudicators" backed by coercive power. Under such circumstances, the ruling must be acceptable to the group to which both parties in the dispute belong. An arbitrator or mediator's only real power in such a system is that of persuasion.[7] Indeed, as Fuller (1981, pp. 110–11) explains, "Being unbacked by state power . . . the arbitrator must concern himself directly with the acceptability of his award. He may be at greater pains than a judge to get his facts straight, to state accurately the arguments of the parties, and generally to display in his award a full understanding of the case." This is particularly likely if either: (1) the arbitrator is a specialist who wishes to build a reputation for good decisions in order to maintain or enhance his position in the market for arbitration services, or (2) the arbitrator is a highly reputable member of the community that wishes to maintain that reputation for other reasons. Thus, if the group is large enough so that disputes are not uncommon, certain highly reputable

[7]In this light, Fuller (1981, p. 134) observes that "A serious study of mediation can . . . offset . . . [the assumption] that all social order must be imposed by some kind of 'authority'. When we perceive how a mediator, claiming no 'authority', can help the parties give order and coherence to their relationship we may in the process come to realize. . . . that social order can often arise directly out of the interactions it seems to govern and direct."

members of the community may be called on to arbitrate disputes so frequently that they can have some formal designation (e.g., elderman, peace chief, consul; see Benson [1989a, 1990, 1992b] and Popisil [1971]). Alternatively, an approved pool of competitive arbitration or mediation specialists might develop (see Hoebel [1954]; Barton [1967]; Benson [1989a, 1990, 1992a]; Berman and Dasser [1990]; and Peden [1971]).

Given that the arbitrator has convinced the individuals in the affected group that a proposed judgment should be accepted, the loser must pay the arbitrated restitution in order to maintain his position within the group; i.e., he buys back his reputation. Because "fairness" is essential for arbitration to arise in a voluntary system, the ruling can also be backed by a threat of ostracism by the members of the entire group (e.g., see Hoebel [1954, 1967]; Barton [1967]; Benson [1989a, 1989b, 1990, 1991a, 1991b, 1992a, 1992b]; Berman and Dasser [1990]; Popisil [1971]; Goldsmidt [1951]; and Trakman [1983]). Thus, decisions can be enforced without backing by a centralized coercive authority.

The nature of the sanction is also likely to vary depending upon the intentions and status of the offender. After all, the members of a group wish to deter costly and potentially violent disputes. Disputes that arise because conditions change in unanticipated ways cannot be effectively deterred, of course; but intentional violation of customary behavioral rules by theft, fraud, or malicious slander can be deterred by explicitly setting a higher payment to buy back the peace. In other words, when an intentional offense occurs, the payment is likely to include both restitution and retribution. Indeed, economic restitution and retribution will be the primary types of punishment in a system of customary law, but they may not be the only types of punishment. After all, "a fine is a [relatively] costless punishment: the cost to the payer is balanced by a benefit to the recipient. It is in this respect superior to punishments such as execution, which imposes cost but no corresponding benefit, or imprisonment, which imposes costs on both the criminal and the taxpayers" (Friedman 1979, p. 408). It is clearly possible, however, that the members of a group may hold that some offenses, perhaps intentional murder or rape, are so heinous that it is impossible to compensate for the harm inflicted. For instance, medieval Icelandic (Friedman 1979) and primitive Kapauka (Popisil 1971) legal systems considered capital punishment appropriate for some crimes. It is also possible that the rest of an offender's life will be committed to working to pay the victim or the victim's family, even if full restitution is never achieved.

Ostracism can also vary in severity depending upon the behavior that it is intended to deter. For some minor offenses or disputes, individuals may face the threat of exclusion from some forms of interaction but not others. The resulting shame or dishonor may be an effective deterrent in these minor cases. In many primitive and religious societies, mythology is invoked, for instance, and the resulting religious ostracism can be a particularly frightening threat. Obligations can be characterized as "taboos" punishable through sorcery and supernatural sanctions, or sins punishable through excommunication. For more severe offenses or disputes, an offender who refuses to participate in non-violent dispute resolution or refuses to accept a fair judgment becomes a social outcast or "outlaw." In fact, "Expulsion from the group is probably the earliest and most effective sanction or 'punishment' which secures conformity, first by mere actual elimination from the group of the individuals who do not conform while later, . . . the feat of expulsion may act as a deterrent" (Hayek 1967, p. 78). As a result of such ostracism, the individual no longer can go to his support group for protection. The plaintiff (or perhaps anyone in the group), therefore, is free to, and perhaps even obliged, to take physical revenge by killing the offender and/or taking the offender's property. Of course, the threat of such violent punishment can be a significant deterrent to illegal behavior. Indeed, similar threats apply in all legal systems, including those that exist today (Umbeck 1981). The fact is, however, that while boycott sanctions are possible, the primary impetus for accepting such rulings is positive self-interest rather than fear of negative consequences. The result can be characterized just as Mises (1949, p. 283) describes the interdependence arising in a free market: "[T]he individual is not bound to obey and to serve the overlord. [Yet] he is certainly not independent. He depends on the other members of society. But this dependence is mutual."

Another characteristic of customary law's sanctions can be predicted in light of its emphasis on individual rights. As with any private property right, the right to restitution will be transferable. An individual might call upon a sub-group (e.g., his immediate family, his religious congregation, his neighborhood) to assist him in prosecuting a strong offender, in exchange for some portion of the settlement, providing the threat necessary to induce that offender to submit to a nonviolent form of dispute resolution (Hoebel 1967; Benson 1991a). Alternatively, a marketable claim for a victim can evolve which can be sold to someone willing to pursue and prosecute the offender (Friedman 1979, p. 414). This, in turn, helps create arrangements under which those who violate the rights of the poor and the weak are pursued and prosecuted. As a customary law system

expands and evolves, victims could offer bounties or rewards, but they might simply sell the right to collect a particular fine. Specialized firms (thief-takers, bounty hunters) could arise to pursue criminals and collect restitution; or individuals might contract with firms that attempt to prevent aggression against clients, pay clients who are victimized as insurance companies do, and pursue offenders to recover the insurance payment. Marketable restitution rights increase the probability of pursuit and prosecution, thereby reducing incentives to commit intentional offenses even further.

It does not follow that violence and blood feud will be completely eliminated under customary law. If one party in a dispute perceives the cost of non-violent dispute resolution to be too high, even given the threat of ostracism, a feud may erupt. As emphasized above, institutions and incentives are developed in a customary law system in order to enhance the potential for peaceful interaction and minimize the potential for violence; but no legal system, no matter how threatening, has ever completely eliminated violence. However, in the event of a feud, customary "rules of war" also generally apply; the result can often be described as "a kind of ritual game" (Leach 1977, p. 25). If one party or the other exceeds the customary bounds of the feud, thereby imposing significant costs on others in the group, they are likely to bring down the wrath of the entire community, so feuds tend to be constrained in their scope and duration. Thus, even when violence arises, rights and obligations apply: "there is, in effect, agreement about how to disagree" (Leach 1977, p. 28).

As Mises (1985b, p. 258) emphasizes, "to deal with social groups adequately and completely, one must start from the actions of the individuals," a condition that clearly applies here. In essence, the individuals "exchange inputs in the securing of a commonly shared output," to use Buchanan's and Tullock's words [1962, p. 19]—the output is the order arising under a commonly accepted set of rules which develops into a customary system of law. But as a consequence of this exchange, total resources devoted to the production of credible threats should fall relative to what individuals acting on their own would have to invest, and the potential for interaction expands.

Changing Property Rights and the Development of Contracts in Customary Law

Customary law has been described as an example of natural law. For instance, Leach contends that

> customary law is not viewed as the recent creation of rational men but as something that was laid down by semi-divine ancestral

> law-givers in remote antiquity. The justification for conforming to custom is not that it makes sense, but that *"that is what our ancestors said we should do"*.... There is an implicit social contract with divine ancestors to obey the rules that they laid down. Failure to conform to conservative custom amounts to an act of sacrilege which will automatically bring about supernatural disaster. (Leach 1977, p. 31)

Equating customary law with natural law is very misleading, however. First of all, even if the rules were passed down unchanged from ancestors, those ancestors were rational humans, not gods, and they developed their rules by considering the costs and benefits of doing so. Second, mythology is important in some customary law systems, particularly among primitive societies and religious communities; but it is not relevant in others (e.g., see the discussions of commercial law in Trakman [1983]; Berman [1983]; Berman and Dasser [1990]; Benson [1989b, 1990, 1992a]). Third, the fact that mythology plays an important role in some customary law systems does not mean that the myth *actually* describes the source of the law. In fact, mutually beneficial behavior can often fit a variety of norms.[8] Fourth, and most significantly, customary law is not static. It evolves and changes as individuals adapt to meet the needs of new conditions. The important issues, then, are why did the rules develop in the first place, an issue discussed above, and why do they evolve and change, rather than how those rules happen to be explained in particular customary law systems.

As Demsetz (1967) explains, property rights will be defined when the benefits of doing so cover the costs of defining and enforcing such rights. Potential benefits of clarifying existing or developing new property rights may become evident because a dispute arises, for example, perhaps implying that existing rules do not adequately cover some new situation. The parties involved must expect the benefits from resolving the dispute and of establishing a new rule to

[8]In fact, mythology appears to be a rational development in itself. Taboos against incest are common among primitive societies, for instance. These people do not know why the offspring of incestuous relationships tend to be physically or mentally impaired but through observation, they learn that they are. Thus, in order to avoid the cost of caring for such people they decide that the gods have declared such relationships to be taboo in order to discourage them. In addition, when the costs of obtaining information exceed the benefits, it is very rational to be ignorant; and similarly, when the desired behavioral results can be obtained without incurring all of the costs of informing others of the precise reason for the behavior, then it is rational to do so. Whether the desired behavior arises because an individual is correctly informed by those knowledgeable of such things, so that he expects the economic benefits to exceed the cost of behaving differently, or if he expects a supernatural disaster if he behaves differently, the outcome is the same.

outweigh the cost of resolving the dispute and enforcing the resulting judgment, or they would not take it to the dispute resolution system. The arbitrator or mediator will often have to make more precise those rules about which differences of opinion exist, and at times even to supply new rules because no generally recognized rules exist to cover a new situation (Hayek 1973, p. 99). A dispute resolution's decision becomes a universally applied rule of customary law only if it is seen as a desirable rule by all affected parties, however (Benson 1990, 1991a, 1992a). It is not coercively imposed on a group by some authority backing the court. Thus, good rules which facilitate interaction tend to be selected over time (e.g., rules that specify or clarify private property rights), while decisions that do not turn out to establish useful rules are ignored.[9] For new rules to be accepted by the members of a group, they generally must be consistent with individuals' expectations, so they must build upon or extend existing values.

Dispute resolution is not the only source of evolving behavioral rules. Individuals may simply observe that others are behaving in a particular way in light of a new situation, and adopt similar behavior themselves, recognizing the benefit of avoiding a confrontation: "It is always an individual who starts a new method of doing things, and then other people imitate his example. Customs . . . have always been inaugurated by individuals and spread through imitation by other people" (Mises 1985b, p. 192). As a consequence of adopting such behavior, the individuals create an obligation to one another to continue the behavioral pattern. A new contract form may develop, for instance, that improves on existing forms by reducing the potential for uncertainty. Others see the benefits of the new contract form and adopt it as well, so it becomes a standard practice in such situations. Fuller (1981, pp. 224–25) explains that "the term *contract law*, therefore, refers primarily not to the law *of* or *about* contracts, but to the 'law' a contract itself brings into existence . . . If we permit ourselves to think of contract law as the 'law' that parties themselves bring into existence by their agreement, the transition

[9]This description of the evolution of customary law may appear to be quite similar to the analysis of common law that has lead several legal theorists to conclude that it produces "efficient" rules (Leoni 1961; Rubin 1977; Priest 1977; Hayek 1973, pp. 94–103). However, there are actually important points of departure. For instance, while much of common law was simply a codification of the basic norms common to Anglo-Saxon society (that is, customary law), common law was also authoritarian royal law, and therefore, even during its earliest development some aspects of it were imposed by authoritarian sources described below (Benson 1990). Footnote 24 contains related discussion.

from customary law to contract law becomes a very easy one indeed." Customary law and contract law are typically differentiated much more sharply than is suggested here. However, Fuller argues that a sharp distinction is inappropriate:

> if problems arise which are left without verbal solution in the parties' contract these will commonly be resolved by asking what "standard practice" is with respect to the issues in question. In such a case it is difficult to know whether to say that by entering a particular field of practice the parties became subject to a governing body of customary law or to say that they have by tacit agreement incorporated standard practice into the terms of the contract.
>
> The meaning of a contract may not only be determined by the area of practice within which the contract falls but by the interaction of the parties themselves after entering the agreement. . . . The meaning thus attributed to the contract is, obviously, generated through processes that are essentially those that give rise to customary law. . . . [In fact,] a contract [may be implied] entirely on the conduct of the parties; . . . the parties may have conducted themselves toward one another in such a way that one can say that a tacit exchange of promises has taken place. Here the analogy between contract and customary law approaches identity. (1981, p. 176)

The expanding use of contract and development of contractual arrangements is, in fact, a natural event in the evolution of customary law. As customary legal arrangements evolve and are improved upon, they tend to become more formal, and therefore, more contractual. In addition, as inter-group interaction develops and expands so that the trust relationships that characterize intra-group interaction do not apply, conflicts are avoided by explicitly stating the terms of the interaction *a priori*; that is, by contracting. A carefully constructed and enforceable contract can substitute for kinship or some other localized source of trust.

III.
Inter-Group Interaction: Competition, Emulation, and Cooperation

No single group is likely to develop its norms and institutions in complete isolation from other groups. Indeed, other groups generally exist in close proximity to any particular group (note that the basis for such groups can but need not be geographic proximity; other bases include kinship and religious or functional proximity, as in the "international business community"), and these other groups'

legal systems are likely to be developing in a parallel fashion. Thus, inter-group competition, emulation, and cooperation become possible.

Since voluntary associations include both the ability to voluntarily join a group, given the individual is acceptable to the group's existing membership, and the ability to voluntarily withdraw, inter-group movements are a distinct possibility (e.g., see Goldsmidt [1951]; Popisil [1971]; Peden [1977]; Friedman [1979]; Umbeck [1981]; Benson [1989a, 1990, 1991a, 1991b]). Thus, if rules and/or institutions develop in one group which differ from the rules and/or institutions in a parallel group, there will be a tendency for individuals to "migrate" to the group whose law best facilitates voluntary interaction. The coexistence of diverse parallel jurisdictions and legal systems therefore creates incentives to compete to attract or hold membership. But, as a result, existing members of all the various legal systems have incentives to adapt to their own uses many of the legal concepts and institutions of other groups which appear to be beneficial. Through imitation of desirable institutions and behavioral rules developed elsewhere, groups can avoid the potential of lost membership (and reduced beneficial interaction) to other groups; and for that reason, too, there is a tendency for the rules and institutions of each group to achieve the same degree of cohesion and sophistication as is developing in parallel systems. Not all differences need be eliminated, but standardization of many rules and institutions across similarly functioning groups is likely.

The formation of several parallel "localized" mutual support groups can take on even more functions. For example, a member of one group may wish to trade with a member of another group, but the two individuals may not expect to trade frequently so the dominate strategy is one of non-cooperation. After all, repeated-game and reputation effects are localized within a group, and there generally is no potential for a boycott sanction to be applied against someone who is not in the group.[10] It may be that there is considerable potential for mutually-advantageous interaction between the two groups as a whole, however, even though each individual within each group may not anticipate frequent interactions with members of the other group. That is, the groups of individuals as a whole may be in a repeated-game situation with one another, with fairly large potential benefits from cooperation that can be internalized, even though this is not necessarily true of any of the specific individuals in the two groups (at least, before inter-group relationships develop). If

[10]There are possibilities of inter-group boycotts, of course. Consumers as a tacitly organized group might boycott individual producers or producer groups, for instance.

members of each group recognize the benefits from inter-group interaction, then inter-group legal cooperation may evolve.

Inter-group cooperation is hindered by a significant assurance problem, however. Each individual must feel confident that someone from the other group will not be able to take advantage of him and then escape to the protection of that other group. Thus, some sort of inter-group insurance arrangement becomes desirable, as well as establishment of an apparatus for inter-group dispute resolution. For instance, in order to develop a group's reputation, the membership might bond all members in the sense that they will guarantee payment if a member is judged to be in the wrong in a dispute with someone from the other group. The mutual support group becomes a surety group as well (e.g., see Rothbard [1973]; Peden [1977]; Friedman [1979]; Benson [1990, 1992b]). Membership in a group then serves as a signal of reputable behavior to members of another group, and lack of membership serves as a signal that an individual may not be reputable. Furthermore, if a member of a group cannot or will not pay off a debt to someone from the other group, as established by an acceptable arbitrator, then the debtor's group as a whole will, in order to maintain the benefits of the group's reputation. And as a consequence, the individual for whom the group has had to pay will owe his own group members rather than someone from a separate group. In this way the boycott threat comes into play once again. Members of a group are not going to continue bonding an individual who generates debts to the group's membership but does not pay them off, after all. More significantly, however, because of the large long-term benefits of intra-group interaction, the self-interest incentives to maintain intra-group relationships come into play.

A dispute resolution apparatus is essential for inter-group cooperation to develop. A judgment involving an inter-group dispute will have to be considered to be fair by members of both groups, of course. Therefore, an equal number of individuals representing the group might serve as an arbitration board for disputes between individuals from the two groups (e.g., see Goldsmidt [1951]; Friedman [1979]; and Benson [1990, 1992b]), for example, or a mutually acceptable third party (i.e., an arbitrator or mediator with a reputation for good judgment) might be chosen (as in Barton [1967]; Hoebel [1954]; Peden [1977]; Popisil [1971]; and Benson [1990]). This provides another reason for the tendency toward standardization of customary law across parallel groups with similar functions.

A group whose members insist on strictly imposing their own morality and penalties on outsiders would probably be unable to initiate inter-group trade or other forms of beneficial interaction. And

if they were able to begin such activity, they would face continual clashes, followed by boycott sanctions by other groups whose members refuse to visit or trade with them. Indeed, if the benefits of inter-group interaction are substantial, those who hold the norms the group wishes to impose, but relatively weakly, will leave first to join other groups, and others will follow as property values and trade generated incomes decline. Thus, if the membership of a group wishes to simultaneously facilitate inter-group interaction and impose laws that differ substantially from the norm in other groups, its members have strong incentives to inform outsiders of the differences in order to avoid conflict and minimize the difficulty of maintaining non-standard laws. Part of the reciprocal agreements with other groups may be the explicit recognition of differences in laws and procedures for treating conflicts, for example. No group can effectively enforce its rules on outsiders without the support of outsiders. Rules for members of a group may be relatively restrictive, but the rules that apply to outsiders as a result of interaction will have to be moderated if the group is to survive in a free and competitive environment. This in turn implies that as inter-group interactions expand, a hierarchical jurisdictional arrangement may become necessary. For example, each localized group may have jurisdiction over disputes between its members, while disputes between members of a confederation of different groups that interact frequently are settled by some higher confederation level court, and disputes between members of even more dispersed groups from different confederations, such that individuals from the localized groups do not interact frequently but individuals from the two confederations do, may go to an inter-confederation court (e.g., see Popisil [1971] and Benson [1990, 1992b]). Note that these courts are not "higher" courts in the sense that one has some power or authority over others that allows them to overturn lower court decisions upon appeal. Rather, this is a jurisdictional hierarchy that defines the role of each court and allows for increasingly more distant interactions. This allows for differences between the customary law that might be applied within different groups *and* between groups (Popisil 1971). Indeed, Llewellyn and Hoebel (1961, p. 53) point out that the traditional (Western) bias of trying to delineate some all-embracing legal system for a society as a whole can be very misleading: "What is loosely lumped as a custom [from an all-encompassing perspective] can become very suddenly a meaningful thing—one with edges—if the practices in question can be related to a particular grouping." They emphasize that an understanding of customary law requires that groups provide the points of reference rather than some "society" as a whole (1961, p. 28): "there

may then be found utterly and radically different bodies of 'law' prevailing among these small units, and generalization concerning what happens in 'the' family or in 'this type of association' made on the society's level will have its dangers. The total picture of law-stuff in any society includes along with the Great Law-stuff of the Whole, the sublaw-stuff or bylaw-stuff of the lesser working units."

There clearly are limits to how extensive an inter-group network of cooperation can be. The limits are not fixed, however. They depend on the relative costs and benefits of information about other groups and their customary legal systems. As economic conditions change the costs and benefits of information can change, so new inter-group relationships may evolve over time. The costs of establishing inter-group legal arrangements depend in part on how "distant" the groups are from one another, where distance can be in terms of geographic space, or in terms of the behavioral norms that are relevant to the groups. While customary groups all tend to emphasize private property, the costs and benefits of establishing the rights and obligations relevant to each group can be quite different, so that different norms are applied. Members of families who join into a larger kinship group, or members of a religious or commercial community with strongly shared values, can easily have most everything go as expected because each individual's expectations about other's obligations are very accurate. Even if disputes arise (and quarreling among members of a family is certainly commonplace) they are very likely to be settled in an amicable way. On the other hand, where individuals in different groups do not share significant values, and therefore, where intra-group behavior is based on substantially different expectations than inter-group behavior must be, inter-group organizations may fail to develop. Individuals who do not interact frequently may base expectations on incorrect or prejudicial views of members of the other group, so mutual incomprehensibility is likely to prevent effective cooperation.

This discussion implies that a customary legal system is, in a sense, flawed, or inefficient. Relative to some perfect ideal, this is certainly the case. However, the ideal against which such a system must be compared in order to draw a conclusion that the system is inefficient, is, in general, unobtainable. Thus, in a realistic sense, the customary legal system is efficient. After all, it results from the interaction of maximizing individuals. Maximizing behavior means that the actions taken are never deliberately wasteful. The actions reflect individuals' weighing of their expected benefits and expected transactions costs, so the perceived gains of a decision always should exceed the perceived costs. Therefore, a decision by individuals in two

different groups not to establish cooperative legal arrangements is an efficient decision. Of course, there may be benefits that the individuals do not fully recognize, so there may be some potential benefits from a more extensive legal arrangement that are not internalized, at least in hindsight, but the fact is that uncertainty and expected transactions costs exist that may prevent the formation of an all-encompassing customary legal system. Possibly through coercion a benevolent legal authority could improve on a completely customary legal arrangement then? Friedman answered this question in the following way:

> One cannot simply build any imaginable characteristics into a government; governments have their own internal dynamic. And the internal dynamic of limited governments is something with which we, to our sorrow, have a good deal of practical experience. . . . the logic of limited government is to grow. There are obvious reasons for that in the nature of government, and plenty of evidence. Constitutions provide, at the most, a modest and temporary restraint. As Murray Rothbard is supposed to have said, the idea of a limited government that stays limited is truly Utopian. (1973, pp. 200–1)

In addition, the limit on the potential for inter-group interaction may actually be less significant than it first appears to be. After all, in reality, as Mises explains,

> Man is not the member of one group only and does not appear on the scene of human affairs solely in the role of a member of one definite group. In speaking of social groups it must be remembered that the members of one group are at the same time members of other groups. The conflict of groups is not a conflict between neatly integrated herds of men. It is a conflict between various concerns in the minds of individuals. (1985b, p. 257)

A member of several groups has obligations to other members of each group and they have obligations to him. Thus, he is in fact familiar with the behavioral rules of several different groups and is in a position to facilitate the development of inter-group ties. "Indeed, in any complex society such as ours, there are almost as many distinguishable systems of customary rules and conventions' as there are individuals" (Leach 1977, p. 28), and yet people from many of these different systems interact regularly without having to call upon any dispute resolution process (not to mention, any legal authority). Inter-group cooperation appears to be the norm rather than the exception, and it appears to be quite widespread.

It should also be noted that an all inclusive legal system has some very undesirable results because it eliminates the potential for competition and emulation. For instance, if a dispute arises with someone else who is also a member of some of the same groups, they might choose among the groups' alternative dispute resolution processes. Indeed, the availability of alternative dispute resolution processes reinforces the tendency of customary law toward fair dispute resolutions. If one forum is biased, a disputant can demand the use of an alternative. A compromise is to use a forum that is fair. As Berman explains,

> The very complexity of a common legal *order* containing diverse legal *systems* contributes to legal sophistication. Which court has jurisdiction? Which law is applicable? How are legal differences to be reconciled? Behind the technical questions lay important political and economic considerations. . . . The pluralism of . . . law, . . . has been, or once was, a source of development, or growth—legal growth as well as political and economic growth. It also has been, or once was, a source of freedom. (1983, p. 10)

Berman includes the "or once was" phrase in recognition of the fact that diverse legal systems are increasingly being subjugated and centralized under the authority of coercive state governments.

IV.
The Conflict Between Custom and Authority

Short-run considerations can dominate under certain circumstances, of course (Mises 1985b, p. 236), and while individuals have strong incentives to cooperate and avoid conflict when they are likely to interact frequently (e.g., when long-run considerations dominate), they have very different incentives when "the discipline of repeated dealings" does not apply (e.g., when short-run gains appear to outweigh long-run benefits). Indeed, when wealth enhancing voluntary interaction is unlikely (or when the gains are not likely to be very large), individuals may have stronger incentives to take wealth away from the others rather than attempt some reciprocal arrangement for mutual satisfaction.[11]

[11]For instance, as Tullock (1985, p. 1079) notes, once a person's reputation is lost, there is virtually no reason to behave cooperatively in the future, because the cost of rebuilding a reputation is extremely high. Therefore, such a person has incentives to become a thief or to "con" people.

Note that wealth or well-being "does not refer only to concerns commonly called egoistic but comprehends everything that appears to an individual as desirable and worthy"; nonetheless, the "fact that most people are eager to get more tangible good is a datum of economic history" (Mises 1985b, pp. 206–7).

The taking of wealth will be resisted, of course, if the potential victim feels that he is strong enough to resist, so violent confrontation is likely, particularly if the potential loser is a member of a support group. After all, one form of mutually beneficial interaction within the groups described above is in cooperative defense against outsiders, since an important internal function of these groups is the protection of private property, and such a taking by an external aggressor is a theft. In order to reduce the cost of such violence, those seeking transfers must amass sufficient strength to coerce compliance.

One way to reduce the potential for resistance to a transfer effort is to employ a "professional army." However, if an individual can persuade others of a like mind to cooperate and share the cost in a taking effort (e.g., by serving in an army or contributing financial support for it) in exchange for a share of the transferred wealth, then that individual lowers his own costs. Thus, there are incentives to develop cooperative mechanisms for taking and transferring wealth. Of course, when some individuals form groups for the purpose of taking from others, then others have incentives to expand their groups which share the cost of protection. Indeed, many of the historical examples of localized support groups whose internal legal arrangements can be characterized by the customary legal system described above, were simultaneously involved in warfare with other groups (e.g., see Popisil (1971); Benson (1989a, 1990, 1991a, 1992b); Hoebel (1954, 1967); and Peden (1971]). In European tribal groups, for example, Kingship initially developed for purposes of warfare (Benson 1990, 1992b). As kingship developed, a centralized hierarchical structure of top-down command also developed since this institutional arrangement proved to be the most effective for the purposes of warfare.[12] During these early developments, however, kings had no law-making or law-enforcing authority.[13]

[12]It does not follow that every kingdom was constantly at war. The competitive process of emulation of successful military institutions, arms built up, and strategic alliances between kingdoms, might maintain relatively equal levels of military power for some time, thereby deterring aggression.

[13]Despite the focus on nation-states and their governments, this theory of authoritarian law is not simply a restatement of the "rent-seeking" or "interest-group" theory of government. Perhaps two points will help to clarify this. First, for reasons explained below, many rules of conduct enforced by governments' legal apparatus are codified custom rather than new rules imposed by some authority. Thus, an examination of any government's law will reveal many aspects which may not fit a transfer theory. Indeed, governments have functions which do not involve internal legal order, some of which may be consistent with a transfer theory (i.e., warfare), but some may not be. Second, as Mises (1985a, p. 47) recognizes, "not every apparatus of compulsion and coercion

Authoritarian Law

Military conquest means that different groups are forced to become sub-groups within a collective kingdom ("kingship" will be used to describe all such arrangements, and the area over which a military leader exerts authority will be called a "kingdom"). As more sub-groups are subjugated by a single centralized military authority, the potential for taking from one sub-group and transfer to another *within* that Kingdom arises. The evolution of kings' authoritarian roles in internal law making and enforcement (i.e., legislation, adjudication, and law enforcement affecting relationships within the Kingdom as apposed to external relations with other kingdoms), is completely analogous to the development of the external role of Kingship (Benson 1990; 1992b). That is, a legal system emanating from a centralized hierarchical authority, referred to here as "authoritarian law," has as its primary functions the development and use of rules and institutions for taking wealth from some and transferring it to others, and for discrimination among sub-groups on the basis of their relative power in order to determine gainers and losers. Indeed, in Europe, authoritarian legal functions were taken on by the kings' military hierarchy initially, until the increasing demands for

---

is called a state. Only one which is powerful enough to maintain its existence, for some time at least, by its own force is commonly called a state." Historically, powerful entities that were not geographically defined states or kingdoms, such as the medieval Roman Catholic Church, have been able to take property rights from others through the use of authoritarian legal institutions (Berman 1983). Even today, there are other sources of such law. Consider modern organized crime, for example. These organizations establish rules of conduct for members backed by enforcement mechanisms and sanctions. Some of their rules and institutions have evolved over time as customary law, through voluntary interactions of members, but they also use an enforcement apparatus and threat of sanctions to extort payments from individuals who do not want to voluntarily interact with them (e.g., "protection rackets"). Thus, organized crime is like kingship and modern representative governments in that it uses authoritarian institutions to take from some individuals within its sphere of influence for the benefit of those with power. The scope of authoritarian law therefore reaches beyond governments' legal arrangements, and it need not cover every aspect of modern government. Nonetheless, "whatever functions it may assume, the state is always characterized by the compulsion and coercion exercised" (Mises 1985a, p. 47) while non-state entities are not necessarily so characterized.

On a related issue, recall the introductory discussion regarding Mises's view of the necessity of a coercive state. A group ruled by customary law need not constitute a state, as typically conceived. Indeed, it might be appropriate to characterize the institutions and processes of the customary law with Buchanan's term of "ordered anarchy" (1975, p. 180). However, von Mises (1985a, p. 93) argues that "The right and true state . . . is the state in which I or my friends, speaking my language, and sharing my opinions, are supreme. All other states are spurious." Thus, Mises appears to mean that at least some "customary law" group is the appropriate state, although he also rejects the idea of ordered anarchy (1985a, p. 48).

authoritarian law led to its own specialized bureaucratic hierarchy.

In many nation-states, rule by kingship has been replaced by other sources of authoritarian law, such as elected representative bodies. Nonetheless, "The essential characteristic features of state and government . . . are present both in despotic and in democratic governments" (Mises 1985a, p. 47). Authoritarian law, whether imposed by kings or an elected representative assembly, involves the taking of wealth from relatively weak sub-groups in order to transfer it to relatively powerful sub-groups, or "interest groups" in reflection of the self-interest motives of the decision-making authorities (Benson 1990; 1992b): the distinction is in terms of who gets what, "not in the incentives and motives" (Mises 1985a, p. 5; also see Hayek 1973, p. 3). Authoritarian decision-makers discriminate between competing interest groups on the basis of what they can give to the decision-maker.[14] The self-interest motives of government decision-makers *must* be recognized in the context of an authoritarian transfer process. Kings were clearly not simply impartial transfer mechanisms. They demanded (took) transfers for their own benefit when they felt they had sufficient power, and even when they entered an exchange, thereby transferring to others, the support gained generally enhanced their own wealth and power relative to what it would have been in the absence of the exchange.

Authoritarian Law and Property Rights

The internal taking/transfer mechanisms all involve property rights alterations to benefit some at the expense of others. Taxation is the taking from a resource owner of part of the right to the income derived from productive uses of property (including labor services), for example.[15] Another fairly obvious transfer occurs when property

[14]In competition between national governments, the determinant of wealth transfers is military strength. Military power can be an important discriminatory criterion in determining internal wealth transfers as well. The control of military forces by earls and barons was one of the most important considerations in early development of authoritarian law under the kingship form of government in England (Benson 1990, 1992b), and military power is still a major factor in many non-western countries (e.g., the Philippines, Nicaragua, El Salvador, Lebanon, Iraq, South Africa, Yugoslavia, etc.). The threat and use of military-like terrorism is also an important political factor, and the ability to *threaten* political disruption remains an important political consideration everywhere. Other bases for sub-groups' political power may be economic power, the number of members (perhaps because of the potential for physical force, but also because of the votes it can muster in a representative democracy), and the ability to organize and voice demands in a political arena.

[15]Indeed, under kings, a major purpose of taxes and other authoritarian developments in law was extraction of revenue to support the external function of kingship—wealth transfer through warfare. As Mises (1985a, p. 3) argues: "Foreign policy and

of some kind is confiscated or someone is forced to sell property for less than its value in a voluntary exchange, and then the property is given to or used for the benefit of others.[16] Other rights modifications simply place limitation on a person's use of his property. For instance, a monopoly franchise simultaneously grants an exclusive right to produce and restricts or attenuates rights to the use of other individuals' resources who might wish to enter that market. All such transfer activities are completely analogous to theft (Tullock 1967).

An important implication of an authoritarian modification in property rights, is that there will be a series of adjustments through time. Some of these changes are predictable. For instance, once sufficiently organized power is exerted to cause decision-makers to make an authoritarian change in a rights assignment, those who would be harmed by the change must either organize and apply counter pressure, or resign themselves to being worse off. The same "prisoners dilemma" arises in this internal political struggle for property rights as arises in the external struggle between governments.[17] Thus, there is a potential for spiralling competition between interest groups much like the spiralling arms build up that typically characterizes inter-governmental competition.[18] As the relative strength of interest groups change, the magnitude and direction of transfers change. Of course, as a new interest group successfully organizes, it does not follow that the original rights modification will be reversed. After all, that would harm the previously organized and already powerful group. Some modification of the earlier change is possible, but a more probable response is that the authority will grant some alternative favorable treatment to compensate the new group for its earlier losses. This change is likely to harm an as yet unorganized group.[19] That group

---

domestic policy are closely linked together; they are but one system; they condition each other."

[16]Property rights transfers can alter the behavior of those directly impacted in ways that benefit other groups as well, so not all beneficiaries need be obvious.

[17]Recall footnote 11, and recognize that once a sub-group establishes a reputation as a political interest group intent on achieving transfers, the probability of that group's becoming an effective part of a cooperative customary law system is very small, because the cost of rebuilding a reputation is extremely high.

[18]This kind of competition implies that resources are "wasted" in the sense that they are used up to "produce" wealth transfers rather than to produce additional wealth.

[19]Often the changes in authoritarian laws and institutions are slow, or marginal, as with customary law, but at times they can be large. Indeed, the competition for authority can turn violent, if the authority attempts to impose a relatively large transfer at the expense of a potential rival for power. Thus, both evolution and revolution shape the development of authoritarian laws (Berman 1983). But a new authority is not likely to radically change the basic institutions of the legal system. After

then has relatively strong incentives to organize and seek rights modifications. Competition leads to emulation, of course, and at times competing interest groups might cooperate with one another in an effort to defeat yet another group. The repeated "redistributive game" is often one of coalition formation and splitting (Jasay 1989, pp. 117–21). Thus, demands for authoritarian rights modifications grow over time.[20]

Another series of adjustments arising from an alteration in property rights is also predictable. Legal authorities can never anticipate all of the consequences of their rulings (Hayek 1973, p. 51; Mises 1985b, pp. 195–96, 378). "Yet every action. . . . affects the course of future events" (Mises 1985b, p. 195). After all, property rights provide incentives which condition behavior, so a change in rights changes behavior. The customary legal structures described above emphasized private property and individual rights. Since authoritarian law produces rights transfers, it follows that at least initially, authoritarian legal developments imply restrictions on private property and individual rights (later, interest groups may form which successfully press for reestablishment of certain rights, of course—those who suffer loses tend to press for a return to a previous rights structure (Benson 1990, 1992b). At any rate, it is clear that under authoritarian law, property rights are permanently vulnerable to authoritarian alterations. When rights are significantly altered through authoritarian changes in law, or when they become sufficiently tenuous due to frequent legal changes, individuals' behavior changes. Given a loss of rights, for instance, individuals will quit performing previously worthwhile functions. If the functions are demanded by powerful interest groups, the legal authority will either try to force the previous behavior, or directly produce the functions (Benson 1990, 1992b).[21]

---

all, those institutions developed for the purpose of transferring wealth and they can serve one authority as well as another. As Mises (1983, p. 120) explains, "the handling of the government apparatus of coercion and compulsion, must necessarily be formalistic and bureaucratic. No reform can remove the bureaucratic features . . ."

[20]There are other reasons to expect increasing numbers of rights modifications. Substantial benefits typically must be anticipated for individuals to incur initial organizational costs, but once organized, the costs of demanding more benefits are relatively low. Also, as power increases goals expand.

[21]As English Kings began to develop a role in law enforcement, they began to shift the form of "punishment" from victim restitution to a fine paid to the king. The right to restitution was one important incentive underlying the reciprocal arrangements for protection, insurance, pursuit, and adjudication. The taking of this right meant that reciprocal arrangements began to breakdown, and ultimately, kings had to create a separate hierarchical enforcement apparatus (Benson 1990, 1992b).

Authoritarian Institutions

Authoritarian decision-makers could conceivably respond to growing interest group demands strictly through legislation, and enforce the resulting law personally, but the fact is that a decision-making authority's own time and resources are limited, so increased demands ultimately force delegation of certain responsibilities to lower levels of authority: a bureaucratic system must emerge "in the administrative apparatus of every government the sovereignty of which stretches over a large area" (Mises 1983, p. 15).[22] This is particularly true in the area of policing. After all, "while there is usually little need for external force to uphold the customary law, the authoritarian law . . . needs for its enforcement the prestige and influence or even the intimidation and physical force of the authority and his supporting minority" (Popisil 1971, p. 344).

When authoritarian law applies and a dispute arises, litigants are generally trying to manipulate the existing rights structure. Wealth transfers are the goal of one party in a dispute and avoidance of the transfer is the goal of the other. The dispute might be taken before a third party tribunal to be resolved. Under these circumstances, disputes are negative sum competitions: one party wins, another loses, and both parties incur dispute resolution costs. They are, therefore, much more adversarial in nature than potential positive sum customary law disputes (i.e., clarification of private property rights to generate long-term benefits), and as a result, the authoritarian institution of dispute resolution will be different from the institutions of customary law. Adjudication, in which a judge is backed by coercion (a police force, prison system, executioner, etc.) to force the disputants into court and impose his decision, is generally necessary when negative sum disputes are involved. The authority may actually take on an adjudication role, as English kings did, for instance, (and use military forces to back his rulings) although a judicial (and policing) bureaucracy is certain to arise. As the scope of legal authority expands and property rights attenuations increase, the cost of judicial activities, in terms of time and effort, become too high for the authority.

[22]There are at least two important consequences of such a hierarchy of delegated authority: (1) as these bureaus increase in number and/or size the ability of higher decision-making authorities to monitor their actions decreases, the power of bureaucrats grows relative to the power of those they supervise, and those they originally obtained their authority from (Mises 1983, pp. 54, 80); and (2) as their discretion increases and they grow in size they generally will demand more rights modifications to enforce (Benson 1990), thus resulting in wealth transfers to bureaucrats (i.e., larger budgets and/or more power).

Since authoritarian law transfers wealth from the weak to the powerful, a powerful individual or group often can induce the authority to serve as a representative in the litigation process. Indeed, the legal authority often benefits from the transfer, and while the authority might be in a position to simply take the desired property, there are strong incentives to make "legitimate" the taking by using legal institutions, in order to minimize the potential for a public outcry and organized resistance, and in order to offer the loser a non-violent arena for protest. Therefore, in matters of authoritarian law the authority often takes on the role of prosecutor before his own judicial bureaucracy and then, as legal activities increase, develops a prosecutorial bureaucracy for that purpose. Thus, as dispute settlement becomes one of deciding who gets what in a negative sum transfer process, rather than a clarification of property rights, "the true plaintiff becomes the victim, [and] the state becomes the plaintiff" (Nader and Todd 1978, p. 38). Indeed, so called "victimless crimes" become increasingly likely as powerful groups demand that new "offenses" be defined as criminal because they offend the "morality" or transfer potential of those with power. Clearly, restitution backed by ostracism can no longer be the relevant sanction since the victim is the loser. Therefore, sanctions take on other forms: capital punishment, confiscation of property, fines paid to the authority, and imprisonment.

Of course, given the expected cost of adjudication, as well as the cost of sanctions which can be imposed through coercion, "extrajudicial processes will develop . . . ; so will self-help procedures" (Nader and Todd 1978, p. 38). The expected loser may be willing to negotiate an out-of-court settlement, for instance, or accept a mediator or arbitrator. The impetus for these extrajudicial processes is similar to the impetus under customary law in that they are means of avoiding costs. Under customary law, they are used to avoid the cost of violence, however, while under authoritarian law they are used to avoid the cost of adjudication. As explained below, however, a legal authority has incentives to monopolize the legal system, so arbitration and other sources of non-adjudicated dispute resolution may be discouraged by making it more costly or even "illegal" (e.g., see Trakman [1983]; Benson [1989b, 1990, 1992b]). But if the potential loser perceives the expected cost of avoiding adjudication and of using extrajudicial processes to be greater than the expected cost of "self-help" (i.e., violence against the other party), then that also becomes a viable option. This self-help is no longer constrained by the threat of ostracism. If the physical and/or economic sanctions threatened by the authority are less effective than the threat of ostracism by a customary law group, then violence can increase. As policing bureaucracies

are expected to enforce increasing numbers of laws (e.g., such as those against victimless crimes), for instance, the probability of being caught by an imperfect policing system is lowered. Indeed, if scarce policing resources are also increasingly less available to control customary offenses against persons and property, such offenses can also increase, and self-help solutions are likely to follow.[23]

Custom versus authority

Authoritarian law requires a substantial amount of localized monopoly power in order to truly impose law that generate transfers; as Mises (1985a, p. 46) notes, "A state without sovereignty is a contradiction in terms." When people can choose between alternative sources claiming legal authority, for example, then these legal arrangements have to compete for the attention of potential subjects. Thus, the supposed authority really has little authority, since individuals will be able to opt for an alternative legal system whenever there is an attempt to take wealth from them without sufficient compensation. As a result, those who wish to generate wealth transfers by establishing some authoritarian rule will have to claim to be the source of all law, whether that truly is the case or not. Competition leads to emulation, of course, and at times competing legal authorities might cooperate with one another in an effort to defeat yet another rival for authority. The changing tides of cooperation and competition between cannon law of the Roman Church, royal law of developing kingdoms, and feudal law of the manors in medieval Europe were very important in shaping Western legal tradition (Berman 1983). Coalitions do not last, however: ultimately authority requires monopoly.

Authoritarian legal systems, with their centralized power, also attempt to absorb customary legal systems over time, simultaneously adopting many aspects of the customary system and altering others. The reason for this absorption is the same as the reason for competing with alternative claimants to legal authority: an effective authority must be an exclusive legal monopoly in some area. In addition, as Mises explains:

> people have been eager to falsify historical evidence and to misrepresent the course of events. The endeavors to mislead posterity about what really happened and to substitute a fabrication for a

[23]Police resources have been shifted to control drug crimes, for example, and property crime has been less effectively deterred so property crime has risen significantly (Benson et al. 1992).

> faithful recording. . . . were often prompted by the [falsifiers'] desire to justify their own . . . actions from the point of view of the moral code of those whose support or at least neutrality they were eager to win. (1985b, pp. 291–92)

Thus, Hayek (1973, p. 126) suggests that as "the enforcement of law [became] regarded as the primary task of government, it was natural that all the rules which governed its activities came to be called by the same name [law]. This tendency was probably assisted by a desire of governments to confer on its [authoritarian] rules of organization the same dignity and respect the [customary] law enjoyed." Furthermore, beneficiaries of the authoritarian transfer process support and encourage this falsification and absorption effort of the authoritarian decision-making institution.

In this regard, Kings claimed exclusive "divine rights" as they attempted to impose legal authority. Authoritarian law also evolves "naturally" from the self-interested behavior of individuals, after all, so it is not surprising to find the concept of natural law being invoked to support authoritarian legal arrangements, just as similar myths are evoked to explain naturally evolving customary law. Indeed, while mythology is often seen as a characteristic of customary law, it may play a more significant role in authoritarian law. Legal positivism is, in fact, a convenient "myth" for those who want to assert the control of a nation's authoritarian legal system.

The myth of legal positivism is clearly revealed when law and justice are equated, as they often are by the backers of a centralized legal system. Centralized authority has increasingly claimed to be the only source of law, but as MacCallum notes, the result is that

> There is in the public sector of our society . . . an organization of force which in collecting its necessary revenues and carrying out its operations contrasts sharply with the proprietary norms. Western society suffers a schizophrenia in the public field whereby the same agency that provides wanted public services also performs such public dis-services in the course of its operations and acts so irresponsibly in other ways as to be cannibalizing the society from which it springs. Its system of coercions and its irregular administration of rules deter, demoralize, and drain the resources of those engaged in economic tasks. Consequently the very word *government* has ambiguous connotations. In one breath it calls to mind an image of benign public service, and in the next, a threat to the continued existence of the community. (1964–65, p. 58)

The apparent "schizophrenia" in government arises because of the conflict between the rules and institutions of custom and authority (or "property and sovereignty"). Yet, so pervasive are the processes of authoritarian absorption of law that Fuller suggests that (also see Mises 1983, p. 4):

> the tendency is to convert every form of social order into an exercise of the authority of the state . . . Legislation, adjudication, and administrative direction, instead of being perceived as distinctive interactional processes, are all seen as unidirectional exercises of state power. Contract is perceived, not as a source of "law" or social ordering in itself, but as something that derives its whole significance from the fact that the courts of the state stand ready to enforce it. (Fuller 1981, pp. 156–57)

Customary rules and institutions which are relatively efficient evolve to replace those which are less efficient. Since authoritarian law often evolves to replace or at least absorb and build upon customary rules and institutions, some observers might contend that the authoritarian system must be more effective. While it is true that "everything that happens is the necessary sequel of the preceding state of things" (Mises 1985b, p. 77), it also follows that the legal institutions which evolve to facilitate involuntary transfers will be quite different from those which characterized the customary law systems detailed above. It is quite conceivable that authoritarian legal institutions which are relatively ineffective will be replaced by more effective institutions through a similar process to that which characterizes the evolution of customary law and its accompanying institutions. The evolutionary processes themselves need not be different, however, for outcomes to be quite different. Mises (1983, p. 52) notes "Government efficiency and industrial efficiency are entirely different things," and in the same fashion, while customary and authoritarian legal institutions could be equally effective at facilitating their purposes, those purposes are different.[24] As Mises (1985b,

[24]Leoni (1961, p. 17) notes that authoritarian legislation may deliberately or accidentally disrupt homogeneity by destroying established rules and by nullifying existing conventions and agreements that have hitherto been voluntarily accepted and kept. Even more disruptive is the fact that the very possibility of nullifying agreements and conventions through supervening legislation tends in the long run to induce people to fail to rely on any existing conventions or to keep any accepted agreements. On the other hand, the continual change of rules brought about by inflated legislation prevents it from replacing successfully and enduringly the set of nonlegislative rules (usages, conventions, agreements) that happen to be destroyed in the process.

pp. 48–49) emphasizes, one of the primary underpinnings of the natural law doctrine is valid: "the idea that every . . . law of a country was open to critical examination by reason." The problem with the advocates of the doctrine of natural law is that they fail to recognize what the appropriate standard of comparison is. The standard is not some set of pre-ordained natural laws, but rather, it "must be found in the effects produced by a law" (Mises 1985b, p. 49). Law can facilitate voluntary interaction or involuntary transfers; clearly this is a standard of comparison. Indeed, Mises (1985b, p. 54) maintains that the "ultimate yardstick of justice is conduciveness to the preservation of social cooperation."

Given the undesirable consequences of authoritarian law for large numbers of individuals, it is not surprising to find that in no case has the power of the authority become absolute (Leach 1977; Mises 1985b, p. 374). In fact, in some cases, the rise of authoritarian law has been successfully resisted to a substantial degree. Resistance to legal authority is likely to be most effective where the benefits generated through voluntary interaction are vary large and/or the relevant group interacts across the jurisdictions of different authorities so that inter-jurisdictional competition occurs. Thus, the international merchant community of medieval Western Europe is one such example (Trakman 1983; Berman 1983; Benson 1989b, 1990, 1992a), and it was from the resulting system of values and customary law that modern commercial law, the backbone of international trade, emerged. Indeed, modern international commercial law which evolved from this medieval legal system, remains as a largely voluntarily produced and enforced system of customary law, despite many attempts by various coercive governments to subjugate it over the centuries (Trakman 1983; Berman and Dasser 1990; Benson 1989b, 1990, 1992a).

Many other groups which started with customary law systems did not achieve a market order, however. The fact is that at some point

---

Recall that Leoni and others (see footnote 9) view judge made law to be fundamentally different from legislation. A sharp distinction is inappropriate, however (Benson 1990). When a coercive authority's judges set a precedent, the resulting rule becomes enforceable law for *everyone* in the society whether it is a mutually beneficial law or not. And like authoritarian legislation, authoritarian precedent can make major alterations in law without the consent of all parties affected. Thus, as Mises (1983, p. 16) suggests, common law has also failed to resist the arbitrariness of centralized, bureaucratic management of legal affairs. The resulting uncertainty about the longevity of rights is a significant source of allocative inefficiency. In contrast, under customary law, an inefficient dispute settlement might arise, but if other parties recognize this the settlement does not become a universal rule of customary law. This suggests that efficient rules are relatively more likely to evolve in customary law than in authoritarian law, including judge made law.

many of these evolutionary processes have been interrupted by coercive forces, either from internal or external power bases, before a market order was able to emerge. The interruption can be abrupt, as through military conquest, or gradual, as through a gradual breakdown in the incentives to voluntarily interact for mutual gain (and the resulting breakdown of these incentives' accompanying norms and institutions), as authoritarian institutions expand their scope. The evolution of rules and institutions is an ongoing process, however, characterized by a continuing conflict between custom (voluntary arrangements) and authority. In some cases custom dominates and the authoritarian powers of government are limited or even diminished, as during the "liberal" era of much of the nineteenth century in the United States, Britain, and some parts of Europe (and apparently today in parts of Eastern Europe). But the fact is that "government becomes liberal only when forced to by the citizens" (Mises 1985a, p. 58). When citizen resistance is not strong enough, authority expands its scope, as it has in most of the world during most of the twentieth century. Indeed, a combination of custom and authority virtually always exists in any legal system. However, just as Mises (1985a, p. 241) convincingly argues that "It is a delusion to believe that planning and free enterprise can be reconciled," it is similarly true that authoritarian government's control of the legal apparatus is incompatible with the establishment of the freedom that arises under customary law. The objectives that underlay these two different sources of law are inconsistent, so no stable "equilibrium" relationship between the two will ever arise.

References

Axelrod, Robert. 1984. *The Evolution of Cooperation*. New York: Basic Books.

Barton, R. F. 1967. "Procedure Among the Ifugao." In *Law and Warfare*, Paul Bohannan, ed. Garden City, N.Y.: The Natural History Press.

Benson, Bruce L. 1989a. "Enforcement of Private Property Rights in Primitive Societies: Law Without Government." *Journal of Libertarian Studies* 9: 1–26.

——. 1989b. "The Spontaneous Evolution of Commercial Law." *Southern Economic Journal* 55: 644–61.

——. 1990. *The Enterprise of Law: Justice Without the State*. San Francisco: Pacific Research Institute.

——. 1991a. "An Evolutionary Contractarian View of Primitive Law: The Institutions and Incentives Arising Under Customary American Indian Law." *Review of Austrian Economics* 5, no. 1: 65–89.

——— . 1991b. "Reciprocal Exchange as the Basis for Recognition of Law: Examples from American History." *Journal of Libertarian Studies* 10: 53–82.

——— . 1992a. "Customary Law as a Social Contract: International Commercial Law." *Constitutional Political Economy* 2: 1–27.

——— . 1992b. "The Development of Criminal Law and Its Enforcement: Public Interest or Political Transfers." *Journal des Economistes et des Etudes Humaines* 3: 79–108.

——— . 1992. Iljoong Kim, David W. Rasmussen and Thomas W. Zuehlke. "Is Property Crime Caused by Drug Use or Drug Enforcement Policy?" *Applied Economics* 24: 679–92.

Berman, Harold J. 1983. *Law and Revolution: The Formation of Western Legal Tradition*. Cambridge, Mass.: Harvard University Press.

Berman, Harold J., and Felix J. Dasser. 1990. "The 'New' Law Merchant and the 'Old': Sources, Content, and Legitimacy." In *Lex Mercatoria and Arbitration: A Discussion of the New Law Merchant*. Thomas E. Carbonneau, ed. Dobbs Ferry, N.Y.: Transnational Juris Publications.

Buchanan, James M. 1975. *The Limits of Liberty*. Chicago: University of Chicago Press.

Buchanan, James M. and Gordon Tullock. 1962. *The Calculus of Consent*. Ann Arbor: University of Michigan Press.

Demsetz, Harold. 1967. "Toward a Theory of Property Rights." *American Economic Review* 57: 347–59.

Friedman, David. 1973. *The Machinery of Freedom: Guide to Radical Capitalism*. New York: Harper and Row.

——— . 1979. "Private Creation and Enforcement of Law: A Historical Case." *Journal of Legal Studies* 8: 399–415.

Fuller, Lon. 1964. *The Morality of Law*. New Haven: Yale University Press.

——— . 1981. *The Principles of Social Order*. Durham, N.C.: Duke University Press.

Goldsmidt, Walter. 1951. "Ethics and the Structure of Society: An Ethnological Contribution to the Sociology of Knowledge." *American Anthropologist* 53: 506–24.

Hayek, F. A. 1973. *Law, Legislation, and Liberty*, Vol. 1. Chicago: University of Chicago Press.

Hoebel, E. Adamson. 1954. *The Law of Primitive Man*. Cambridge, Mass.: Harvard University Press.

——— . 1967. "Law-Ways of the Comanche Indians." In *Law and Warfare*, Paul Bohannan, ed. Garden City, N.Y.: The Natural History Press.

Jasay, Anthony de. 1989. *Social Contract Theory: A Study of the Public Goods Problem*. Oxford, England: Clarendon Press.

Leach, Edmund. 1977. *Custom, Law, and Terrorist Violence*. Edinburgh: The University Press.

Leoni, Bruno. 1961. *Freedom and the Law*. Los Angeles: Nash Publishing.

Llewellyn, Karl N. and Adamson E. Hoebel. 1961. *The Cheyenne Way*. Norman, University of Oklahoma Press.

Luce, Duncan R. and Howard Raiffa. 1957. *Games and Decisions*. New York: Wiley Publishing.

MacCallum, Spencer. 1964–1965. "The Social Nature of Ownership." *Modern Age* 9: 49–61.

Mises, Ludwig von. 1949. *Human Action: A Treatise on Economics*. 3rd rev. ed. Chicago: Contemporary Books.

——— . 1983. *Bureaucracy*. Grove City, Penn.: Center for Futures Education.

——— . 1985a. *Omnipotent Government: The Rise of the Total State and Total War*. Spring Mills, Penn.: Libertarian Press.

——— . 1985b. *Theory and History: An Interpretation of Social and Economic Evolution*. Auburn, Ala.: Ludwig von Mises Institute.

Nader, Laura and Harry F. Todd, Jr., eds. 1978. *The Disputing Process: Law in Ten Societies*. New York: Columbia University Press.

Peden, Joseph R. 1971. "Property Rights in Celtic Irish Law." *Journal of Libertarian Studies* 1: 81–95.

Popisil, Leopold. 1971. *Anthropology of Law: A Comparative Theory*. New York: Harper and Row.

Priest, George L. 1977. "The Common Law Process and the Selection of Efficient Rules." *Journal of Legal Studies* 50: 65–82.

Rothbard, Murray N. 1970. *Power and Market: Government and the Economy*. Kansas City: Sheed Andrews and McMeel.

——— . 1973. *For a New Liberty*. New York: MacMillan.

Rubin, Paul H. 1977. "Why is the Common Law Efficient?" *Journal of Legal Studies* 6: 51–64.

Schmidtz, David. 1991. *The Limits of Government: An Essay on the Public Goods Argument*. Boulder, Colo.: Westview Press.

Trakman, Leon E. 1983. *The Law Merchant: The Evolution of Commercial Law*. Littleton, Colo.: Fred B. Rotham.

Tullock, Gordon. 1967. "The Welfare Costs of Tariffs, Monopolies and Theft." *Western Economic Journal* 5: 224–32.

——— . 1985. "Adam Smith and the Prisoners' Dilemma." *Quarterly Journal of Economics* 100: 1073–81.

Umbeck, John. 1981. *A Theory of Property Rights With Application to the California Gold Rush*. Ames, Iowa: Iowa State University Press.

Williamson, Oliver E. 1983. "Credible Commitments: Using Hostages to Support Exchange." *American Economic Review* 83: 519–40.

The Protectionist Roots of Antitrust

Donald J. Boudreaux and Thomas J. DiLorenzo*

I. Introduction

Economists and legal scholars have studied the effects of antitrust policy for decades, but it is only within the past several years that the origins of antitrust have received much scholarly attention. In *The Origin of the Sherman Act* (1985) George Stigler was among the first to reexamine "the problem of why the United States introduced an affirmative competition policy." He tested an agrarian interest hypothesis—that "the Republicans passed the Sherman Act to head off the agrarian . . . movements" for price controls and other interventions—against a self-interest hypothesis that small businesses wanted a law to protect them from their larger, more efficient rivals. He found little, if any, empirical support for either hypothesis.

DiLorenzo (1985) examined the origins of the Sherman Act from a public choice or interest-group perspective and provided evidence that industries accused of being monopolized in the late 1880s were in fact dropping prices and expanding output faster than the rest of the economy. The Sherman Act might have been a political smokescreen to pave the way for the McKinley tariff, which was passed just four months after the Sherman Act and was sponsored in the U.S. Senate by Senator John Sherman himself.

In an early analysis of the origins of antitrust, Robert Bork (1966) claimed to have found evidence in the *Congressional Record* that the

*Donald J. Boudreaux is associate professor of economics and legal studies at Clemson University. Thomas J. DiLorenzo is professor of economics in the Sellinger School of Business and Management at Loyola College in Baltimore.

The Review of Austrian Economics Vol.6, No. 2 (1993): 81–96
ISSN 0889-3047

"legislative intent" of Congress in passing the Sherman Act was consumer protection.

The public interest interpretation of the origins of antitrust—that the law was passed as a benevolent response by Congress to a form of market failure—is by far the predominant view among economists and legal scholars. This viewpoint is so widely believed that attempts to explore the alternative, self-interest hypothesis are sometimes met with indignation and dismissed out of hand. For example, when Robert Bradley recently (1990, p. 737) explored the self-interest hypothesis he was chastised by a referee for his "cynical explanation of the passage of the Sherman Act, a view not shared by most contemporary economists." Similar statements were once made about law and economics, public choice, and many other out-of-the-mainstream research programs.

Despite the predominance of the public-interest view of the origins of antitrust, there are reasons to be skeptical of this view. This paper reexamines the genuine roots of antitrust—the state-level antitrust laws that were enacted several years prior to the 1890 Sherman Act. In the mid 1880s, strong political movements emerged at the state level of government in favor of "anti-monopoly" legislation that eventually took the form of antitrust statutes. Although some analysts, such as Stigler (1985) and Thorelli (1955), have noted the existence of these state statutes, no one to our knowledge has thoroughly investigated the possible relation between these movements and the Sherman Act.

The Sherman Act was not enacted in a Washington, D.C. political vacuum. It emanated from the same economic and political forces that gave rise to state antitrust legislation. It is particularly relevant that in 1890 state legislatures still directly elected U.S. Senators, and that the Sherman Act was introduced in the U.S. Senate, not the House.

Section II discusses the economic and political forces at work during the emergence of state antitrust legislation in the late-nineteenth century by focussing on one state, Missouri, which was representative of the states that enacted antitrust legislation during this period. With the exception of Maine, all states that enacted antitrust statutes in 1889 were located in or near the Mississippi valley (see appendix table 1). Section III contains a summary.

II.
Interest-Group Politics and the Missouri Antitrust Law

Close study of late nineteenth-century politics in Missouri suggest that farmers there were a major special interest behind state antitrust legislation. There is evidence that farmers did indeed view large-scale enterprise as a competitive threat and sought antitrust laws to protect them from competition.

The Missouri Farm Lobby

The "Farmer's Alliance" was the most powerful political coalition in Missouri in the years preceding the enactment of the 1889 antitrust law. Democrats affiliated with the Alliance dominated the 1888 state elections. The Democrats were very farm conscious. There were farmer-lawyers, farmer-bankers, farmer-teachers, farmer-preachers, farmer-editors, and farmer-druggists. The Alliance confronted candidates for the state legislature with a card containing the following pledge: "I pledge myself to work and vote for the [Farmer's Alliance's] demands irrespective of party caucus or action" (Drew 1891, p. 303). The pledge card was widely distributed to farmers who were instructed: "If any candidate refuses to sign . . . vote against him and use your influence to elect those who sign, irrespective of party."

Of the 174 state senators and representatives, 140 signed the pledge, as did all of the congressmen-elect headed for Washington and the winners of all three statewide races in that year.

Antitrust and the Missouri Farm Lobby

One reason Missouri farmers wanted an antitrust law was that many of them were being *under*priced by larger, more-efficient farms. The Farmer's Alliance repeatedly warned of the dangers of "the land concentrating in the hands of capitalists" (Clevenger 1940, chap. VI). For example, at a 1889 meeting of the National Farmers Alliance in St. Louis, a Declaration was issued that first urged "care for the widows and . . . orphans," and then called for legislation to "suppress . . . all unhealthy rivalry" (Drew 1891, p. 786). Farmers were bitter about the low and falling agricultural prices, and they blamed the trusts for the decline in their economic position. They complained of "our depressed condition" because of the fact that "the price of the farmers' grain is below the cost of production." As David D. March wrote in his *History of Missouri* (1971, p. 1169), "Just as the low price of raw cotton spurred the expansion of the Southern Alliance, so low grain prices in the late 1880s caused thousands of farmers in the wheat belt . . . to join the National Farmer's Alliance."

To the extent that agricultural prices were falling, the notion that the Missouri antitrust law enhanced consumer welfare is suspect. Missouri farmers were an appropriate special-interest group to launch an antitrust policy on grounds of self-interest if it could be expected that an "antitrust" statute would be enforced and interpreted as an anti-*bigness* statute to protect some producers from the competition of larger and more-efficient rivals.

III.
Missouri Agriculture in the Late-Nineteenth Century: Monopoly or Competition?

If the consumer-welfare interpretation of antitrust legislation explains Missouri's experience with such laws, the following trends should be evident in the economic data on Missouri's agricultural sector for the 1870s and 1880s: (1) the real price of farm outputs should have been rising (or not falling); (2) the volume of farm outputs should have been falling (or not rising); and/or (3) the real price of farm inputs should have been rising.

However, if the real prices of farm outputs and inputs fell—and if the volume of output rose—the protests against supposed monopolization are inconsistent with what was actually happening in Missouri's agricultural economy. Indeed, if real prices decreased and outputs increased, the cries against monopolization are more plausibly interpreted as rent-seeking attempts of less-efficient producers to protect their markets from the increasing competition of more-efficient producers.

During the 1880s, cattle was Missouri's single largest agricultural output in terms of percentage of the state's agricultural gross output (Klepper 1978, p. 320). In 1889, nearly one-quarter of all agricultural output in Missouri was cattle production. Hog production was a close second, accounting for more than 20 percent of Missouri's agricultural gross product. Wheat was the state's third-largest agricultural product, representing more than 13 percent of Missouri's agricultural gross product in 1889. Cattle, hogs, and wheat together account for almost 60 percent of Missouri's total agricultural production in 1889.[1] Appendix table 2 shows the market value of Missouri-raised cattle and hogs per head from 1879 through 1891, as well as the price of wheat in Missouri for these years.

[1]Missouri was the fourth largest cattle-producing state in the United States (behind Texas, Iowa, and Kansas), the nation's third largest hog-producing state (behind, Iowa and Illinois), and the nation's fifth largest wheat producer (behind California, Illinois, Indiana, and Ohio). See *Abstract of the Eleventh Census: 1890*, U.S. Bureau of the Census (Washington, D.C.: U.S. Government Printing Office, 1896), Table 4 and Table 7.

Cattle

Although a simple comparison of, say, the 1879 per-head value of Missouri cattle with the 1889 value shows a slight increase, a different and more significant picture emerges by examining the trend of cattle values from the mid 1880s to the end of the decade. Compared to the peak value in 1884, the per-head value of cattle in Missouri in 1889 was 28.8 percent lower (and it was to fall even further by 1890). Looked at another way, the average value of cattle per head for the years 1887–89 was 18.8 percent less than was the average value per head for the years 1882–84. This decline in cattle values—which affected all the major cattle-producing states—was accompanied by a steady increase during the 1880s of the quantity of cattle entering into the gross national product. Measured in pounds of live weight, cattle supply during the 1880s increased by about 50 percent for the United States as a whole, while the price per hundredweight received by cattlemen in the United States fell from an average of $5.69 in 1880 to $3.86 in 1890–a 15 percent decrease.

This increased supply and reduced price of cattle resulted in *lower* prices of beef (and beef by products) for final consumers. According to economic historian Mary Yeager (1981, p. 70), the average price of beef tenderloins in the United States fell nearly 38 percent between 1883 and 1889.

Hogs

As with cattle, the market value of hogs in Missouri peaked in the early-to-mid 1880s. The 1889 value of a Missouri-raised hog was approximately 19 percent lower than it was six years earlier. The average value of hogs in the state for the 1887–89 period was more than 15 percent lower than it was in 1882–84.

The nationwide output of hogs and hog products increased during the 1880s while the price per hundredweight of hogs fell precipitously—from $6.07 in 1880 to $3.60 in 1890—a decrease of more than 40 percent.[2]

Wheat

The trend of prices for Missouri wheat was also downward during the 1880s, although as in much of the midwest during the late nineteenth century, wheat prices in Missouri fluctuated a good deal.[3]

[2]The 1870 price per hundredweight of hogs in the United States was, at $6.80, even higher than it was in 1880.

[3]McGuire (1981) ranked 14 states according to the extent of variability from year-to-year in their wheat prices. Missouri is ranked eighth.

The 1889 price of wheat in Missouri was 34.7 percent lower than it was a decade earlier. The average price of wheat in Missouri during the 1882–84 period was 97 cents per bushel as compared to 72 per cents per bushel on average for the 1887–89 years. The latter price is almost 27 percent lower than the price of wheat earlier in the 1880s.

These data do not support the notion that Missouri agriculture was becoming monopolized during the 1880s. Moreover, it is doubtful that "predatory pricing" was taking place, for prices fell for the entire decade (and, indeed, since 1870). Predatory pricing for that length of time would be irrational.

Farm-input costs

The farm input that first comes to mind as possibly having been monopolized in the late nineteenth century is transportation by railroad. Although rail rates did fluctuate over time[4]—and varied from region to region and from shipper to shipper—there is broad agreement among economic historians that railroad rates fell dramatically during the several decades following the Civil War (North 1966, pp. 139–40). According to Stigler: "[a]verage railroad freight charges per ton mile had fallen by 1887 to 54 percent of the 1873 level, with all lines in both the eastern and western regions showing similar declines" (1885, p. 2). Henry Varnum Poor found that railroad rates fell from an average charge per ton-mile of $2.90 in 1865 to $0.63 in 1885—a rate decrease of over 78 percent.[5]

Consistent with the significant railroad-rate reduction was the equally significant increase in the quantity of rail services during the latter part of the nineteenth century. According to Poor, total ton-miles carried by U.S. railroads increased by 700 percent between 1865 and 1885 (Hilton 1966, p. 89). In Missouri, there were 4,234 miles of railroad track in 1880; by 1889 this figure increased by almost 45 percent to 6,118 miles of track (Clevenger 1940).[6] No evidence that we know of exists to support the belief that railroad rates were monopolistically high during the period leading up to the passage of antitrust legislation in Missouri.[7] All evidence points in the opposite direction.

[4]Stanley Lebergott (1984, pp. 284–85) argues that the variability of rail rates during the late nineteenth century was an effect of keen competition among the railroads.

[5]Poor, quoted in Hilton (1966), pp. 89–90.

[6]Clevenger (1940) reports that in 1879 Missouri had 27 counties without railroad service, but by 1891 only 11 counties remained unserviced by the railroads.

[7]In fact, the intensity of the competition among the railroads, and the resulting continual downward trend in rail rates in the decades following the Civil War, is considered to be the reason underlying the passage of the 1887 Act to Regulate Interstate

Nor is the evidence consistent with the farmers' contention that financing costs increased during the late nineteenth century. In fact, real interest rates fell dramatically during the 1880s. In the midwest region of the country, defined to include Missouri, real interest rates on farm mortgages fell from an average of 11.41 percent in 1880 to 7.84 percent in 1889. This fall represents a 31 percent reduction in real interest rates during the 1880s.[8]

As for the prices of farm machinery, we were unable to find specific data on farm-machinery prices in Missouri. However, Clevenger reports that, although the 1880s was a period of falling input, output, and consumer-goods prices in Missouri, downward adjustments in farm-output prices usually occurred before downward adjustments in the prices of consumer goods. But, the decreases in the prices o/f farm outputs in Missouri was generally *preceded* by decreases in the prices of farm inputs. "In terms of bushels of wheat, oats, or corn, a mowing machine, binder, or cultivator could be bought for less in 1892 than in 1882" in Missouri (Clevenger 1940, p. 46).

Clevenger's claim that the price of farm inputs in Missouri decreased in real terms during the 1880s is consistent with the trends in farm-machinery prices for the United States as a whole during the latter part of the nineteenth century. This trend was downward during the decades following the Civil War. Towne and Rasmussen (1960) constructed an index of U.S. farm-machinery prices (in constant 1910–14 dollars) and found that this index fell from 251 in 1870 to 124 in 1880 and to 101 by 1890. This index shows that farm machinery was 2.5 times more costly in 1870 than it was in 1890.[9] There is no reason to believe that the trend of farm-machinery prices in Missouri differed significantly from the nationwide trend.

Missouri's economy was undoubtedly becoming more and more commercialized and competitive in the post-Civil War era. The rapid economic growth of Missouri's economy and its increasing integration with other states is reflected in the number of railroad carloads of general merchandise unloaded or loaded in St. Louis. In 1870, 20,542 cars were unloaded or loaded. By 1880 this figure had nearly quadrupled to 125,939, and by 1890 this figure had more than doubled again to 323,506 (Thelen 1986, p. 32). These data question the

---

Commerce. Sponsors of this Act hoped that the Interstate Commerce Commission would effectively cartelize the railroads. See, e.g., Kolko (1963), MacAvoy (1965), and Hilton (1966).

[8]Jeffrey G. Williamson (1974, p. 153).

[9]This index fell to 94 by 1900.

contention that the Missouri economy was falling into the consumer welfare-reducing grips of monopolists.[10]

In short, available data on the economic factors pertaining to Missouri's agricultural sector in the decades leading up to the enactment of the 1889 antitrust statute contain no clear evidence of monopolization. Indeed, every sector of Missouri's economy—especially its agricultural sector—shows signs of being highly competitive during the last three decades of the nineteenth century.

What, then, did the agrarians in Missouri have to gain from the passage of an antitrust statute? Agrarians and local merchants in Missouri (as elsewhere) correctly perceived that the larger producers were responsible for the downward pressures on the prices of their outputs (Thelen 1986). Because economies of scale caused a decrease in the optimal number of producers of any particular commodity, the economy *looked* as if it were becoming more "monopolized." As such, in their attempts to protect their local markets from the lower-priced and/or higher-quality goods being shipped to towns and countrysides on the railroads from the increasingly centralized production locations, politically-organized agrarians complained of the evils of "monopoly." But "monopoly," as used by the agrarians, referred only to the larger and more efficient firms who were driving many small farmers and merchants out of their traditional lines of work and business.[11]

Our interpretation of anti-monopoly sentiment in Missouri as being rooted in local-producer opposition to the more intense competitive pressures resulting from "big" firms and the growing commercialization of Missouri's economy is more consistent with the data presented above than is the public-interest interpretation.[12]

[10]Thelen, a historian who is sympathetic with populist ideals and goals, reports that "[r]ailroads transformed the size and shape of [Missouri's] market economy, forcing businessmen and farmers to produce at unprecedented rates to survive the new competition" (p. 32).

[11]Our interpretation of the anti-monopoly protests of the late nineteenth century is, of course, not novel. For example, Dudden, argues that "in the United States by the middle of the nineteenth century, monopoly was generally deplored as *hampering opportunity*. . . . [T]he anti-monopoly spirit of the Guilded Age took shape as a widespread but essentially middle-class protest against the *centralizing* tendencies in transportation, land tenure, business, and industry, which characterized the period" (1957, p. 588; emphasis added).

[12]For further evidence in support of our interpretation of the political motivation behind antitrust legislation in the case of Missouri in particular, see Clevenger (1940), Piott (1985) and Thelen (1986). Dudden (1957), Wiebe (1967), Mayhew (1972), and McDonald (1974) are only a handful of the historians who interpret nineteenth century agrarian political protests—including the agrarians' ubiquitous calls for antimonopoly legislation—as an attempt to stave off the increasing commercialization of their occupations and lives.

However, a more complete understanding of the specific forces at work in Missouri in the late 1880s requires a discussion of the livestock and meat-packing industry. Producers in this industry played a key role in the passage of Missouri's 1889 antitrust statute.

IV.
Cattlemen, Butchers, and Other Rent Seekers

The agrarian interest group that seems to have exerted the greatest pressure for passage of Missouri's 1889 antitrust statute was comprised of cattlemen and local retail butchers who were agitated over the allegedly monopolistic practices of the "beef trust"—the centralized butchering and meat-packing firms that emerged in Chicago in the early 1880s as a result of the development of an economical refrigerated railroad car. The four largest Chicago meat packers during the 1880s were Swift, Armour, Morris, and Hammond, collectively known as "the Big Four."

Although Gustavus Swift was not the first entrepreneur to ship slaughtered cattle by refrigerated railroad car, he was the first to do so economically, shipping his first refrigerated car full of beef from Chicago to Massachusetts in the fall of 1877. The "refrigeration" of this 1877 shipment of dressed beef was little more than open doors on a railroad car being hauled in cold weather. However, Swift saw profits in being able to slaughter meat in a centralized location served by several railroads (i.e., Chicago) and shipping it out year round to cities and towns across the country. The successful development of an economically viable refrigerated car allowed Swift to begin year-round shipments of dressed meats in 1879 (Clemens 1923, pp. 235–36).

In addition to integrating forward into wholesaling and retailing, Swift and his rival Chicago meat packers created markets for beef and hog by-products that had never before existed, thus extracting more profit from each cow or pig slaughtered than was being extracted by local butchers. When this less wasteful use of the whole cow or pig is combined with the great economies of scale that were made possible by the centralization of butchering and shipping, it is not surprising that the price of meats to consumers fell throughout the 1880s (Yeager 1981, p. 70).

The average quality of beef also improved during the 1880s. This quality improvement is closely connected with the fall in the price of cattle that occurred from the mid 1880s through the early 1890s. The fall in cattle prices, in turn, was responsible for the decline of the range-cattle industry beginning in the mid 1880s.

In the wake of the decline of the range-cattle industry there emerged, for the first time in the midwest and the west, rumors of a

"beef trust." Range-cattle producers, whose product—live grass fed cattle shipped by rail to wholesale or retail butchers or sold directly to butchers in nearby towns—simply could not compete with the much less expensive and higher-quality dressed meats shipped from Chicago. Cattlemen contended that "the Big Four" meat packers were conspiring to *depress* the price of range cattle (Yeager 1981, pp. 172–73).

In May 1886 the "National Butchers' Protective Association of the United States of America" was formed in St. Louis. The goal of this organization of butchers "was to destroy the dressed meat industry, which was shipping meat from Chicago to eastern cities and selling it for less than the meat killed by local butchers" (Clemens 1923, p. 243).

The complaints of the range-cattle producers and of the local butchers prompted the first investigation of the meat-packing industry by the U.S. Congress (Clemens 1923, p. 479). Responding to these complaints, the Senate in May 1888 appointed a commission to investigate the cause for the *low* price of cattle seemingly spawned by "the Big Four."

Senator George Vest of Missouri was appointed to chair this committee.[13] From its inception to the delivery of its final report in May 1890, the Vest Committee—comprised of five midwestern and western Senators (from Illinois, Kansas, Missouri, Nebraska, and Texas)—sympathized strongly with its cattle-raising constituents. The Vest Committee concluded in its final report that "the principle cause of the *depression* in the prices paid to the cattle raiser and of the remarkable fact that the cost of beef to the consumer has not decreased *in proportion*, comes from the artificial and abnormal centralization of markets, and the absolute control by a few operators thereby made possible" (Senate Report No. 829 [commonly referred to as the Vest Report], p. vii).

The Vest Committee did not deny that the price of beef to consumers had fallen, only that this price did not fall "in proportion" to the reduction in the price of range cattle. Consumer welfare is increased, of course, when the price of a consumer good falls—especially when the quality of the good rises simultaneously—regardless of whether the price of an input fell by more or less than in proportion to the reduction of the price that the consumer must pay for the good.

The Vest Committee found no evidence of collusion by the major Chicago meat packers. Instead, the Committee *inferred* the existence

[13]The Vest Committee began its hearing in St. Louis in November of 1888, "this place being chosen because the International Cattle Range Association and the Butchers' National Protective Association were in session there" (Clemens 1923, p. 749).

of collusive action among the major packers in the buying of cattle from the fact that cattle prices fell during the mid and late 1880s. The Vest Committee reported that "Mr. P. D. Armour testifies at Washington that no such [collusive] agreement existed between himself and other packers *and we do not contradict this statement*. . . . [However] it is difficult to believe that with the most apparent motive for such action the same parties, or their subordinates with their knowledge, do not avail themselves of the opportunity presented by the centralization of markets to combine for the purpose of lowering the price of cattle" (Vest Report, p. 6; emphasis added).

Several state legislatures also attempted to take action against the "beef trust." Late in 1888, Governor Lyman Humphrey of Kansas called on the governments of the states in the Mississippi valley region to send delegates to a conference for the purpose of framing statutes that could be passed by all states in the region.[14] The ultimate goal of this conference of state legislators was uniform state statutes designed to "protect the stock-grower and farmer against the manipulations of such alleged [beef] trust."[15] It eventually adopted a model antitrust statute to meet this goal. There was no mention during the convention or in the proposed statute of the need to protect consumers from high prices; only to protect stockgrowers and farmers from lower-priced competitors.

The model antitrust statute declared all "trusts" to be in violation of the state corporate charter. Significantly, this model antitrust statute included in its definition of a trust the ability of "a combination of capital, skill or acts by two or more persons, firms, corporations or association of persons. . . . [t]o limit or reduce the production, or increase or *reduce* the price of merchandise or commodities" (emphasis added).[16] The statute that was eventually enacted in Missouri was entitled "An Act for the punishment of pools, trusts and conspiracies." It passed by a vote of 98 to 1 in the House, and by 27 to 4 in the Senate.[17]

Missouri's legislation prohibited "restraints of trade" in the form of pooling, forming trust companies, interlocking directorates, and so

[14]Piott (1985, p. 26).

[15]*Journal of the Senate of Missouri*, 35th General Assembly, 1889, p. 165. The entire text of this joint resolution of the Kansas Senate and House calling for a conference of midwestern state legislators, as well as Missouri Governor Francis's message to the Missouri General Assembly, can be obtained from the authors upon request.

[16]Ibid., p. 407. On the prevalent nineteenth century view that the proper and legal means for controlling the size and manufacturing activities of corporations was the state corporate charter, see McCurdy (1979).

[17]*Journal of the House of Missouri*, 35th General Assembly, 1889, pp. 952–53, and *Journal of the Senate of Missouri*, 35th General Assembly, 1889, pp. 410–11.

on, the effects of which were "to fix or limit the amount or quantity of any article, commodity or merchandise to be manufactured, mined, produced or sold" in Missouri.

This statute also prohibited actions intended "to *limit* or fix the price" of outputs (emphasis added).[18] Although the wording of the proscription against actions intended to "limit" the price of outputs is subject to interpretation, one plausible meaning of the verb "to limit" as it is used in this statute is "to reduce" or "to keep from rising." This interpretation of the statute as prohibiting actions intended to reduce prices is consistent with (1) the downward trend of prices in Missouri during the 1870s and 1880s; and (2) the support given by Missouri's Governor Francis and by Missouri's farmer-dominated General Assembly to the St. Louis beef-trust conference of March 1889 in light of the fact that this conference adopted a model antitrust statute that explicitly prohibited price reductions.

Our interpretation of the political events in Missouri during the winter and spring of 1889 is that Missouri's agrarian-dominated General Assembly passed antitrust legislation in 1889 as part of an attempt to shield politically powerful producer groups—especially range-cattle producers and independent retail butchers—from the intense competitive pressures being exerted by the centralized, vertically integrated meat-packing firms headquartered in Chicago. (Recall that cattle was Missouri's single largest agricultural output during the 1880s.) No evidence exists to suggest that consumers in Missouri (or anywhere else in the United States) were harmed by the so-called beef trust. In fact, as shown above, the evidence suggests just the opposite: The centralization of meat packing generated substantial benefits to consumers in the form of lower prices and higher quality meat, as well as greatly expanded use of meat by-products which, until the 1880s, were discarded as waste. However, the growth of the centralized meat packers did result in lower prices for range-cattle producers and, of course, for independent local butchers whose services ran head to head in competition with the services being performed more efficiently in the Chicago slaughtering and packing houses.

III.
Conclusions

The political and economic roots of antitrust are at the state level of government. Numerous states passed antitrust laws before the 1890

[18] *Laws of Missouri*, 35th General Assembly, 1889 (Jefferson City, Missouri, 1889), pp. 96–97; emphasis added.

Sherman Act, itself initiated in the U.S. Senate which, at that time, was directly elected by state legislatures.

The political impetus for some kind of antitrust law came from the farm lobbies of mostly midwestern, agricultural states, such as Missouri. Rural cattlemen and butchers were especially eager to have statutes enacted that would thwart competition from the newly centralized meat processing facilities in Chicago. The evidence on price and output in these industries, moreover, does not support the conjecture that these industries suffered from a monopoly in the late nineteenth century, if monopoly is understood in the conventional neoclassical way as an organization of industry which tends to restrict output and raise prices. These industries were fiercely competitive because of relatively free entry and rapid technological advances such as refrigeration.

As Armentano (1982) has shown, for over a century the antitrust laws have routinely been used to thwart competition by providing a vehicle for uncompetitive businesses to sue their competitors for cutting prices, innovating new products and processes, and expanding output. This paper has argued that, moreover, antitrust was a protectionist institution from the very beginning; there never was a "golden age of antitrust" besieged by rampant cartelization, as the standard account of the origins of antitrust attests.

References

Abstract of the Eleventh Census: 1890. 1896. U.S. Bureau of the Census. Washington, D.C.: U. S. Government Printing Office.

Armentano, Dominick. 1982. *Antitrust and Monopoly: Anatomy of a Policy Failure*. New York: Wiley.

Bradley, Robert L., Jr. 1990. "On the Origins of the Sherman Antitrust Act." *Cato Journal* (Winter): 737–42.

Bork, Robert. 1966. "Legislative Intent and the Policy of the Sherman Act." *Journal of Law and Economics* (October): 15–56.

Clemens, Rudolf A. 1923. *The American Livestock and Meat Industry*. New York: The Ronald Press.

Clevenger, Homer. 1940. *Agrarian Politics in Missouri, 1880–1896*. Unpublished Ph.D. Dissertation. University of Missouri.

DiLorenzo, Thomas J. 1985. "The Origins of Antitrust: An Interest-Group Perspective." *International Review of Law and Economics* 5, no. 6: 73–90.

Dudden, Arthur P. 1957. "Men Against Monopoly: The Prelude to Trust-Busting." *Journal of the History of Ideas* 18 (October): 586–93.

Drew, Frank M. 1891. "The Present Farmers' Movement." *Political Science Quarterly* 6.

Hilton, George W. 1966. "The Consistency of the Interstate Commerce Act." *Journal of Law and Economics* 9 (April): 87–113.

Journal of the House of Missouri. 1889. 35th General Assembly. Jefferson City, Missouri.

Journal of the Senate of Missouri. 1889. 35th General Assembly. Jefferson City, Missouri.

Laws of Missouri. 1889. 35th General Assembly. Jefferson City, Missouri.

Klepper, Robert. 1978. *The Economic Bases for Agrarian Protest Movements in the United States, 1870–1900*. New York: Arno Press.

Kolko, Gabriel. 1963. *The Triumph of Conservatism*. New York: The Free Press.

Lebergott, Stanley. 1984. *The Americans: An Economic Record*. New York: W. W. Norton.

MacAvoy, Paul W. 1965. *The Economic Effects of Regulation*. Cambridge: MIT Press.

March, David. 1971. *History of Missouri*. Columbia: University of Missouri Press.

Mayhew, Anne. 1972. "A Reappraisal of the Causes of Farm Protest in the United States, 1870–1900." *Journal of Economic History* 32 (June): 464–75.

McCurdy, Charles W. 1979. "The Knight Sugar Decision of 1895 and the Modernization of American Corporation Law, 1869–1903." *Business History Review* 53 (Autumn): 304–42.

McDonald, Forrest. 1974. *The Phaeton Ride: The Crisis of American Success*. Garden City, N. J.: Doubleday.

McGuire, Robert A. 1981. "Economic Causes of Late-Nineteenth Century Agrarian Unrest: New Evidence." *Journal of Economic History* 41 (December): 835–52.

North, Douglass C. 1966. *Growth and Welfare in the American Past*. New Jersey: Prentice-Hall.

Piott, Steven L. 1985. *The Anti-Monopoly Persuasion: Popular Resistance to the Rise of Big Business in the Midwest*. Westport, Conn.: Greenwood Press.

Senate Report No. 829 from the Select Committee on the Transportation and Sale of Meat Products. 1890. Report to Accompany S3717, 3718, 3719 and Senate Joint Resolution 78. 51st Congress, 1st Session, Serial Set 2705. Washington, D.C.: U. S Government Printing Office.

Stigler, George J. 1985. "The Origin of the Sherman Act." *Journal of Legal Studies* 14 (January): 1–11.

Thelen, David. 1986. *Paths of Resistance*. New York: Oxford University Press.

Thorelli, Hans. 1955. *Federal Antitrust Policy*. Baltimore, Maryland: Johns Hopkins University Press.

Towne, Marvin E. and Wayne D. Rasmussen. 1960. "Farm Gross Product and Gross Investment in the 19th Century." In National Bureau of Economic Research, *Trends in the American Economy*. Pp. 255–315.

Wiebe, Robert H. 1967. *The Search for Order, 1877–1920*. New York: Hill & Wang.

Williamson, Jeffrey G. 1974. *Late Nineteenth-Century American Development*. New York: Cambridge University Press.

Yeager, Mary. 1981. *Competition and Regulation: The Development of Oligopoly in the Meat Packing Industry*. Greenwich, Conn.: JAI Press.

Appendix Table 1
State Antitrust Laws by Date of Passage

State	Year of Passage
Maryland	1867
Tennessee	1870
Arkansas	1876
Texas	1876
Georgia	1877
Indiana	1889
Iowa	1889
Kansas	1889
Maine	1889
Michigan	1889
Missouri	1889
Montana	1889
Nebraska	1889
North Carolina	1889
North Dakota	1889
South Dakota	1889
Washington	1889
Kentucky	1890
Louisiana	1890
Mississippi	1890
Alabama	1891
Illinois	1891
Minnesota	1891
California	1893

Source: George Stigler, "The Origin of the Sherman Act," *Journal of Legal Studies* 14 (January 1985): 1–11.

Appendix Table 2
Prices of Missouri's Three Leading Agricultural Products, 1879–1891

	Cattle (per head)	Hogs (per head)	Wheat (per bushel)
1879	$22.95	4.36	1.01
1880	$25.06	5.59	0.89
1881	$27.03	6.29	1.19
1882	$29.01	7.68	0.85
1883	$31.18	7.99	0.88
1884	$32.61	6.75	0.62
1885	$31.05	5.75	0.77
1886	$28.60	5.44	0.63
1887	$26.49	5.83	0.62
1888	$25.65	6.71	0.88
1889	$23.22	6.48	0.64
1890	$21.86	5.44	0.83
1891	$21.92	5.40	0.80

Source: Robert Klepper, *The Economic Bases for Agrarian Protest Movements in the United States, 1870–1900*. New York: Arno Press, 1978.

Review Essays

Toward a Deconstruction of Utility and Welfare Economics

David Gordon*

Welfare Economics and Externalities in an Open-Ended Universe: A Modern Austrian Perspective. By Roy E. Cordato. Boston: Kluwer Academic Publishers, 1992.

Roy Cordato's ambitious and well-organized book addresses a central problem in economics. Standard neoclassical analysis finds fault with the unhampered free market, on a ground that Austrian economists resolutely reject. People's activities in a free market, it is claimed, may impose benefits or harms on others in a way that their decisions on production fail accurately to reflect. Some economists (the "Pigouvians") look to government to remedy these inefficiencies, termed "externalities." Others, the "Coaseans," call for much less intervention, but they too accept the underlying analysis.

Cordato, firmly in the Austrian camp, begins with a summary of the reasons Austrians dissent from the neoclassical view of externalities. His aims go far beyond this, however; he presents an alternative Austrian conception of efficiency, which he calls "catallactic efficiency."

Cordato starts with a short account of the neo-classical position and at once proceeds to the Austrian critique of that view. As he rightly notes "[t]he optimal solution [of the standard approach] is given by the price and output that is obtained under conditions that would exist in a perfectly competitive general equilibrium (PCGE) . . . This result is shown to be Pareto optimal, i.e., no one can be made better off without making someone else worse off, and social efficiency is maximized. Externalities result in a deviation from the standard" (p. 2).[1]

*David Gordon is a senior fellow with the Ludwig von Mises Institute.

[1]On p. 2, line 10, "pecuniary" should read "non-pecuniary."

The Review of Austrian Economics Vol. 6, No. 2 (1993): 99–112
ISSN 0889-3047

Much of Cordato's criticism of this position follows familiar lines. As he notes, constantly changing conditions rule out the use of a static PCGE as a welfare ideal (pp. 4–5). Further, no central authority could gather together the immense body of data required to calculate the PCGE solution (p. 8). But in the course of his comments, Cordato makes an astonishing statement: "In order to implement Pareto optimality as a welfare criteria [sic], an analyst must make both interpersonal and intertemporal comparisons of utility" (p. 6).

This is an elementary error. As Cordato has himself noted, a situation in which an externality is present is not Pareto optimal. If so, a Pareto superior move may be made: since this, by definition, makes no one worse off, no interpersonal comparison of utility is required.

Perhaps Cordato has been misled on the issue by the fact that Pigou himself accepted interpersonal utility comparisons, at least for practical purposes. He believed, e.g., that "it is evident that any transference of wealth from a relatively rich man to a relatively poor man of similar temperament, since it enables more intense wants to be satisfied at the expense of less intense wants, must increase the aggregate sum of satisfaction."[2] Were Cordato commenting on this, he would of course be right to object. But Pigouvian subsidies and taxes, despite their name, involve no interpersonal utility comparisons.

Or have I interpreted Cordato uncharitably? His statement begins, "In order to *implement* Pareto optimality . . ." (p. 6, emphasis added.) His claim may be, then, not that the theoretical model requires interpersonal comparisons, but rather that the attempt to put the model into practice does so. But if this is his meaning, it is once more unclear why he holds it. Or does he in fact adopt a yet more attenuated view? Perhaps by "interpersonal comparison" all he intends is that implementation of the model requires that people's utility functions be known to the policymaker. This, however, is not what the expression "interpersonal comparison of utility" normally means. I hope that on a future occasion Professor Cordato will clarify his unusual remarks.

An argument that Cordato takes over from O'Driscoll and Rizzo also seems to be incorrect. "With respect to externalities, in order for the standard tax or subsidy solution to work, the analyst must have better information concerning market conditions than is actually

[2]A. C. Pigou, *The Economics of Welfare*. 4th ed. (London: Macmillan, 1932), p. 89.

being generated in the markets themselves. If this were possible, the actual markets, and in particular the exchange relationships that comprise them, would not be needed" (p. 3).

I entirely agree that no planner can acquire the requisite information, but why need the market to be superfluous if someone could discover all the optimal conditions? What if the optimal conditions can be put into practice only through a market, regardless of whether someone knows them through other means? If so, the market is still needed and O'Driscoll's and Rizzo's argument fails. To make their case, they must show that if the optimal conditions were known, they could be put into practice without a market.

After disposing of the standard view, Cordato next summarizes the Austrian approach to externalities. He very usefully contrasts the position of Mises and Rothbard, on the one hand, with that of Hayek on the other. Mises and Rothbard distinguish sharply between positive and negative externalities. The former (Mises's Type 1 externalities) presents no problem at all: since these authors do not adopt the PCGE as a welfare standard, it is irrelevant to them whether these externalities are generated in an "optimal" amount. Negative externalities (Mises's Type 2) are a problem only if property rights have not been exactly defined. Given a precise delineation of property rights, no external standard may properly be used to challenge the outcome of the free market.

Cordato's discussion of Mises's and Rothbard's views on externalities is largely accurate and well put, but he is badly amiss on one issue. He correctly notes that Mises displays more sympathy than Rothbard for patents (p. 21), but he unaccountably suggests that Rothbard opposes copyright as well. "From his [Rothbard's] perspective, intellectual property rights cannot be derived from principles of natural law and therefore the state has no moral 'right' to impose these through the institution of patent and copyright laws" (p. 22; see also p. 80).

In support of his claim, Cordato quotes a passage from Rothbard condemning patents. Why does Cordato feel free to extend Rothbard's criticism, on Rothbard's behalf, to copyright? Perhaps Cordato assumes that patents and copyrights must be dealt with identically; if Rothbard denounces patents, his remarks apply equally to copyright.

Rothbard's actual position, many times expressed, differs entirely from Cordato's summary of it. Rothbard states: "Yet this bracketing of patents and copyrights is wholly fallacious; the two are completely different in relation to the free market . . . On the free market, there would therefore be no such thing as patents. There would, however,

be copyright for every inventor or creator who made use of it, and this copyright would be *perpetual* . . ."[3]

Although most economists group Hayek and Mises together, Cordato rightly points out that they differ on externalities. Hayek did not adopt Mises's position but instead adhered to the "standard" view of both positive and negative externalities.

Hayek's position is not to Cordato's liking, and he endeavors to show that Hayek's adoption of it leads him to self-contradiction. Cordato locates a passage from Hayek critical of welfare economics and pounces on the apparent incongruity. "On the one hand he rejects the welfare standard used in neoclassical externalities analysis but embraces much of the analysis that is derived from it. His assessment of welfare economics leaves little room for the policy prescriptions that he suggests are appropriate" (p. 25).

Cordato's criticism of Hayek misfires, since it rests on the mistake already discussed. In the passage Cordato cites, Hayek criticizes "the whole of the so-called 'welfare economics', which pretends to base its arguments on the interpersonal comparisons of ascertainable utilities . . ." (p. 29). Hayek contradicts himself only if the standard analysis of externalities involves interpersonal comparisons of utility. It is Cordato, not Hayek, who errs in thinking that it does.

Hayek's target becomes ever clearer if one looks at his remarks just before the passage Cordato quotes: "The childish attempts to provide a basis for 'just' action by measuring the relative utilities or satisfaction of different persons simply cannot be taken seriously. . . . But most economists seem to begin to see that the whole of the so-called 'welfare economics' . . . [here follows the passage Cordato quotes, as cited in the preceding paragraph]."[4] Since most economists do *not* reject the standard analysis of externalities, it is apparent that Hayek's attack is directed elsewhere.

Cordato now prepares the way for his principal task, the construction of an Austrian welfare standard. He does so by an assessment of two earlier proposals of an Austrian standard, one by Murray Rothbard and the other by Israel Kirzner.

Rothbard's proposal has the virtue of simplicity. Economists in his view cannot exceed the bounds of demonstrated preference when they analyze choices on the market. An economist cannot legitimately

[3]Murray N. Rothbard, *Man, Economy, and State* (Princeton: D. Van Nostrand, 1962) II, pp. 653, 656.

[4]F. A. Hayek, *Law, Legislation, and Liberty*; vol. 3: *The Political Order of a Free People* (London: Routledge and Kegan Paul, 1979), p. 201.

speak of hypothetical preferences—what people would have chosen in situations other than the actual world; the assessment of choice apart from action depends upon conjectures inadmissible into praxeology. Given this restriction, the welfare criterion at once follows. People who engage in an exchange in the free market do so because they expect to benefit. Every free exchange, then, increases utility *ex ante*—and this is all the economist may properly identify as a rise in social welfare: "the rest is silence."

Cordato rejects Rothbard's short and sure treatment of welfare economics. "Rothbard's conclusions concerning welfare and social utility can be taken to task on several crucial points" (p. 41). First, "Rothbard does not allow for any consideration of harm that is not demonstrated, i.e., psychic harm. The welfare effects of envy, trauma, etc. are ruled out of his model" (pp. 42–43). Contrary to Rothbard's view, one cannot avoid interpersonal comparisons of utility when one assesses social utility. The effects of an exchange cannot be confined to the exchangers: one needs to ask how others benefit or lose, a fact Rothbard himself seems elsewhere to recognize.

"But there are even more damaging criticisms to be made of Rothbard's approach" (p. 43). Cost, as Austrians conceive of it, is subjective: the cost of an action is the highest ranking alternative foregone. "By definition costs cannot be demonstrated. Therefore, in Rothbard's model only benefits, that is, utility gains, are recognized." Further, Rothbard errs by considering only *ex ante* utility. People often regret the choices they have made: "Rothbard's welfare economics . . . ignores the fact that preferences are expressed sequentially through time, as part of a general set of goal oriented activities" (p. 43).

Cordato's final verdict on Rothbard's criterion is a severe one: "Rothbard's welfare economics does not offer much promise as a general guide for externalities theory or policy" (p. 44). Before moving with our author to the Kirznerian climes he finds more congenial, let us pause to evaluate Cordato's assault.

Cordato's misses completely the point of Rothbard's article. The piece in question, a veritable *tour de force*, attempts to overturn the conclusions of mainstream welfare economics. In the standard view, economists can neither make interpersonal comparisons of utility nor introduce controversial normative premises into their analyses. Given these restrictions, many practitioners of welfare economics still endeavor to find imperfections in the free market. Rothbard convincingly shows that these attempts end in failure. This, however, does not entail the collapse of welfare economics: given the restrictions under

which economic science operates, one can arrive at a welfare economics that supports the free market.

Crucial to understanding the article is, to reiterate, a simple point. Rothbard is offering an internal criticism of welfare economics, not a complete presentation of his own views on social philosophy. A brief glance at the article suffices to show this. He remarks, e.g.: "The fact that the free market maximizes social utility, or that state action cannot be considered voluntary . . . in itself implies no plea for *laissez faire* or for any other social system. What welfare economics does is to present these conclusions to the framer of ethical judgments as part of the data for his ethical system."[5]

If the limited intent of Rothbard's welfare criterion is borne in mind, Cordato's criticisms of it fall to the ground. Thus, it is quite true, as Cordato says, that the criterion takes no account of effects of exchanges on third parties or of utility *ex post*. It is entirely in order for Cordato to argue that, from the point of view of a complete social philosophy, these need to be considered. But, it does not follow that the economist, speaking in his professional capacity, can deal with them. Rothbard contends that the economist cannot do so: demonstrated preference forbids it.

He notes, e.g., about the envious: "We are not interested in his opinion about the exchanges made by *others*, since his preferences are not demonstrated through action and are therefore irrelevant."[6] In saying this, Rothbard begs no questions: he would do so only if he concluded that, because a matter is irrelevant to the economist, it is of no importance to the social philosopher. And of course he does not do so. If he wishes to overthrow Rothbard's criterion, Cordato must either arrive at a scientifically acceptable notion of preference to replace demonstrated preference, or else deny that demonstrated preference involves the limitations Rothbard draws from it. Cordato might also claim that given its limitations, Rothbard's criterion has little importance; but this again is a philosophical point that leaves the criterion untouched within economics.

The fundamental flaw of Cordato's criticism is his failure to heed the sage advice of R. G. Collingwood: "I began by observing that you cannot find out what a man means by simply studying his spoken or written statements . . . In order to find out his meaning you must also

[5]Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics" in Mary Sennholz, ed. *On Freedom and Free Enterprise: Essays in Honor of Ludwig von Mises* (Princeton: D. Van Nostrand, 1956), pp. 261–62. The printing of the essay cited here differs from that used by Cordato, so the pagination does not correspond to his citations.

[6]Ibid., p. 250.

know what the question was . . . to which the thing he has said or written was meant as an answer."[7]

Beyond this general failing, one of Cordato's points misfires on its own terms. He has rightly noted that an actor's opportunity cost cannot be demonstrated in action. But it does not follow from this that "in Rothbard's model only benefits, that is utility gains, are *recognized*" (p. 43, emphasis added). No one but the actor himself can specify his opportunity cost: but to take account of cost does not require this knowledge. Whatever the cost, we know that, *ex ante*, the expected gains exceed it. This is precisely the recognition of cost.

But this response leads Cordato to a related criticism. Is not Rothbard's point trivially true? "By definition, though, people always expect to benefit, relative to the alternatives, from every action that is undertaken. This is true under any institutional arrangement. An action taken at the point of a gun is expected to result in an increase in utility relative to the available alternatives" (p. 43). True enough; but has Cordato forgotten that two pages earlier, he had pointed out that Rothbard's criterion depends on the definition of a voluntary act? As he there rightly remarked, Rothbard's approach to coercion is clear from his other writings (p. 41). Is it too much to ask Cordato to bear in mind his own statements? Once one offers a definition of "voluntary," it is not at all trivial to say that voluntary actors expect to raise their utility, relatively to their baseline. No doubt the victim of a threat endeavors to maximize his utility "relative to the alternatives." But he hardly can anticipate a rise in utility relative to his starting point.[8]

One more issue and then we can have done with this unfortunate section of the book. Although it is true that Rothbard's welfare criterion does not take account of *ex post* utility, Rothbard does have something to say about it. He contends that the free market tends to maximize *ex post* utility; "in sum, the free market always benefits every participant, and it maximizes social utility *ex ante*; it also tends to be so *ex post*, since it works for the rapid conversion of anticipations into realizations."[9] Adhering strictly to demonstrated preference, Rothbard cannot prove the latter contention; but he is free to argue in a common sense way about tendencies.

[7]R. G. Collingwood, *An Autobiography* (Oxford: Oxford University Press, 1939), p. 31.

[8]I sidestep complications in setting the baseline, arising e.g., from so-called "non-productive" exchanges.

[9]Murray N. Rothbard, *Power and Market* (Menlo Park, Calif.: Institute for Humane Studies, 1978) p. 10.

Cordato's comments on Kirzner's view of efficiency are best taken together with his presentation of his own notion of "catallactic efficiency." He begins, reasonably enough, by setting forward some requirements for a sound Austrian concept of efficiency. But two of these requirements will make any alert reader gasp in amazement: "any analysis of people's preferences must be based on a recognition and acceptance of the guiding principle behind Rothbard's theory of social utility, revealed or 'demonstrated' preference . . . preferences can only be deduced by observing activities. Furthermore, since states of knowledge can and do change with the passage of time, preferences that are revealed at a point in time cannot be assumed to remain constant over time. Again, this is an important part of Rothbard's analysis that can and should be used as a building block for the theory presented here" (p. 59).

I have no quarrel with these requirements—quite the contrary. But Cordato has here taken for his own exactly the doctrines of Rothbard that he earlier condemned. Cordato, it will be recalled, criticized Rothbard's use of demonstrated preference because it led to the neglect of effects on third parties. He rose in protest against Rothbard's failure to consider plans carried out over time. Now, demonstrated preference, exactly as Rothbard uses it, has become a requirement. Apparently, a radical conversion has taken place somewhere on the road between the end of chapter 2 and the onset of Chapter 3. "The stone that the builders rejected has become the chief cornerstone of the temple."

But enough of preliminary: what exactly is Cordato's catallactic efficiency? To understand it, we must return to Chapter 2 and Israel Kirzner. In a section of his early book *Market Theory and the Price System* (1963), Kirzner suggested a criterion of efficiency that rested on the coordination of the plans of market participants. Coordination of plans depends on knowledge; therefore "Kirzner reasons that an economic system can be judged efficient to the extent that it generates knowledge of mutually beneficial exchange possibilities" (p. 47).

Cordato has been greatly influenced by Kirzner's analysis; and his own criterion, as we shall see, bears more than a passing resemblance to Kirzner's prescriptions. But in Kirzner's argument, Cordato finds a crucial flaw. Following Jack High, he points out that an increase in information need not result in the coordination of plans. An entrepreneur, taking advantage of new information, may drive his rivals out of business. By doing so, he upsets their plans as well as those of their customers (p. 52).

If coordination of plans is not the key to the mystery, what can replace it? Catallactic efficiency, Cordato tells us. In this view, the

efficiency of a catallaxy "is to be judged by the extent to which the catallaxy encourages individuals existing in a social context to pursue their own goals as consistently as possible" (p. 62). What institutional setting will best promote this end?

Since "without access to physical resources all the knowledge in the world would be useless" (p. 63), a stable system of property rights must be established. In it, each person will know what resources he may use in his plans. "In a social setting, where different individuals are pursuing different ends, efficient resource use can only occur when conflicts in the use of resources are minimized" (p. 63).

But if knowledge without property is empty, property without knowledge is blind. Individuals' pursuit of goals depends on the acquisition of knowledge about favorable opportunities for exchange. Here once more a stable system of private property is vital. In it, entrepreneurs will have a financial incentive to bring new information to light through the exploitation of discrepancies in prices (p. 63). Cordato's catallactic efficiency, then, recommends exactly the same institutional setting as does Kirzner: one of private property, in which individuals may use their resources to pursue their own ends, so long as they do not invade the property rights of others (p. 66). This system Cordato terms the Ideal Institutional Setting (IIS).

I entirely agree with Cordato that a system of private property is desirable. With the rationale he advances for the IIS, I am much less satisfied. No doubt each person wishes, other things being equal, to acquire information about profitable exchanges. But it is very far from the case that each individual benefits from the general dissemination of information. This should come as no surprise to Cordato, since he makes this point himself in his discussion of discoordination. (Has he had another memory lapse between Chapter 2 and 3?) Surely if someone's gain in information enables him to overthrow my business, I have not benefited through the spread of more information.

And the point is of much wider application than to the discoordination effects that High and Cordato cite. Consumers may be affected adversely by the spread of information in other ways than through the misfortunes of displaced entrepreneurs. It hardly helps me if others discover my favorite restaurant and crowd me out or if someone else locates the bargain antique I wished to purchase.

If it need not be the case that each individual benefits from an increase in information, why should the maximum spread of information be taken as a criterion of welfare? Whose welfare is advanced by it? Perhaps the contention is that under a system in which the spread of information is maximized, each individual will gain more from knowledge of advantageous exchanges than he will lose through the

acquisition of information by rivals. But why believe this? No reason has been given to accept it. And to justify the criterion, one needs to add that the net gain to each individual exceeds that of any other workable system. Or should it be the probability of net gain to each individual that is maximized?

Some of the problems of catallactic efficiency stem from one of Cordato's insights. As discussed earlier, he correctly argues against Kirzner that the increase of information need not lead to plan coordination. But, while dropping Kirzner's reason for using the growth of information as a welfare ideal, he retains the standard. "This [Cordato's] view of catallactic efficiency is, in a fundamental sense, Kirzner's standard of welfare economics without invoking interpersonal plan coordination as the normative goal" (p. 70). It is indeed; but, absent Kirzner's justification, he needs to provide some other reason that the general spread of information is to the advantage of each market participant, or at least to no one's disadvantage. Incidentally, even if Kirzner were right that increased information always leads to plan coordination, he would still not have justified his criterion. What if someone lost more by the general coordination of plans than he gained through the coordination of his plans with others? Some people may lose out by the end of a chaotic state of affairs. Why should they support Kirzner's criterion?

But Cordato has another reason besides the spread of information to support catallactic efficiency. Whatever the benefits of maximizing the growth of information, do not the manifest advantages of lack of conflict in the use of resources justify the stable system of property rights of the IIS?

I fear that I must once again dissent. First, in many other systems than the free market, people know what resources are available to them. Suppose, e.g., that the state takes 80 percent of the income of anyone who earns $5,000 or more. Someone who earns $20,000 will know exactly what resources are available to him. Further, while it is surely desirable, for the reasons Cordato states, to know what resources one may use, must this knowledge not be weighed against other goods? Imagine one had a choice between the tax system just described and one in which the government randomly decided each year on a tax rate between 1 percent and 10 percent. Would the former system be preferable, simply because in it one knew exactly the resources that would be available?[10]

[10]It might be objected to the example that in the second case, one always knows one will retain at least 90 percent of one's income: therefore, this is preferable, both on grounds of stability and control of resources, to the 80 percent tax. Although I think this response changes the criterion at issue—stability—to a combination of stability

Again, granted that each person prefers, other things being equal, that he know the resources he may without conflict use, why is it to each person's advantage that everyone have stable property rights? Perhaps some would benefit from instability in the property rights of their rivals.

One might object in this way to the line of criticism against catallactic efficiency that I have been pursuing. Why does Cordato need to show that the spread of information and a stable set of property rights are to the advantage of each person? Why is it not sufficient that the IIS benefit most people? Here one needs to recall the purpose of a criterion of welfare within economics. Since economics is a value-free science, the criterion must appeal only to non-controversial normative principles (if, indeed, there are such). Otherwise, one is straightaway in the midst of philosophy. It is for exactly this reason that both the neoclassicals and Rothbard use the Unanimity Principle in their respective criteria. As Rothbard puts the point: "Generally, even the most rigorously *Wertfrei* economists have been willing to allow themselves one ethical judgment; they feel free to recommend any change or process that increases social utility under the Unanimity Rule"[11] (Cordato apparently agrees that economics is value free; see p. 90, n. 13).

It may well be that the Unanimity Rule is not so free from controversy as its advocates imagine. But no principle more controversial than it can be used in scientific economics. If, then, Cordato rejects my criticisms on the ground that his criterion need not follow the Unanimity Rule, he confronts a daunting task: he must produce some other normative rule, equally uncontroversial, which supports his criterion. I wish him well in the attempt to do so.

Catallactic efficiency faces yet another difficulty; the problem, however, is not intrinsic to the idea but arises from an earlier section of *Welfare Economics and Externalities*. Before presenting his criterion, Cordato set forward various requirements for an acceptable standard, among them demonstrated preference. He agreed with Rothbard that one cannot assume that people's preferences are consistent over time.

How does catallactic efficiency stand up, measured by Cordato's own requirements? The question answers itself. To say that someone

---

and amount of resources under one's control, the example can be modified to accommodate those who find this response persuasive. Suppose that in the latter system, there is a 1 percent chance that the state will tax 81 percent of total income and a 99 percent chance it will randomly select a tax of 1 to 10 percent. Which system is preferable?

[11]Rothbard, "Toward a Reconstruction," p. 20.

will better fulfill his preferences given more information or a stable system of property rights seems *prima facie* to require reference to more than the preferences he indicates by his action at a particular time. To assess Cordato's criterion, one needs to use judgments of this kind: "If A had known a, b, and c, he would have chosen x instead of y, raising his level of utility." How can one show, adhering strictly to demonstrated preference, that someone benefits from an increase in information? And even more obviously, increased information and stable property rights are in part desirable because they help people carry out their plans over time, as Cordato himself mentions (p. 61). But to take account of this contradicts his stipulation that preferences not be assumed consistent over time.

The situation then is this. Cordato in Chapter 2 criticized Rothbard's welfare criterion. In Chapter 3, he advanced as requirements for a criterion exactly the features that led to his criticisms of Rothbard in the previous chapter. And when he at last presents his own criterion, it turns out to fail these requirements. Cordato's inability to pursue a consistent line of argument brings to mind Samuel Johnson's observation on conversation with the Highlanders: "the inquirer is kept in continual suspense, and by a kind of intellectual retrogradation, knows less as he hears more."[12]

After presenting his criterion, Cordato discusses its application to externalities and to tort liability. On the whole, his treatment is insightful: he in particular makes valuable criticisms of the Coasean approach to externalities (pp. 92ff). Rather than discuss his analysis in detail in an already long review, I shall select for discussion a few points in his torts liability chapter.

He draws a valuable contrast between the Coasean approach to externalities (particularly as Richard Posner applies it) and his own catallactic efficiency view. Confronted with a legal case in which positive transactions costs prevent the parties concerned from bargaining their way to a solution, "the task of the [Posnerian] judge is to decide *who should* have the property rights, not *who does* have the property rights" (p. 100). The catallactic efficiency position takes just the reverse stand: property rights cannot be taken away by the judge's belief that someone other than the owner will use the disputed property more "efficiently."

Cordato's conclusion is entirely commendable, but a few details arouse misgiving. For one thing, he claims "[T]he theory presented

[12]Samuel Johnson, *A Journey to the Western Islands of Scotland*, R. W. Chapman, ed. (Oxford: Oxford University Press, 1970), p. 45.

here leads to a non-Pigouvian efficiency defense of strict liability" (p. 100). While I share Cordato's admiration for the work of Richard Epstein on strict liability, I cannot find any argument in the book defending strict liability. Cordato has argued that tort cases should be settled by reference to property titles, rather than on grounds of economic efficiency; but this by itself does not entail strict liability. Epstein succinctly characterizes strict liability in this way: "[the theory] holds the defendant *prima facie* liable whether or not either of the two further conditions relating to negligence and intent is satisfied."[13]

Suppose one agrees with Cordato that judges should decide tort cases on the basis of property rights. How does this by itself settle whether intent or negligence should play a role in assessing damages? Of course, Cordato is right that to use an economic standard as the exclusive criterion of decision is inconsistent with strict liability, and he has criticized doing so. But this is the sum and substance of his "argument" for strict liability.

Cordato rightly points out that the Coasean framework rejects causation; and his instincts are sound in combatting this. But his execution is faulty. He endorses an analysis of causality which he claims his view of strict liability supports. "The notion of strict liability that is derived from that [Austrian] view of property rights casts up a 'but for' test of causality that subverts these conceptual ambiguities. Causality is established, at least *prima facie*, if, but for the fact that the plaintiff (*P*) invaded the property rights of the defendant (*D*), the harm would not have occurred" (p. 102).

He presents on the same page an objection to the "but for" analysis of causation that so far as I can see is perfectly correct. In essence, the objection is this; any necessary condition of an event fulfills the "but for" requirement. If a violation of rights would not have happened "but for" someone's invasion, it would also not have happened "but for" the fact that the property was there. This objection, it should be clear, if correct overthrows neither causation nor strict liability. It is an objection to one particular conception of causality.

Cordato's reply to this objection is: "it is as if all property lines had been erased, or never existed" (p. 102). Not at all! The objection has nothing to do with property rights. Far from responding adequately to the objection, Cordato appears not to have understood it.

[13]Richard A. Epstein, *A Theory of Strict Liability* (San Francisco: Cato Institute, 1980), p. 5.

As to Cordato's claim that strict liability leads to 'but for' causation, let us hope it is false. Otherwise, one would have an excellent argument against strict liability. Perhaps Cordato, rightly thinking that strict liability requires acceptance of causation, believes that this is why he must accept 'but for' causation. This line of thought would work—but for the existence of other conceptions of causation.

Epstein's view of the issue differs from that of our author. He states: "Its affinity for absurd hypotheticals should suggest that the 'but for' test . . . be abandoned as even a tentative account of the concept of causation."[14] Epstein's analysis of causation depends on certain paradigms, not 'but for'. After presenting one of these paradigms, "*A* hit *B*," he remarks: "No question of 'but for' is ever raised, much less answered."[15] Is Epstein wrong about the implications of strict liability for causation? If so, one would like to know why.

Professor Cordato has obviously read very widely in the literature, and he has the ability to present the essence of a theory simply and clearly. But his many mistakes and inconsistences, along with the failure of his catallactic efficiency standard, make his book largely a missed opportunity. Rigor in argument cannot be abandoned—even if we inhabit an "open-ended universe."

[14]Ibid., p. 16.
[15]Ibid., p. 24.

Mises and Hayek Dehomogenized

Joseph T. Salerno*

A Man of Principle: Essays in Honor of Hans F. Sennholz. John W. Robbins and Mark Spangler, eds. Grove City, Pennsylvania: Grove City College Press, 1992.

An important contributing factor to the resurgence of Austrian economics in the 1970s was the appearance of a handful of articles which drew the attention of the economics profession to the distinctiveness of the tradition of economic theorizing founded by Carl Menger.[1] Arguably the most influential of these articles was written by the eminent Walras scholar, William Jaffé, and entitled "Menger, Jevons and Walras Dehomogenized."[2] In this article, Jaffé argued persuasively that the three founders of marginalism, whose contributions up to that point had tended to be conflated due to an exclusive focus on their contemporaneous discoveries of the marginal principle, each initiated a separate and distinct tradition of economic method and analysis. Taken in conjunction with the 1974 award to F. A. Hayek of the Nobel Prize in Economics and

*Joseph T. Salerno is professor of economics in the Lubin Graduate School of Business at Pace University, New York.

I wish to gratefully acknowledge comments on an earlier draft of this essay by Murray N. Rothbard, David Gordon, Israel M. Kirzner, and Lawrence H. White for helping me to rectify errors and ambiguities in, as well as to generally improve upon, my original exposition. This acknowledgement does not imply that these individuals bear any shred of responsibility for the remaining imperfections in the essay or that the latter two concur in any of its arguments regarding their respective works.

[1]For example, Erich Streissler, "To What Extent Was the Austrian School Marginalist?," *History of Political Economy* 4 (Fall 1972): 426–41; William Jaffé, "Menger, Jevons and Walras De-Homogenized," *Economic Inquiry* 14 (December 1976): 511–24; and the articles in the Special Issue on Carl Menger and the Austrian School of Economics, *Atlantic Economic Journal* 6 (September 1978).

[2]Jaffé, "Menger, Jevons and Walras De-Homogenized."

The Review of Austrian Economics Vol.6, No. 2 (1993): 113–46
ISSN 0889-3047

the scholarly conferences on Austrian economics held annually between 1974 and 1976, this article and the others mentioned above broadened and reinforced recognition of and interest in contemporary Austrian economics as an alternative to the prevailing neoclassical paradigm.

But the Mengerian tradition was developed in very different directions by his brilliant followers, Eugen von Böhm-Bawerk and Friedrich von Wieser, and by their own students and followers. Without tracing out this doctrinal development in any detail, suffice it to say that today the term "Austrian economics" is used to designate two very different paradigms. One derives from Wieser and may be termed the "Hayekian" paradigm, because it represents an elaboration and systematization of the views held by F. A. Hayek, a student of Wieser's at the University of Vienna. Although it is yet to be generally recognized by Austrians, Wieser's influence on Hayek was considerable and is especially revealed in the latter's early work on imputation theory, which sought to vindicate the Wieserian (as against the Böhm-Bawerkian-Misesian) position that the imputation problem must be solved within the context of an exchangeless economy subject to the control of a single will yet somehow able to calculate using (subjective) value as the "arithmetic form of utility."[3]

[3]See, especially, F. A. Hayek, "Some Remarks on the Problem of Imputation," in idem *Money, Capital, and Fluctuations: Early Essays*, Roy McCloughry, ed. (Chicago: University of Chicago Press, 1984), pp. 33–54. That there is no possibility of economic calculation and rational or purposeful allocation of resources within an economy based on division of labor where one will alone acts is, of course, the essence of Mises's critique of socialism. Perceiving the unbridgeable gulf between his own and Wieser's position on the possibility of directly imputing values to higher-order goods in the absence of monetary exchange, Mises, in his *Notes and Recollections* ([Spring Mills, Ill.: Libertarian Press, 1978], p. 36), wrote that "[Wieser's] imputation theory is untenable. His ideas on value calculation justify the conclusion that he could not be called a member of the Austrian School, but rather was a member of the Lausanne School." Also, Hayek, explicitly following Wieser, conceives the main problem of capital theory to be to explain how it is that the nonpermanent resources constituting the capital stock can yield a permanent net (physical) return (F. A. Hayek, *The Pure Theory of Capital* [Chicago: University of Chicago Press, 1952], pp. 54–55). This Wieser-Hayek method of describing the *quaesitum* of capital theory loads the dice in favor of explaining the interest return on capital in terms of productivity (rather than time-preference) considerations and, at the same time, diverts attention from what Böhm-Bawerk brilliantly perceived to be the fundamental question that must be satisfactorily answered by a correct theory of interest and was so answered by Mises's pure time-preference theory: What is the cause of the difference in value between goods which differ only in their temporal availability? In theorizing on capital, moreover, Hayek (ibid., pp. 27, 156) makes significant use of the Wieserian device of a communist society subject to the control of an omniscient dictator, a device which reflects a paradigmatic lack of concern with problems of monetary appraisement and calculation. Finally, we have Hayek's revelation that his neutral-money doctrine represents a development, albeit "unconscious," of Wieser's remarks on the

The Hayekian paradigm stresses the fragmentation of knowledge and its dispersion among the multitude of individual consumers and producers as the primary problem of social and economic cooperation and views the market's price system as the means by which such dispersed knowledge is ferreted out and communicated to the relevant decision-makers in the production process.[4]

The other paradigm is the "Misesian" paradigm, so called because Ludwig von Mises was the first to systematically expound it. This paradigm represents a development of Böhm-Bawerk's thought and focuses on monetary calculation using actual market prices as the necessary precondition for the rational allocation of resources within an economic system featuring specialization and division of labor.[5]

Unfortunately, the majority of those who currently regard themselves as "Austrian economists" have failed to recognize the considerable differences between these two paradigms. And because Mises was the main influence on Hayek's early writings on business cycle theory and on socialist calculation, the most important manifestation of this failure is the tendency to attribute to Mises positions originated by Hayek or independently developed by those working within the Hayekian paradigm. This tendency is reinforced by what may be called the "Whig presumption," still inexplicably prevailing among many Austrians despite the publication of Thomas Kuhn's book three decades ago, that since Hayek "came after" Mises he must have incorporated in his own work all that was worthwhile in his

---

effects of "a one-sided supply of money" (Hayek, "On Neutral Money," in idem, *Money, Capital, and Fluctuations*, p. 160).

[4]Thus, for example, Wieser's critique of central planning rests on a proto-Hayekian view of the market as the means for solving knowledge problems. Writes Wieser (*Social Economics*, A. Ford Hinrichs, trans. [New York: Augustus M. Kelley, 1967], pp. 396–97): "The one will and command which, in war and for legal unity, is essential and indispensable as the connecting tie of the common forces, detracts in economic joint action from the efficacy of the agency. In the economy, though it has become social, work is always to be performed fractionally.... Part-performances of this sort will be executed far more effectively by thousands and millions of human beings, seeing with thousands and millions of eyes, exerting as many wills: they will be balanced, one against the other, far more accurately than if all these actions, like some complex mechanism, had to be guided and directed by some superior control. A central prompter of this sort could never be informed of countless possibilities, to be met with in every individual case, as regards the utmost utility to be derived from given circumstances or the best steps to be taken for future advancement and progress." I am indebted to Peter Boettke, of New York University, or calling my attention to this passage.

[5]On the crucial significance of monetary calculation in the Misesian paradigm see Joseph T. Salerno, "Ludwig von Mises as Social Rationalist," *Review of Austrian Economics* 4 (1990): 36–41. Also see idem, "Two Traditions in Modern Monetary Theory: John Law and A. R. J. Turgot," *Journal des Economistes et des Etudes Humaines* 2 (June/September 1991): 368–70.

predecessor's.[6] The result is that attention has been deflected from the Misesian paradigm, and those seeking to deepen and extend it have found it increasingly difficult to gain recognition for their own efforts or to channel the interests and efforts of younger Austrian scholars into the same endeavor. There thus currently exists a pressing need, especially for Misesians, to undertake the task of a courageous and thoroughgoing doctrinal dehomogenization of Hayek and Mises.

Evidence of this need is presented in some of the contributions to this Festschrift honoring Hans Sennholz—ironically, a student of Mises's whose writings on most topics fall squarely within the Misesian paradigm. While this volume contains many informative, instructive, or inspiring papers by individuals who have been associated with Dr. Sennholz in various capacities or who have been profoundly influenced by his prodigious and insightful writings on a broad range of politico-economic subjects, I am mainly interested in a handful of contributions from academic Austrian economists. Rather than offering a critical analysis of these papers, I will restrict myself to demonstrating that, in each case, the author imputes to Mises implicit or explicit support for or authorship of one or more positions originated by Hayek or rooted in a Hayekian view of the market's pricing process.

Let me begin with Israel M. Kirzner's contribution on "Human Action, Freedom and Economic Science" (pp. 241–49), which deals with the evolution of his own understanding of the Misesian concept of human action from the publication of his first book in 1960[7] to 1991, the year the essay under review was completed. In this essay, Kirzner explicitly repudiates the position he took in the concluding chapter of his 1960 book that the defining element of human action is "purposefulness" narrowly construed as expressed in economizing and choice and that the entire structure of Misesian economics, including its adumbration of the dynamic market process, can be logically deduced from insight into the "power of reason to guide purposeful behavior" (p. 244). Now, Kirzner informs us, he has come to realize that his earlier understanding of Mises's position is "inadequate," because it can only yield conclusions about "decisions made in given situations"

[6]This recrudescence of the "Whig presumption" among members and observers of the current Austrian school was recently brought to light in Murray N. Rothbard, *The Present State of Austrian Economics*, Working Paper from the Ludwig von Mises Institute, Auburn, Alabama (November 1992), pp. 4–5.

[7]Israel M. Kirzner, *The Economic Point of View: An Essay in the History of Economic Thought*, 2nd ed. (1960; Kansas City: Sheed and Ward, 1976).

and is thus incapable of analyzing "those systematic market processes which are so central to Misesian economics" (p. 244).

While Kirzner still ascribes a central role to the concept of purposefulness in his reinterpretation of Mises, it is a concept purged of explicit reference to economizing and choice and completely redefined in terms of alertness and discovery. Thus for Kirzner, "the purposefulness of human action . . . is the essential key to the discovery by agents that they are in fact *not* in the 'given situations' which they had hitherto assumed to be relevant," and it is the "purposefulness which defines and identifies conscious human action" that motivates "alertness to the dynamic world in which we live" (pp. 245, 247). These essential attributes of purposefulness are summed up elsewhere by Kirzner in the statement that "purposive human action involves a posture of alertness toward the discovery of as yet *unperceived* opportunities and their exploitation."[8] To be sure, in proposing this definition, it is not Kirzner's intention to completely ignore the aspect of purposefulness that is expressed in human choice.[9] However, he offers no argument establishing a logical link between these two aspects of purposefulness and merely asserts a predominating "propensity," inherent in human action, "to sniff out opportunities lurking around the corner," "to discover what is useful," to be alert to opportunities," "to notice what may be useful," etc. By this procedure, Kirzner hopes to provide a praxeological foundation for the *empirical* tendency of the market process toward equilibrium that is alleged by Hayek.[10] Thus Kirzner dismisses what he calls "any programmed pattern of allocative maximization" or "static decision making," i.e., choice, as a trivial expression of purposefulness that is unable to illuminate the equilibrating tendencies of the dynamic market process. In its stead he proposes "discovery," i.e., "man's entrepreneurial propensity to discover changes which can redound to his benefit," as the hallmark of purposive human action (p. 245).

It is important to reiterate at this point that Kirzner is not faulting Mises's conception of purposeful behavior but his own earlier failure to fully comprehend this conception, thereby imputing to Mises the origination of the discovery perspective which Kirzner has so elegantly elaborated in his later works. Thus when confronting the question of why Mises apparently endorsed Kirzner's earlier, mistaken interpretation of his position by writing a laudatory Foreword

[8]Israel M. Kirzner, *Perception, Opportunity, and Profit: Studies in the Theory of Entrepreneurship* (Chicago: University of Chicago Press, 1979), p. 109.

[9]Ibid., pp. 28, 30–31.

[10]Ibid., pp. 13–33.

to Kirzner's 1960 book, Kirzner responds that Mises did not "explicitly articulate" the insights yielded by this perspective and therefore may well have believed that what was implicit in his own position was also implicit in Kirzner's "superficial exposition" of that position. Or, alternatively and even less plausibly, Kirzner speculates that Mises himself may not have been consciously aware of these momentous implications of his own thought (p. 249, n. 1).

I would like to suggest however that the simplest and most plausible explanation for Mises's uncensorious Foreword is the correct one: Kirzner's concluding chapter gave a full and accurate explication of what Mises knew to be his own "economic point of view," whose central element Mises himself repeatedly and explicitly characterized as purposive human action describable in terms of choice and the efficient allocation of scarce resources. Moreover, contrary to Kirzner's contention, Mises did indeed succeed in deducing from this restricted notion of purposeful behavior catallactic theorems relevant to the analysis of the dynamic market process. Preliminary to arguing this point, I will demonstrate that Kirzner's emphasis on discovery as the essence of purposiveness leaves him unable to logically account for the choice process and, ultimately, for the very existence of acting man.

For Mises, human action, whether isolated or involving monetary exchange, is always motivated by the eagerness of the actor to enhance his welfare and consists of choosing among alternative employments of resources whose necessarily future results are not known with certainty. Because the choice process logically implies uncertainty—choice and action would be obviously futile in a world where humans are predestined to endure a rigidly unchangeable sequence of future events known with perfect certainty—the prerequisite of any specific act of choice is the acquisition of knowledge, via direct experience or from other sources of information, about the events and prevailing circumstances of the recent past that may be relevant in formulating an "understanding" of the future conditions upon which the actions under consideration will impinge. For example, if the actor is choosing among alternative investments of resources for producing goods intended for sale on the market, then information about "current" prices, i.e., realized prices of the immediate past, in addition to qualitative knowledge concerning the most recent technical conditions of production and conditions underlying consumer demands, is an almost indispensable guide to forecasting future market conditions. It is only upon the basis of such knowledge and forecasts that the actor is able to appraise and estimate the future prices of the various products which enter into his calculations

of monetary profit. These calculations permit his ranking of the alternative investments under consideration, which then enables him to purposefully and efficiently allocate his resources at the moment of choice.

Thus, for Mises, the moment of choice coincides with the emergence of a value scale that is the *raison d'etre* and consummation of the actor's previous "discovery" activities and that provides the framework for purposive behavior. Choice and action can only be conceived as occurring within such a "a given situation." Contrary to Kirzner's later interpretation of Mises, discovery cannot serve as the core of the central axiom in a praxeological system, precisely because there is no possibility of inferring from it the "given situation" prerequisite to the moment of choice. A being who is ever seeking to "discover changes that have occurred" in his situation can never *act* on those discoveries because he is incapable of creating the framework for choosing. In the newer Kirznerian interpretation, therefore, the Misesian *homo agens* has been transformed into *homo quaerens*, a perpetual and aimless seeker of new knowledge who is forever unable to turn it to account in improving his welfare; a shade who has become unstuck in (praxeological) time, having no existence in what Mises calls the "real present," that neverending sequence of "given situations" which is created by purposive entrepreneurial evaluation of past experience and forecasting of the future and in which all action is initiated and all human life is lived.[11]

We have thus established that, according to Mises, "discovery" is logically implied in the very concept of choice and need not be posited as an independent facet of human purposiveness and, furthermore, that the propensity to discover new opportunities, when analyzed in isolation as the essential or predominant feature of purposiveness is incapable of generating any meaningful propositions about human action, not to mention the market process. Or, in other words, from the perspective of Misesian praxeology, entrepreneurial information gathering and forecasting are never autonomous and free-flowing activities directly expressing purposefulness, but are always rigidly governed by the exigencies of choosing under uncertainty. In my interpretation, therefore, it is a significant distortion of Mises's view to say with Kirzner that it is the discovery element in human action rather than "maximizing rationality" that "drives the market" (p. 247); for Mises, it is the fact

[11]For Mises's conception of the "real present," see *Human Action: A Treatise on Economics*, 3rd ed. (Chicago: Henry Regnery, 1966), pp. 100–1. As Mises points out, "The present qua duration is the continuation of *the conditions and opportunities given* for action (ibid., p. 101). I have added the emphases in this quotation.

that the entrepreneur desires to efficiently allocate his resources in service of his goal of maximizing profit (and ultimately, utility) that drives both his quest for understanding of future market conditions and, when this quest culminates in the purposive choice of production processes, the dynamic market process.

But what of Kirzner's claim that a theorematic system derived from a concept of purposefulness lacking an independent discovery dimension is unable to elucidate "those dynamic processes through which the market absorbs and responds to exogenous changes" and which are central to Misesian economics (p. 245). In fact Misesian catallactics is exactly the spinning out of the implications of purposeful behavior engaged in by individuals who perceive the benefits of specialization and exchange described by the law of comparative advantage and whose productive activities are oriented by monetary calculation to satisfying anticipated consumer demands in the cheapest possible way. For Mises one of the most important functions of the market process is to provide the meaningful numerical data, the money prices, that are used in such economic calculations. These computations of monetary profit enable each producer to discern and purposefully choose that pattern of uses for his resources that he expects to maximize his satisfaction from participation in the exchange process. Because of the complexity of the technical interrelationships between the factors of production and the innumerable possibilities of their use and combination within a capital-using economy, without the ability to calculate, producers, no matter how much qualitative knowledge of the economic data they discovered or were endowed with, would never be able to use such knowledge in pursuit of their purposes and would abandon social cooperation under the division of labor as a means for enhancing their welfare.[12] Thus, severing choice from discovery, far from elucidating the nature and operation of the dynamic market process, yields the condition under which it ceases to operate.

Having linked up purposive individual behavior with the market process through the theory of monetary calculation, Mises then

[12]For recent discussions of Mises's contribution to the socialist calculation debate that characterize it as essentially an argument about calculation and not knowledge, see Salerno, "Ludwig von Mises as Social Rationalist," pp. 41–49; idem, "Postscript: Why a Socialist Economy Is 'Impossible'," in Ludwig von Mises, *Economic Calculation in the Socialist Commonwealth* (Auburn, Ala.: Praxeology Press, 1990), pp. 51–71; Murray N. Rothbard, "The End of Socialism and the Calculation Debate Revisited," *Review of Austrian Economics* 5 (2) (1991): 51–76; and idem, "The Present State of Austrian Economics," pp. 19–22. It seems that Richard Ebeling now also interprets Mises's argument along similar lines. See Richard M. Ebeling, "Introduction" in idem, *The Global Failure of Socialism* (Hillsdale, Mich.: Hillsdale College Press, 1992), pp. 6–8.

formulated his catallactic theory, based on Böhm-Bawerkian price theory and his own theory of the promoter-entrepreneur, to analyze the operation of this process. For purposes of arguing that Kirzner's view of the market process has much more in common with Hayek than Mises, allow me to briefly enumerate the most salient features of Mises's understanding of the dynamic market process as the outcome of calculable actions.

I focus first on the characteristics of the prices that are generated by the market process and serve as the data for economic calculation. These are realized prices; or, in other words, they are the actual outcome of the historical market process at each moment in time and are determined by the value scales of the marginal pairs in each market. They are, therefore, also market-clearing prices the establishment of which coincides with a momentary situation, what Mises calls the "plain state of rest" (PSR),[13] in which no market participant, given his existing marginal-utility rankings of goods and money and knowledge of prevailing prices, can enhance his welfare by participating in further exchange. However, despite their character as market-clearing prices, these are also disequilibrium prices. Thus as a consequence of the unavoidable errors of entrepreneurial forecasting and price appraisement under uncertainty, most goods are sold at prices that do not conform to their monetary costs of production, thereby generating realized profits and losses for producers. Nor does the law of one price for commodities and the associated but broader law of the absolute spatial equality of the purchasing power of money hold in the PSR, because market conditions are continually changing, while the information of each transactor

[13]According to Mises (*Human Action*, p. 762), "The notion of the plain state of rest as developed by the elementary theory of prices is a faithful description of what comes to pass in the market at every instant. Any deviation of a market price from the height at which supply and demand are equal is—in the unhampered market—self-liquidating." For further discussion of the PSR, see ibid., pp. 244–45. Arthur Marget also clearly recognizes that all prices that actually emerge in the course of the historical market process are and must be market-clearing prices that create a temporary lull in the process. In Marget's words, "the prices which we must ultimately explain are the prices 'realized' at specific moments in clock time [and] the only demand and supply schedules which are directly relevant to the determination of these 'realized' prices are market demand and supply schedules prevailing at the moment the prices are 'realized'. . . ." (Arthur W. Marget, *The Theory of Prices: A Re-examination of the Central Problem of Monetary Theory*, 2 vols. [New York: Augustus M. Kelley, 1966], 2, p. 253). For an exposition of Marget's view of the pricing process and its relevance to monetary theory, see Joseph T. Salerno, "Ludwig von Mises's Monetary Theory in Light of Modern Monetary Thought," presented at the Austrian Scholars Conference, New York City, October 1992 (unpublished ms), pp. 46–50.

about current conditions is necessarily incomplete and arbitrage processes do not operate instantaneously.[14]

Second, for Mises, the market process is open-ended and entrepreneurial. It is open-ended because the continual exogenous changes in the economic data preclude it from ever reaching a state of long-run equilibrium or what Mises refers to as a "final state of rest" (FSR), in which all commodity prices and the purchasing power of money are perfectly arbitraged, speculative holding of commodity stocks is absent, and profits and losses have been completely eradicated.[15] The FSR is an imaginary construct that enables the economist to isolate and describe the entire sequence of adjustment, including the time-consuming reorientation of the production structure, which results from a given change in the economic data. In FSR analysis, the economist begins with an initial FSR, introduces an alteration in the data, i.e., in tastes, technology, money supply, etc., and then traces out the steps by which the market adjusts to a new FSR, all the while rigidly maintaining a *ceteris paribus* assumption. From this analysis it may be inferred that the reallocation of resources from less profitable to more profitable production processes coincides with an improvement in the satisfaction of consumer wants.

Or the economist may employ FSR analysis to demonstrate that, if at any point in time, all further changes in the economic data were to suddenly cease, the adjustment processes currently operating in response to past changes would eventually culminate in an FSR and, if no further changes intervened, in a state of eternally repetitive robotical activity or "evenly rotating economy" (ERE) in which uncertainty, entrepreneurship, and the demand for a medium of exchange are eliminated and the very conditions of choice and action abolished. This latter mode of employing the analysis is effective in illustrating the point that at any instant in time all purposive behavior aimed at attaining a state of optimum satisfaction is tending toward establishing a state of nonaction. What prevents the emergence of such a state is the neverending flux in the means and ends of action. Thus, from the standpoint of Misesian catallactics, to declare that the market is "equilibrating" can never be taken to mean that the market process ever actually progresses toward a given long-run equilibrium in historical or calendar time. It can mean that

[14]For a Wicksteedian micro analysis of the market's tendency to rapidly establish and maintain interspatial equality in the purchasing power of money, see ibid., pp. 41–45.

[15]Mises's discussion of the nature and uses of the FSR concept can be found in Mises, *Human Action*, pp. 245–46.

the reallocations of productive resources undertaken by entrepreneurs seeking to exploit anticipated profit opportunities—if and when such profits are realized—result in a relatively improved state of want satisfaction for consumers; or it can mean that the complex of autonomous yet coordinated choices and actions that constitute the market process, at any given moment in historical time, is aimed at establishing an optimum state of consumer satisfaction and would eventuate in such a state in the absence of further change in the data.

But despite its usefulness, FSR analysis was never intended by Mises to provide a grasp of the function of the entrepreneur or "promoter," whose activities drive the open-ended market process actually unfolding in time. For Mises, the promoter concept goes beyond the category of the pure entrepreneur derived from the action axiom, and its construction embodies cognition of a fundamental datum of catallactic analysis: that some people are more adept than others at anticipating and adjusting to change.[16] Within the context of the Misesian market process, promoter-entrepreneurs are those who seek to profit by actively promoting adjustment to change. They are not content to passively adjust their catallactic activities to readily foreseeable changes or changes that have already occurred in their circumstances; rather, they regard change itself as an opportunity to meliorate their own conditions and aggressively attempt to anticipate and exploit it. The real market process is thus entrepreneurial in the sense that it is driven by an identifiable, though ever-changing, class of individuals whose productive activities are guided by monetary calculations based upon purposeful and perpetual forecasting of an uncertain and changing future.[17] As noted above, the prices used in such calculation are the appraised prices of the future, i.e., the prices anticipated to be realized at future moments of an open-ended market process that will never cease to be buffeted by changes in the economic data. It should be emphasized that these prices are *not* the same prices which emerge during the

[16]On the "promoter" concept, see ibid., pp. 254–55, 303–11. As Mises (ibid., p. 585) points out, "What distinguishes the successful entrepreneur and promoter from other people is precisely the fact that he does not let himself be guided by what was and is [i.e., by realized prices], but arranges his affairs on the ground of his opinion about the future. He sees the past and present as other people do, but he judges the future in a different way. . . . The impulse of his actions is that he appraises the factors of production and the future prices of the commodities which can be produced out of them in a different way from other people."

[17]It was William H. Hutt (*The Keynesian Episode: A Reassessment* [Indianapolis: Liberty*Press*, 1979], p. 165) who felicitously described entrepreneurial activity as "dominated by perpetual forecasting."

course of a *ceteris paribus* or "systematic" (as Kirzner terms it) market process smoothly progressing toward the FSR.

Third, and finally, Mises conceives the market process as coordinative, "the essence of coordination of all elements of supply and demand."[18] This means that the structure of realized (disequilibrium) prices, which continually emerges in the course of the market process and whose elements are employed for monetary calculation, performs the indispensable function of clearing all markets and, in the process, coordinating the productive employments and combinations of all resources with one another and with the anticipated preferences of consumers. Such "price coordination," by insuring that scarce resources are secured by the entrepreneurs bidding the highest prices, also insures that at each instant Böhm-Bawerk's "Law of Costs" prevails, that is, that the constellation of resource prices that emerges on a market unhampered by legal restrictions *always* reflects the circumstance that existing resources are devoted to their most valuable uses as determined by entrepreneurial appraisements of future output prices.[19] It should be noted that as a concept applicable to the real world of uncertainty and change, Misesian price coordination is consistent with the speculative withholding of labor and other resources from current production in anticipation of the later emergence or discovery of more valuable employments.[20] While such speculative activities may modify the shape of the momentary supply and demand curves and the valuations of the marginal pairs

[18]Ludwig von Mises, "The Position of Money among Economic Goods," in *Money, Method, and the Market Process: Essays in Honor of Ludwig von Mises*, Richard M. Ebeling, ed. (Norwell, Mass.: Kluwer Academic Publishers, 1990), p. 65.

[19]On Böhm-Bawerk's law of costs as an early formulation of the concept of price coordination, see Salerno, "Two Traditions in Modern Monetary Theory," p. 369. Böhm-Bawerk's erroneous characterization of his law of costs as "a law which has only approximate validity and teems with exceptions" resulted from his failure to realize that this law does not depend on the assumption of perfect knowledge and foresight. The law of costs no more requires that entrepreneurs have perfect knowledge of future market conditions than the law of marginal utility requires that consumers are able to perfectly predict their future value scales. Both laws require for their full applicability only that agents, whether allocating resources to achieve final consumption goals or the business goal of pecuniary profit, evaluate and rank the *anticipated* outcomes of the alternative actions under consideration. For Böhm-Bawerk's statement of the law, see Eugen von Böhm-Bawerk, *Capital and Interest*, vol. 2, *Positive Theory of Capital*, George D. Huncke, trans. (Spring Mills, Penn.: Libertarian Press, 1959), pp. 248–56. Böhm-Bawerk's error occurs on pp. 255–56. A more detailed presentation and defense of the law of costs can be found in idem, "The Ultimate Standard of Value," in *Shorter Classics of Eugen von Böhm-Bawerk* (Spring Mills, Penn.: Libertarian Press, 1962), pp. 351–70.

[20]On this point see, Joseph T. Salerno, "Commentary: The Concept of Coordination in Austrian Macroeconomics," in Richard M. Ebeling, ed., *Austrian Economics: Perspectives on the Past and Prospects for the Future* (Hillsdale, Mich.: Hillsdale College Press, 1991), pp. 330–40.

in the affected markets, they do not in any way alter the coordinative quality of the market process.[21]

From the Misesian perspective, price coordination is thus the very essence of the market and a necessary attribute of its real existence. As such it is an *ex post* concept. In the absence of price coordination, e.g., in a regime of all-around price controls, the allocation of scarce resources within the social system of want satisfaction becomes purposeless and chaotic. The concept of equilibration, on the other hand, is an *ex ante* concept expressing recognition that entrepreneurs responding to the lure of expected monetary profits seek to anticipate and remove the continually emerging maladjustments between means and ends and that their success in doing so would culminate in a state of optimum satisfaction, i.e., nonaction. Equilibration therefore presupposes price coordination in the same way that, in a nonsocial process of individual want satisfaction, purposeful allocation of resources presupposes the existence of a unitary value scale by means of which resources can be meaningfully evaluated and ranked.[22]

Let me now contrast this interpretation of Mises's view of the market process as deduced from the axiom of purposeful behavior with the Kirznerian interpretation that ascribes the axiomatic position in Mises's praxeological system to the proposition that individuals have a propensity to discover changes that have already occurred in their given situations. In the latter interpretation, Mises does not view the market as an open-ended process, as a complex entwinement of mutually-influencing historical adjustment processes in various states of completion, a process which is constantly shifting direction in response to new changes in the data and never actually temporally approaches a state of final rest and nonaction. Rather, the Kirznerian interpretation emphasizes the market as a "systematic" process, one that really progresses toward equilibrium by effecting an increasing coordination of the plans of market participants. The ultimate goal of this process, the perfect coordination of individual plans, is an attribute of the final equilibrium state. But such "plan coordination" is worlds apart from the concept of price coordination adumbrated

[21]For an analysis of speculation which demonstrates that, whether successful or not, it does not impede the functioning of the coordinative market process, see Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles*, 2 vols. (Los Angeles: Nash Publishing, 1970), 1, pp. 112–18.

[22]This understanding of equilibration as a strictly *ex ante* concept accords with the "purely logical concept of equilibration" superbly expounded and defended by George Selgin. See G. A. Selgin, "Praxeology and Understanding: An Analysis of the Controversy in Austrian Economics," *Review of Austrian Economics* 2 (1988): 33–43.

above. The latter concept, as I have argued, refers to a realized coordination of all the disparate and contingent individual buying and selling plans underlying the market demand and supply curves that actually exist at any given moment in a changing and uncertain world. Plan coordination, on the other hand, describes an imaginary situation in which automatons endlessly repeat a logically consistent pattern of actions, a situation that is akin to the perfect adaptation of the elements of a completely robotized factory to one another.

In fact, Kirzner's discovery perspective does not originate in Mises's concept of human action but in Hayek's conception of the market as a means for disseminating the knowledge which systematically guides decentralized and initially ignorant decision-makers toward a full, *ex ante* coordination of their various production and consumption plans.[23] But since *ex ante* plan coordination can only be achieved in long-run equilibrium—is a condition defining such equilibrium—as both Hayek and Kirzner recognize, Kirzner is forced to shift his analytical focus from the real-world, open-ended market process to a hypothetical market process which is generated by initial ignorance among market participants of the full range of exchange opportunities afforded by the prevailing and *fixed* configuration of the economic data and which must therefore eventually terminate in an FSR.

With the possibility of exogenous change and genuine uncertainty thus banished from its purview, Kirzner's analysis of the market process has no use for the concept of the dynamic promoter-entrepreneur who is perpetually forecasting and appraising the future in quest of anticipated profit opportunities. The market process is now characterized as driven toward its fixed and final goal of perfect-plan coordination by discoverer-entrepreneurs alert to "changes that have occurred in their very market situations," i.e., to contemporaneously emerging discrepancies between prices of the same good available at different locations or in different forms (virtual products, i.e., resources and actual products). In these quasi-static conditions, production loses its temporal dimension and may be conceived of as a matter of pure arbitrage, i.e., of simultaneously buying and selling the same good in spatially diffuse markets. It is only under these circumstances, where producers may be characterized as arbitrageurs, that the Hayekian proposition that information about prices of the immediate past

[23]Hayek (*Pure Theory of Capital*, p. 23) referred to this state of affairs as "a state of complete compatibility of *ex ante* plans." Adopting the preferred terminology of current Hayekians, I refer to it alternatively as "*ex ante* coordination of plans."

substitutes for detailed qualitative knowledge of past and future market conditions in guiding the production process holds true. As producer-arbitrageurs act to exploit newly-discovered discrepancies between prevailing input and output prices, ignorance of mutually beneficial exchange opportunities among market participants measurably diminishes, the buying and selling plans of individuals are progressively coordinated (in the *ex ante* sense), and prices are systematically driven toward their final equilibrium values.

Once we drop the assumption of an absence of exogenous change in analyzing the market process, Kirzner's characterizations of the entrepreneur as an alert discoverer of existing opportunities, of the market process as the means for plan coordination, and of realized prices as a surrogate for qualitative knowledge about the economic data all fall to the ground. And this we indeed must do in interpreting Mises, because he does not employ such an assumption for analyzing the function of the entrepreneur or deducing conclusions about the dynamic market process. As I pointed out above, for Mises, FSR analysis, which utilizes this assumption, is primarily useful for demonstrating that the consequences of a change in the economic data are not restricted to the initial adjustment of the market price but also involve longer-run adjustments in resource allocation and the production structure.

Hayek, on the other hand, even in his earliest writings on business-cycle theory, in which he was most heavily under Mises's influence, envisaged the economy as actually departing from and rapidly returning toward a "static state" under impact of changes in the data. Thus, in *Monetary Theory and the Trade Cycle*, for instance, Hayek wrote that "For so long, at least, as disturbing monetary influences are not operating, we have to assume that the price which entrepreneurs expect to result from a change in demand or from a change in the conditions of production will more or less coincide with the equilibrium price. For the entrepreneur . . . will generally be in a position to estimate the price that will rule after the changes have taken place [i.e., in the new FSR]."[24]

While in later writings Hayek emphasized that the state of equilibrium and *ex ante* plan coordination is "an admittedly fictitious construction" never to be observed in the real world, he still insisted that the efficiency of the economic process is to be gauged by its observed proximity to such a state. Accordingly, in the *Pure Theory*

[24]F. A. Hayek, *Monetary Theory and the Trade Cycle*, N. Kaldor and H. M. Croome, trans. (New York: Augustus M. Kelley, 1966), p. 29.

of Capital, he argued that the "justification" of the concept of equilibrium "is not that it allows us to explain why real conditions should ever in any degree approximate towards a state of equilibrium, but that observation shows that they do to some extent so approximate, and that the functioning of the existing economic system will depend on the degree to which it approaches such a condition."[25] Affirming the "tendency" of market prices to conform to their equilibrium levels, Hayek clearly indicates that he considers the historical market to usually operate in close proximity to the equilibrium state. Thus he defines "tendency" in the following terms: "A given phenomenon may tend to [approximate towards] a certain magnitude if in a great number of cases it may be expected to be fairly near that magnitude, even if there is no reason to expect that it will ever actually reach it, however long the time allowed for the adjustment."[26]

Indeed, as Hayek points out, in order for prices to fulfill their knowledge-disseminating and plan-coordinating functions, the economy must subsist in a state of what I will call "proximal equilibrium," wherein realized prices are always fairly accurate indicators of future prices. Writes Hayek:

> successful economic action [or the fulfillment of the expectations which prompted it] depends largely on the approximately correct predication of future prices. These predictions will be based on present prices and their trends. . . . Indeed the function of prices is precisely to communicate, as rapidly as possible, signals of changes of which the individual cannot know but to which his plans must be adjusted. This system works because on the whole current prices are fairly reliable indications of what future prices will probably be.[27]

Kirzner evidently rejects the Hayekian concept of proximal equilibrium as a realistic description of the operation of the market economy, arguing that "the market is in a continual state of flux and is never in or near a state of equilibrium." He then goes on to argue that "the [endogenous] layer of change, consisting of systematic equilibrating tendencies (which never do manage to become fully completed before being disrupted by new exogenous change) is responsible for the degree of allocative efficiency and of growth potential that market

[25]Hayek, *Pure Theory of Capital*, pp. 27–28.

[26]Ibid., p. 27, n. 2.

[27]F. A. Hayek, *Denationalization of Money—The Argument Refined: An Analysis of the Theory and Practice of Concurrent Currencies*, 2nd ed. (London: Institute of Economic Affairs, 1978), p. 82.

economies display."[28] But, if this is the case, Kirzner must logically conclude, which he does not, that market economies are not very efficient at all, because he has already argued that the market process never proceeds very far toward the ideally efficient state of perfect plan coordination.[29] This point aside, Kirzner's theory of the discoverer-entrepreneur, whose activities systematically drive market prices toward their equilibrium configuration, can be viewed as an attempt to liberate Hayek's notion of catallactic efficiency as the *ex ante* coordination of decentralized plans from its dependence upon the vague and untenable assumption of proximal equilibrium as the normal state of the historical market economy. However, Kirzner's attempt itself implicitly invokes the ideas of quiescent calendar periods which separate successive exogenous shocks and during which equilibrating endogenous changes are given scope to work themselves out to some extent.

But there is no more basis in Mises's work for Kirzner's idea of real-time equilibration than there is for Hayekian proximal equilibrium. As Mises emphasized, it is impossible to determine and meaningless to suggest that the real economy is closer to the FSR, and therefore manifests a superior coordination of plans and greater allocative efficiency, at one instant of time than it was at a previous instant. For Mises, each moment that passes introduces fresh exogenous changes into the system which impinge upon and reorient the ongoing market process toward a new FSR. As a result, very little can be established about the progress of any one of the host of individual adjustment processes that compose the market process. In fact the very idea of a single, compartmentalized adjustment process is no more than a useful analytical fiction which permits the economist to make sense of the overwhelmingly complex phenomena of the unitary market process. In Mises's words, "The various adjustment processes are in reality not isolated. Synchronously an indefinite number of them take their course, their paths intersect, and they mutually influence one another. To disentangle this intricate tissue and to observe the chain of actions and reactions set into motion by a definite change of the data is a difficult task for the historian's understanding and the results are mostly meager and questionable."[30]

[28]Israel M. Kirzner, *The Meaning of the Market Process: Essays in the Development of Modern Austrian Economics* (New York: Routledge, 1992), pp. 38–39.

[29]However, if Kirzner's standards for efficiency are relatively undemanding and are met by even small movements of the market process toward his ideal of perfect plan coordination, then this criticism loses its force. I am indebted to David Gordon for enlightening me on this point.

[30]Mises, *Human Action*, p. 653.

In the alternative interpretation of Mises's view of the market process that I have been expounding, the notion of allocative efficiency has nothing to do with the Hayekian criterion of plan coordination. Rather, it derives from an analysis of principles of purposeful behavior. Thus, from the *ex ante* standpoint, the market economy is perfectly efficient, because entrepreneurial decisions based upon monetary calculation always result in the appraisement and allocation of resources in strict accordance with anticipated consumer preferences, in the same manner in which the choices of an individual actor produce a pattern of resource use reflecting his value ranking of expected satisfactions. Thus the Böhm-Bawerkian law of costs, according to which the money price of each and every resource always corresponds to the lowest appraised of the employments for which its available quantity just suffices, i.e., its expected marginal revenue product, is the perfect catallactic equivalent of the law of marginal utility that governs autistic exchange. Far from being trivial, this concept of *ex ante* efficiency is indispensable for distinguishing the unhampered market economy from other conceivable methods of organizing social cooperation under a division of labor. Thus a completely centrally-planned industrial economy is impossible of realization because, in the absence of actual exchange of productive factors and genuine factor prices, the planners are unable to "cost" and therefore purposefully or efficiently allocate the given resources under their control in accordance with even their own known scale of ends valuation.

The criterion of social welfare that is implicit in Misesian catallactics is therefore "Böhm-Bawerk efficiency," which emphasizes the role of monetary calculation in enabling individuals to rationally evaluate and allocate the means at their disposal when pursuing their goals through social action, i.e., action that makes use of voluntary exchange and the social division of labor to realize its aims. Whereas Pareto efficiency and its Hayek-Kirzner plan coordination variant represent unrealizable standards—because based on perfect information and foresight—for evaluating the social *outcomes* of the choice process, Böhm-Bawerk efficiency invokes an ideal but attainable standard, i.e., the efficient *ex ante* allocation of resources by an individual choosing under uncertainty, and indicates the day-to-day coordinated functioning of the economy that results when the institutional *preconditions* of monetary calculation and, therefore, of rational social action are fulfilled. Judged by this criterion, the erroneous forecasts and malinvestments that sometimes characterize entrepreneurial choices are not proof against the efficiency of the real-world market; the market is efficient

because it enables individuals to calculate and therefore to make meaningfully choices to reap the overwhelming benefits described by the law of comparative advantage and not because it yields absolute or approximate certitude about the outcomes of these choices (which is, in any event, also denied to autarkic choosers). In sum, the unhampered market is *socially* efficient because it provides the incentive for social action by establishing a tight producer-consumer nexus that gives full sway to consumer choice in determining the allocation of resources.[31] On the other hand, any coercive intervention into the market, which necessarily distorts or annuls its intricate calculational nexus coordinating consumer preferences and entrepreneurial choices, *ipso facto* generates a less efficient allocation of resources, i.e., one that does not completely and exclusively reflect the anticipated preferences of the participants in the social division of labor, and lowers social welfare. We may thus conclude that every act of intervention unambiguously lowers social welfare.[32]

Regarding *ex post* efficiency, the market economy is once again on all fours with the autarkic economy, with entrepreneurial errors and inefficiencies in production the inevitable product of uncertainty and change. However the market economy does embody a process which operates to minimize such errors and efficiencies. This is what Mises calls the "selective process," which is continuously and actually operating in calendar time via monetary profits and losses to weed out

[31]Mises, of course, vigorously upheld "consumer sovereignty" as the operating principle of the unhampered market economy, while demonstrating the coordinative property of the market's price structure and its indispensability to economic calculation and rational social action. However, curiously, he never attempted to derive a formal criterion of social welfare from these elements.

[32]Murray N. Rothbard (*Toward a Reconstruction of Utility and Welfare Economics* [Burlingame, Calif.: Center for Libertarian Studies, 1977]) has ably demonstrated on purely scientific grounds that government intervention always fails to increase social welfare. In advancing to our more radical conclusion, we are able to completely discount any gains, in terms of direct utility or exchangeable goods, that accrue to the interveners and their beneficiaries, while remaining safely within the bounds of strict *Wertfreiheit*. The concept of Böhm-Bawerk efficiency is only concerned with the utility that derives from actions that take place completely within the social nexus, that is, the utility of "productive" consumers who earn income—and only to the extent that they earn this income—through voluntary exchange. Since it is the prospective or *ex ante* utility to be derived from acts of consumption that provides the rationale for individuals to participate in the social division of labor, it is their preferences and demands that must serve as the sole and ultimate standard of socially efficient resource use. Thus, for example, the redistribution of income to "nonproductive" consumers may be represented as a net siphoning off of resources from society that reduces the utility of at least some of its members and weakens their incentives for social action. The market demands of the nonproductive recipients of these resources then can be treated as falsifying monetary calculation and fostering a socially inefficient reallocation of productive resources.

from the market the relatively unastute and inefficient entrepreneurs while transferring the power to choose the best uses and technical combinations of productive resources to the more farsighted and technically proficient entrepreneurs.[33]

In the Kirznerian interpretation there is no clear and meaningful distinction drawn between *ex ante* and *ex post* efficiency because the entrepreneur as *homo quaerens* never confronts the moment of choice, which would involve him in the purposeful allocation of resources or "Robbinsian economizing." Nor, for the same reason, can the historical market process in this interpretation possess a means of systematically eliminating less successful entrepreneurs and shifting control over productive processes to the more successful. Never burdened with the necessity of *choosing*, discoverer-entrepreneurs need never place any resources at risk of loss in *deciding* to seize a profit opportunity. In criticizing the term "decision-making" which had come into vogue along with other technocratic jargon in the 1950s, Mises pointed out that the term is "designed to divert attention from the fact that what matters is not simply to make a choice but to make the best possible choice. This means: to proceed in such a way that no less urgently desired end should be satisfied if its satisfaction prevents the attainment of a more urgently desired end."[34] Given the obvious importance that Mises attaches to purposeful choice in his praxeology and catallactics, it is difficult to fathom that he would have acquiesced in an interpretation of his view of the market process that assigns the central role to a nonchoosing entrepreneur.

Perhaps one of the more unfortunate consequences of the homogenization of Mises's and Hayek's thought is manifested in the common tendency of current Austrian economists to formulate their entire research program in terms of a dictum uttered by Hayek, while uncritically attributing support for such a program to Mises. The dictum to which I refer is Hayek's oft-quoted remark that "it is probably no exaggeration to say that every important advance in economic theory during the last hundred years was a further step in the consistent application of subjectivism."[35] For Mises, however, the goal of theoretical research in economics was not to simply "extend subjectivism," but to elucidate the crucial link between the subjective realm of individual purpose and valuation and the social pricing

[33]On the selective process, see Mises, *Human Action*, pp. 311–15.

[34]Ludwig von Mises, *The Ultimate Foundations of Economic Science: An Essay on Method*, 2nd ed. (Kansas City: Sheed Andrews and McMeel, 1978), p. 69.

[35]F. A. Hayek, *The Counter-Revolution of Science: Studies on the Abuse of Reason*, 2nd ed. (Indianapolis: Liberty*Press*, 1979), p. 52.

process that provides the objective data for economic calculation. According to Mises, such an endeavor must begin with "that brilliant achievement of the classical economists . . . essentially a theory of calculated action" and then broaden it into a "a system dealing with all human choices, a general theory of action."[36] Elsewhere Mises wrote that "supply and demand are only the links in a chain of phenomena, one end of which has . . . visible manifestation in the market, while the other is anchored deep in the human mind."[37] A further indication that Mises perceived the task of modern economics to be that of explicating the connection between individual purpose and the objective catallactic foundations of society is Mises's letter to Hayek in which he relates that he was initially undecided whether to entitle his *magnum opus Human Action* or *Social Cooperation.*

Richard M. Ebeling's contribution to the volume "Variations on the Demand for Money Theme: Ludwig von Mises and Some Twentieth-Century Views" (pp. 127–38) exemplifies this confusion of research programs. Ebeling gives a very good account of the essential differences between Mises's cash-balance approach to the demand for money, which derives from Carl Menger, and the Cambridge cash-balance approach as formulated in the writings of A. C. Pigou and drawn from the "oral tradition" which had been initiated by Alfred Marshall. Ebeling then proceeds to analyze the neo-Keynesian and monetarist macroeconomic approaches from the perspective of the methodologically individualistic Misesian approach, criticizing the propensity of both monetarists and Keynesians to argue in terms of the stability or instability of the aggregate demand for money. Unfortunately, in his critique, Ebeling throws out the demand-for-money baby with the stability bathwater, arguing that "from Mises's perspective, it is inappropriate to speak about *the* demand for money and *its* stability" and that "to speak of the community's 'aggregate demand for money' is not only methodologically unsound, but analytically incomplete" (pp. 135, 137).

Contrary to Ebeling's assertion, however, Mises did indeed hold that individual demands for cash balances could and should be aggregated into an overall market demand schedule for money. Thus, while he warned that investigation into the demand for money could not "begin with the demand for money of the community," he fully accepted the legitimacy of aggregating the individual demands into a social demand, declaring that "[t]he demand for money of the

[36]Mises, *Human Action,* p. 231.

[37]Ludwig von Mises, *The Theory of Money and Credit,* H. E. Batson, trans., 2nd ed. (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1971), p. 131.

economic community is nothing but the sum of the demands for money of the individual economic agents composing it."[38] While such a seemingly innocuous aggregate of homogeneous quantities may very well violate some unwritten canon of the Hayekian "subjectivist" paradigm, Mises clearly recognized that without reference to *the* demand for and supply of money it would be impossible to carry out the core of his own research program: integrating value and monetary theory to permit the explanation of the unified structure of money prices whose existence is the *sine qua non* for economic calculation and the purposeful allocation of resources within the framework of an economy based upon the division of labor.

In support of his anti-aggregation interpretation, Ebeling adduces Mises's insights that: (1) the purchasing power of money is not a single price but an array of the alternative quantities of the various goods which the monetary unit commands in exchange and (2) changes in the supply of money never affect the elements of this purchasing-power array simultaneously and equiproportionally and therefore invariably result in permanent redistributions of real income and wealth (p. 136). But, as Mises clearly recognized, these important insights establishing the nonneutrality of money are not relevant to the question of whether or not money-demand schedules may be properly aggregated across individuals; rather, they speak to the issue of the shape of the aggregate demand curve for money, leading to the conclusion that such curves can never be rectangularly hyperbolic.[39]

Although reluctance to employ the concept of a social demand for money cannot properly be attributed to Mises, it can be detected in Hayek's early works on business cycle theory. Thus, in *Monetary Theory and the Trade Cycle*, Hayek criticizes Menger and Mises for "including in the theory of the value of money *all* influences of money on prices."[40] In effect, Hayek is reproaching Mises in particular for attempting to provide an integrated analysis of variations in the supply of money in terms of both their systematic effects on relative prices and their effects on the height of overall prices, rather than just concentrating on the former type of analysis which Hayek considers the "far more important task" of monetary theory.[41] In *Prices and Production*, Hayek goes even further to encourage the realization by monetary theorists of "the superfluity of the concept of a general value of money, conceived as the reverse of some price level." He goes

[38]Ibid., pp. 131–32.

[39]On this point, see Salerno, "Mises's Monetary Theory," pp. 19–33.

[40]Hayek, *Monetary Theory and the Trade Cycle*, p. 117, n.

[41]Ibid.

on to write that the type of monetary theory whose development he looks forward to "will be no longer a theory of the value of money in general, but a theory of the influence of money on the different ratios of exchange between goods of all kinds."[42] Lest it be thought that Hayek is here objecting only to the concept of a statistical price level, it should be noted that his critique of Menger and Mises was advanced despite his explicit recognition that their notion of the general value of money ". . . has nothing to do with any measurable value, in the sense of some price level."[43] By challenging the very notion of the general purchasing power of money, Hayek, of course, is implying the uselessness of the concept of an aggregate demand for money.[44]

In contrast to the Wieser-Hayek position,[45] however, Mises held that the social appraisement of productive factors via entrepreneurial competition in resource markets, which is the very basis of economic calculation and purposive action, can only proceed in monetary terms.[46] Thus, in the course of estimating the expected marginal revenue products of the various inputs into his planned production processes and determining what prices to bid for them, the entrepreneur cannot help but estimate the absolute height of prices, i.e., the general purchasing power of money, because the exchange ratios between the various present goods and between present and future goods, i.e., Hayek's all-important "relative prices," are and must be embedded in the structure of money prices. Or, to put it another way, money's nonneutral effects on the economy operate only through the medium of *money* prices.

These considerations tend to be lost sight of when focusing on Hayekian proximal equilibrium because, outside of an uncertain and changing world, there is no need for a monetary appraisement process to continually revolutionize and recreate the price structure; in proximal equilibrium, money plays the role of a shadowy *numeraire*, and efficient action depends only on entrepreneurs knowing the currently prevailing configuration of relative prices, which serves as a good, if

[42]F. A. Hayek, *Prices and Production*, 2nd ed. (New York: Augustus M. Kelley, 1967), p. 29.

[43]Hayek, *Monetary Theory and the Trade Cycle*, p. 117, n.

[44]As Hayek ("On Neutral Money," p. 161) concludes, ". . . the theoretical concept of neutral money, which relates to the influence of money upon the price relationships [simultaneous and intertemporal] determined by real factors, cannot bear any relation at all to the concept of some 'price level' [even if this concept is introduced merely implicitly in the form of a 'demand for money' related to a definite price level]."

[45]As set forth in Hayek, "Some Remarks on the Problem of Imputation."

[46]See Mises, *Human Action*, pp. 331–38, for an explanation of the distinction between imputation and appraisement as these processes relate to the valuing of higher-order goods and of the relevance of this distinction for economic calculation.

not perfect, indicator of their likely future configuration. For Hayek, it is only when the money spending stream expands or shrinks that it has a nonneutral impact on the economy by causing reversible changes in the ruling barter rates of exchange and jarring the economy temporarily out of its proximal equilibrium. For Mises, on the other hand, it is only the existence of a real and tangible medium of exchange, with a market and, hence, a driving force all its own, that permits the operation of market processes at all. From Mises's standpoint, then, it is not the inescapable fact of money's inconsistency with an imaginary state approximating equilibrium but monetary intervention misdirecting the dynamic appraisement process that falsifies entrepreneurial calculations, undermines efficient resource allocation, and discoordinates the economy.

Sanford Ikeda's contribution, entitled "The Dynamics of Government Intervention: Theory and Implications" (pp. 201–12), is an interesting and original effort to formulate "a more systematic theory of what can be called the 'interventionist process'" that takes Mises's critique of interventionism as its point of departure (p. 202). What Ikeda seeks is to integrate the Misesian critique with public choice theory as a means of explaining the observed "ebb and flow of government growth," featuring prolonged periods of progressive deregulation alternating with periods of increasing interventionism, with neither the deregulatory phase nor the interventionist phase ever culminating in complete laissez-faire or thoroughgoing socialism, respectively (pp. 203–4).

In analyzing the "Misesian interventionist dynamic" which drives the process, however, Ikeda resorts to the Kirznerian discovery view of entrepreneurship, wherein the entrepreneur "serves a social function by [unintentionally] solving the knowledge problem" (pp. 204–5). By discovering and arbitraging discrepancies between simultaneously existing prices of the same or virtually the same goods, the entrepreneur repairs the gaps in knowledge of decentralized market participants and better coordinates their individual buying and selling plans. As I argued above, however, this view is at odds with Mises's theory of entrepreneurship, which focuses on the entrepreneur's function of *calculating* the most valuable uses of currently available inputs on the basis of *anticipated* output prices.

Ikeda also uses the Hayekian concept of "unintended consequences" to describe the outcome of single acts of intervention, and he characterizes the interventionist process as an "unintended process" (p. 205). From the Misesian perspective, however, the motivation for the various acts of intervention is precisely those immediate benefits that are intended by its proponents. And while Mises admits

that there may be "unforeseen" long-run consequences of any intervention, he attributes them not to an inevitable and irremediable condition associated with the Hayekian "knowledge problem," but to antisocial and deliberately obscurantist ideologies that blind the masses to the conclusions of economic theory.

Moreover, Mises's analysis of the interventionist process does not preclude the possibility that the proponents of an intervention recognize and intend its generally unforeseen consequences. Thus unions support minimum wage laws precisely because these laws price low-skilled workers out of the labor market and increase the demand for skilled union workers, while bureaucrats manning municipal rent-control boards may welcome the growing apartment shortage resulting from rent control because it increases their power, prestige, and the value of the favors they can bestow. Indeed, it is precisely the goal of many radical environmentalists to cripple capital formation and productivity and to bring about a decline of real income and population via environmental regulations. The very crises which regularly recur as the interventionist process proceeds also may be desired by those who are ideologically committed to the extension of political control over the economy.

Finally, I contend that Ikeda is simply incorrect when he asserts that "the reasoning underlying [Mises's] critiques of both socialism and interventionism [is] the same—the existence of the knowledge problem makes the consequences of government intervention nasty and unexpected" (p. 208). First, as Mises emphasizes time and again throughout his writings, "economic calculation," and not knowledge, is the "essential and unique problem of socialism."[47] Thus, according to Mises, even if the central planning board was endowed with full and perfect knowledge of the relevant economic data, without recourse to monetary calculation using genuine market prices, it would not be able to determine the optimal among the infinitude of possible uses and technical combinations of the available factors of production.[48] Second, as I have just pointed out, from the Misesian perspective, the consequences of an intervention are not necessarily "unexpected" to its active promoters and beneficiaries and need not continue to be so to the masses it victimizes.

In his essay on "Mises on Free Banking and Fractional Reserves" (pp. 517–33), Lawrence H. White interprets Mises's advocacy of free banking based on fractional gold reserves as a program for economiz-

[47]Ibid., p. 703.

[48]For a review of Mises's argument on this point, see Salerno, "Postscript: Why a Socialist Economy Is Impossible," pp. 52–54.

ing on the resource costs of supplying the medium of exchange while insuring that the issuance of fiduciary media is regulated in accordance with the desideratum of a neutral money, i.e., a money that does not impinge upon or distort the underlying real processes of the economy. It was Adam Smith, the acknowledged father of free banking, who introduced into monetary theory the proposition that a pure specie money involved a waste of scarce resources, while it was Hayek who originated the concept of, if not the term, "neutral money." According to Hayek in his most mature writings, the "nearest practical approximation" to such an admittedly "fictitious" ideal is a monetary system in which "increased demand for liquidity" is met by increases in the money supply aimed at maintaining stability of an index of raw materials prices that serve as a proxy for the average prices of the original factors of production, land and labor.[49] Assuming no increase in the stocks of the original factors, the practical attainment of Hayek's monetary ideal would result in "constancy of the money stream,"[50] which, not coincidentally, also happens to be the desired goal of modern free bankers.[51]

In his paper, White characterizes Mises as the prototype of modern free bankers, who opposed any ban on competing private banks issuing fiduciary media redeemable in gold on demand on the grounds that ". . . such a ban (1) would make the economy more vulnerable to money demand shocks, and (2) would needlessly increase the cost of supplying the economy with media of exchange" (p. 528). As White notes, this interpretation of Mises's rationale for free banking clashes sharply with Murray Rothbard's argument that Mises favored free banking as a preferred means of suppressing the issuance of fiduciary media, because it circumvents the dangers associated with ceding virtual control over the banking system to government, a result that

[49]Hayek, *Denationalization of Money*, pp. 84.

[50]Ibid., p. 77.

[51]For the free banking argument in favor of maintaining "monetary equilibrium," defined in Hayekian terms as a constant aggregate spending flow, see George A. Selgin, *The Theory of Free Banking: Money Supply under Competitive Note Issue* (Totowa, N.J.: Rowman & Littlefield, 1988), pp. 52–69. I should note that nowhere in his essay does White invoke the Hayekian concept of "neutral money." In fact, in another essay, White expresses mild skepticism about whether a free banking system is fully compatible with any macroeconomic norm including Selginian monetary equilibrium, although he seems to count it as a merit of the system's operation that it comes relatively closer to obeying this norm in practice than the central banking alternative. See Lawrence H. White, "Commentary: Norms for Monetary Policy," in Ebeling, *Austrian Economics*, p. 477 . Nonetheless, as I shall argue below in the text, the goal of "avoiding monetary demand shocks," which White imputes to Mises as a reason for supporting free banking and which White himself is obviously sympathetic to, is tantamount to stabilization of the money-spending stream.

Mises believed might be entailed by an outright legal prohibition of fractional reserves.

In fact, White's interpretation of Mises's views on fractional reserves and free banking is based on his unwarranted, if unintentional, homogenization of Mises with Smith on the question of the criteria of an ideal monetary system. White falls into error because he overlooks important passages in the very works of Mises that he cites, and because he ignores significant developments in Mises's theory of money that occurred between the publication of the first German edition of *The Theory of Money and Credit* in 1912 and the publication of *Nationalökomie* (the German language forerunner of *Human Action*) in 1940. In his 1940 work, Mises tells us, his "monetary theory achieve[d] completion" with the merger of "the theory of indirect exchange with that of direct exchange into a coherent system of human action.[52] These developments resulted in an important modification of Mises's earlier assessment of the relative benefits and costs of fiduciary media that is not acknowledged by White.

As White correctly points out (pp. 520–22), in *The Theory of Money and Credit*, Mises identifies three significant benefits of the issuance of fiduciary media. The first benefit involves the prevention of "convulsions" to economic activity that would have occurred in the absence of an expansion of the money supply caused by the creation of fiduciary media as a result of "an enormous extension of the demand for money" and the consequent increase in its purchasing power that was brought about by the historical extension of the money economy. The second benefit is the familiar Smithian one of reducing the "cost of the monetary apparatus." And the final benefit of fiduciary media is that their issuance sufficiently enhanced the profitability of the credit activities of the banking system early in its history to permit its survival and growth. The only disadvantage of fiduciary media that Mises recognized in this book, according to White, is a relatively minor one: the risk of default by the issuing bank due to mismanagement or bank runs. Thus White concludes that Mises "viewed fractional-reserve banking as a natural and desirable development in a free society" (p. 522).

But White's conclusion is mistaken, attributable to his failure to fully come to terms with one of Mises's most famous contributions to economic theory: his demonstration of the causal link between fiduciary media and the business cycle. White (pp. 524–25) evidently holds that according to Mises business cycles are generated by the

[52]Mises, *Notes and Recollections*, p. 112.

overexpansion of fiduciary media by central banks unrestrained by competitive market forces. However, Mises's chapter on the business cycle, following directly upon the chapter enumerating the benefits of fiduciary media which White cites in support of his own interpretation,[53] makes it pellucidly clear that the necessary and sufficient cause of the cycle is the unsustainable divergence between the "loan" and "natural" rates of interest effected by the creation of fiduciary media. For Mises, then, cyclical discoordination of the economy is indeed a disadvantage to be counted against fiduciary media *per se*. Accordingly, it is only *after* fully discussing both the advantages and disadvantages of fiduciary media, that Mises, in a section comprising the concluding five pages of the book—which is not referred to by White—addresses the "basic questions of future currency policy."[54] Here, Mises reprints the conclusion of the first German edition (the English edition is a translation of the second German edition published in 1924), in which he emphatically urged the suppression of all further creation of fiduciary media, if not the outright banning of fractional-reserve banking. Contrary to White's assertion, Mises was evidently convinced that the disadvantages of issuing fiduciary media, now including their cycle-generating property, far outweighed their earlier enumerated advantages.

Concludes Mises:

> [Fiduciary media] should logically be subjected to the same principles that have been established with regard to money proper; the same attempts should be made in their case as well to eliminate as far as possible human influence on the exchange ratio between money and other economic goods. The possibility of causing temporary fluctuations in the exchange ratios between goods of higher and of lower orders by the issue of fiduciary media, and the pernicious consequences connected with a divergence between the natural and money rates of interest, are circumstances leading to the same conclusion. Now it is obvious that the only way of eliminating human influence on the credit system is to suppress all further issue of fiduciary media. The basic conception of Peel's Act ought to be restated and more completely implemented than it was in the England of his time by including the issue of credit in the form of bank balances within the legislative prohibition.

[53]Mises's discussion of the advantages of fiduciary media occurs on pages 298–99 and 323, while his business cycle theory is presented on pages 339–66 (Mises, *Theory of Money and Credit*).

[54]Ibid., p. 406.

> *It would be a mistake to assume that the modern organization of exchange is bound to continue to exist. It carries within itself the germ of its own destruction; the development of fiduciary media must necessarily lead to its breakdown.* . . . It will be a task for the future to erect safeguards against the inflationary misuse of the monetary system by the government and against the extension of the circulation of fiduciary media by the banks.[55]

It is hardly to be concluded from the passage I have emphasized in the foregoing quotation that Mises looked with equanimity, let alone favor, upon the further creation of fiduciary media by banks, whether "free" or not.

White (p. 520) cites a part of a paragraph from a later, 1928 work of Mises's,[56] in which Mises reiterates the point that a suppression of the issue of fiduciary media would have given rise to historical situations in which the emergence of an excess demand for money resulted in an increase in the purchasing power of money that was temporarily disadvantageous to the economy. However, White does not cite the last sentence of this same paragraph, which identifies an important benefit that would have followed from the prohibition of further emission of fiduciary media: "the economy surely would not then have experienced the stormy upswings followed by dramatic reversals of the upswings into crises and declines."[57]

Mises also makes it clear later in the same work that the benefits of fiduciary media fall far short of their costs in terms of cyclical discoordination of economic activity. He therefore calls for the implementation of a revised Currency school program in the following terms:

> The most important prerequisite of any cyclical policy, no matter how modest its goal may be, is to renounce every attempt to reduce the interest rate, by means of banking policy, below the rate which develops on the market. That means a return to the theory of the Currency school, which sought to suppress all future expansion of circulation credit and thus all further creation of fiduciary media. . . . [I]t means the introduction of a new program based on the old Currency school theory, but expanded in the light of the present state of knowledge to include fiduciary media issued in the form of bank deposits.[58]

[55]Ibid., p. 407–09.

[56]The English translation is Ludwig von Mises, "Monetary Stabilization and Cyclical Policy," in idem, *On the Manipulation of Money and Credit*, Bettina Bien Greaves, trans. (Dobbs Ferry, N. Y.: Free Market Books, 1978), p. 145.

[57]Ibid.

[58]Ibid., pp. 167–68.

Far from rejecting the Currency school program, as White would have us believe, it is clear Mises desired to reformulate it on a sounder theoretical basis in order to strengthen its practical application. Thus, contrary to White, Mises supported a free banking regime precisely because it would eventually result in "extreme restraint in the issue of fiduciary media." Free bankers would learn such restraint from their experiences of the crises and bank runs that would inevitably occur during the historical course of development of fiduciary media. Once such lessons were absorbed by the more astute banking entrepreneurs, policies of extreme caution and restraint would be enforced on the entire banking system as less responsible banks persisting in the further creation of fiduciary media would be immediately confronted by the twin threats of adverse interbank clearings and of loss of confidence by a once or twice chastened and now more sophisticated bank clientele.[59] At this point the program of the Currency school would be fully and properly implemented, as further extension of "circulation credit" by the banks would be checked and any additional accumulation of bank assets would reflect an increase in commodity credit based on time deposits and equity investments of voluntarily saved funds.

Unlike our modern free bankers, Mises emphatically did not foresee the free banking system evolving toward a minuscule reserve ratio of gold to demand liabilities and the progressive transformation of gold into a practically demonetized interbank "clearing asset."[60] For Mises, rather, evolution was all in the opposite direction, with initial entrepreneurial ignorance precipitating an early splurge in the creation of fiduciary media and the resulting cyclical fluctuations leading slowly back to a system of marginal 100 percent reserves while painfully renewing awareness among the public that bank notes and deposits are not money *per se* but merely claims to and substitutes for money, i.e., gold.

In his earlier writings, then, Mises did perceive there to be definite advantages associated with the issue of fiduciary media, but

[59]Ibid., pp. 138–40.

[60]Lawrence H. White and George A. Selgin, "The Evolution of a Free Banking System," in Lawrence H. White, *Competition and Currency: Essays on Free Banking and Money* (New York: New York University Press, 1989), p. 235. At least one prominent member of the modern free banking school, Richard H. Timberlake (*Gold, Greenbacks, and the Constitution* [Berryville, Va.: George Edward Durell Foundation, 1991]) has taken the leap and now forthrightly advocates free banking on a nonspecie standard, although White himself continues to firmly insist upon gold as the proper monetary standard for a free banking regime. For a critique of Timberlake's plan, see Murray N. Rothbard, "Aurophobia: or, Free Banking on What Standard?" *Review of Austrian Economics* 6, no. 1 (1992): 97–108.

he was willing to forego such advantages for the greater advantage of maintaining the integrity of monetary calculation and preventing disruptions of the price-and-interest-rate coordination of the economy. By the time he came to write *Human Action*, however, his views on entrepreneurship, monetary calculation, and money had evolved to the point where he was able to recognize that the benefits he had once attributed to the creation of fiduciary media were largely illusory. In particular, the later Mises abandoned his earlier belief that an increase in the purchasing power of money is somehow disadvantageous for the market economy.

Regarding a world in which there occurs a persistent "goods-induced" rise in the purchasing power of money resulting from secular growth in the supplies of commodities and services in conjunction with a rigidly fixed nominal money supply, Mises argued in *Human Action* that such a state of affairs would not disrupt the moment-to-moment price coordinating function of the market or upset the monetary calculations that lead entrepreneurs to efficiently allocate productive resources in service of anticipated consumer preferences.

As Mises wrote:

> Entrepreneurs and investors . . . do not heed the general movement of all prices. What matters for them is the existence of discrepancies between the prices of the complementary factors of production and the anticipated prices of the product. No businessman embarks upon a definite production project because he believes that *the prices*, i.e., the prices of all goods and services, will rise. He engages himself if he believes that he can profit from a difference between the prices of goods of various orders. In a world with a secular tendency toward falling prices, such opportunities for earning profits will appear in the same way in which they appear in a world with a secular trend toward rising prices. . . .
>
> A secular tendency toward a rise in the monetary unit's purchasing power . . . would certainly not influence substantially the course of economic affairs. It would not remove the urge of people to improve their material well being as far as possible by an appropriate arrangement of production. It would not deprive the economic system of the factors making for material improvement, namely, the striving of enterprising promoters after profit and the readiness of the public to buy those commodities which are apt to provide them the greatest satisfaction at the lowest costs.[61]

[61]Mises, *Human Action*, pp. 469–70.

Nor does the later Mises share with Hayek and the free bankers a dread of "monetary demand shocks," i.e., a "money-induced" increase in the purchasing power of money caused by a shrinkage of the money-spending stream due to hoarding. In particular, Mises denies that an increase in the demand for money at the expense of spending on consumer goods while the money supply remains unchanged will impede the process of transforming the additional real savings thus generated into an accumulation of new capital goods. Monetary calculation, taking into account the relative decline in prices of lower-order and consumer products and of the nonspecific factors of production, will faithfully reflect the increase in the availability of capital goods, and the prospect of higher profits will induce entrepreneurs to employ them in the expansion of their operations. As Mises concludes, "the main thing is that the capital goods resulting from additional savings are not destroyed by coincident monetary changes. . . . Whenever an individual devotes a sum of money to saving instead of spending it for consumption, the process of saving agrees perfectly with the process of capital accumulation and investment. It does not matter whether the individual saver does or does not increase his cash holding."[62] For the Misesian, then, the coordinative and calculative market process can and will respond with perfect (*ex ante*) efficiency to any combination of anticipated changes in the set of consumer preferences, including changes in "liquidity" preferences.[63]

This leaves us, finally, only with the advantage of fiduciary media in reducing the cost of supplying a medium of exchange. Although, as White notes, Mises was inclined to heavily weight this alleged advantage in his earlier writings, in *Human Action*, Mises does not allude to it; however, he does refer to "the expensiveness of gold production" as "the minor evil" when compared to the inflationary potential of paper fiat and credit money.[64]

Of course, in *Human Action*, Mises still adhered to his previous view concerning the overwhelming disadvantage of the creation of fiduciary media associated with its potential for falsifying interest rates and monetary calculation, introducing inefficiency into the

[62]Ibid., pp. 521–22.

[63]For a demonstration of this, see Salerno, "Commentary: The Concept of Coordination in Austrian Macroeconomics," pp. 335–40.

[64]Mises, *Human Action*, p. 422. In fact, when free banks invoke option clauses, post-dated notes, and other devices permitting the contractual suspension of specie payments, their notes and deposits are effectively transformed into a credit money, whose value is determined independently of the value of the original money commodity. For a discussion of Mises's neglected concept of credit money that touches upon this point, see Salerno, "Mises's Monetary Theory," pp. 8–11.

intertemporal allocation of resources, and precipitating the business cycle. This later assessment of the massive imbalance in favor of the disadvantages of fiduciary media may finally have led Mises to overcome his earlier fears of the expansion of political interference with banking that he foresaw as a possible ramification of the ultra-hardcore neo-Currency school program legally debarring all further additions to the outstanding circulation of fiduciary media, including demand deposits as well as notes. Thus, in his 1952 essay on "Monetary Reconstruction," which was included as Part Four in the second English edition of *Theory of Money and Credit*, Mises proposed just such a program as the basis for "the United States return to a sound currency."[65]

I conclude, then, that White's attempt to portray Mises's views on fractional reserves and free banking as prototypical of the modern free banking school, whose members draw their analytical orientation from equilibrium-based Hayekian monetary theory, is untenable. To the extent that Mises advocated the freedom of banks to issue fiduciary media, he did so only because his analysis led him to the conclusion that this policy would result in a money supply strictly regulated according to the Currency principle. Mises's desideratum was not a neutral money, or even a practical approximation thereof, but to completely eliminate the distortive influences of fiduciary media on monetary calculation and the dynamic market process.

As I indicated at the outset, my purpose in writing this review essay has been specifically to illustrate and rebut the common tendency that I believe exists among fellow Austrian economists to conflate the views of Mises and Hayek. Rigid adherence to this purpose has caused the tone of the review to be decidedly negative. However, this should not be construed to mean that I disagree with all or even most of each of the essays under review. Had I reviewed these papers with a broader purpose in mind, the extent of the common ground between myself and the papers' authors, based on the "Mengerian overlap" between the Misesian and Hayekian paradigms, would have been quite evident. Moreover, I regard the contributions by Kirzner and White to this volume to be, each in its own respect, excellent summaries of these authors' pioneering efforts elsewhere to systematize and extend the Hayekian paradigm. In the case of Kirzner, it can be argued that his formidable body of work

[65]Mises, *Theory of Money and Credit*, pp. 448–52.

largely defines this paradigm as it currently stands. And the endeavor by White and the modern free banking school to give this paradigm a contemporary macroeconomic expression rests on the Kirznerian conception of the market process. Ikeda's essay, his attributions to Mises notwithstanding, is a promising initial step in the direction of adumbrating a Hayekian theory of interventionism, and Ebeling's essay, for the most part, does capture the uniqueness and fruitfulness of the Misesian approach to the demand for money. Having said this, I still insist that the homogenization of the views of two brilliant but very different thinkers serves no purpose today but to significantly impede the quest for knowledge and truth among those working within the Mengerian tradition.

Book Reviews

Capitalism and Individualism. By Tibor Machan. New York: St. Martin's Press, 1990.

Tibor Machan is not the philosopher than whom no more productive can be conceived—that distinction belongs to Nicholas Rescher. But no other philosopher rivals Machan in his relentless stream of books, articles, and—not to be forgotten—letters to the editor in defense of a free society. *Capitalism and Individualism* ranks as one of Machan's best works. Its thesis deserves to arouse wide discussion among economists.

Although most American economists look favorably on the free market, Machan finds their characteristic defense of it lacking. As he sees it, economists uncritically assume that morality is not objective. Values consist entirely of subjective preferences, no more and no less.

This position appears to place its advocates in a difficult position. If they wish to support a particular social policy, are they not merely expressing their preferences? Why should others listen? Economists such as Milton Friedman and James Buchanan who favor moral subjectivism claim that they nevertheless can adequately defend the free market.

They assume that most people want material wealth. Given this goal, the economists can prescribe the method that offers the best chance toward its attainment. But goals are not confined to material wealth, important as this ranks. People wish to realize their preferences, whatever they may be, and the free market enables them to do so better than any alternative system. Every trade makes people better off from their own point of view.

Machan finds this approach "weighed, and found wanting in the balance." It rests, he thinks, on reductivist materialism and denies free will. Besides depending on these dubious philosophical underpinnings, the view fails on its own terms. People are not always better off when they make an exchange: is a drug addict better off when he

The Review of Austrian Economics Vol.6, No. 2 (1993): 149–51
ISSN 0889-3047

buys narcotics (p. 10)? Further, many people do not rank material wealth first above all else. If the "neo-Hobbesians" then shift to the claim that people in the free market select their highest valued preference, whatever it is, they have arrived at a tautology. Finally, the economists' defense of the market does not inspire people. Even so wrong-headed a philosophy as Marxism does better on this score.

What is one to think of Machan's provocative diagnosis? Machan seems to me entirely on target in challenging the uncritical assumption among many economists that value subjectivism is correct. I am less sure of his amalgamation of this view with materialism and determinism. Value subjectivism, so far as I can see, implies neither of these doctrines. James Buchanan, one of Machan's prime targets, advocates free will; and Ludwig von Mises, who to some extent fits Machan's model so far as value is concerned, supported dualism and free will as methodological assumptions. Nevertheless, I think Machan is right to assume some affinity between the various strands of the "neo-Hobbesian" account. The nature of the connection, if indeed it exists, needs to be spelled out.

Machan argues that those who say that we always choose our most highly valued preference have fallen into tautology. This seems to me mistaken. "Most highly valued preference" is not, after all, defined as "whatever we in fact choose," and some people, e.g., the proponents of satisficing rationality, deny that the statement is true. As they see it, we need only choose what is good enough: we need not select our highest ranked choice. Whether they are right is another question, but surely their contention is not self-contradictory. How then can the principle that we always choose our highest-ranking preference be empty of content?

Fortunately, this point does not much affect Machan's argument. Together with his criticism of the economists, he offers a proposal of his own. Defense of the market should rest on an explicit philosophy. It will come as no surprise that the philosophy Machan supports takes its chief inspiration from Ayn Rand.

Values in this system are objective, though not intrinsic. The world consists of multiple layers of being; he rejects mechanistic materialism in favor of a philosophy of emergence. Machan argues strongly for free will, citing the work of R.W. Sperry in its defense.

If people have freedom of choice, they bear responsibility for their actions. They are not passive products of changing circumstances. To meet their responsibilities, the cultivation of virtue is essential, and this vital task demands freedom for its realization. Attempts to impose virtue on others neglect this crucial condition. Here in essence

is Machan's argument for freedom: it rests on the requirements of virtue rather than the vagaries of skepticism.

Machan's case for freedom does not reject economic efficiency. Rather, he maintains that arguments based on economics require philosophical support. He contends that without such support, the calculation argument of Mises and Hayek achieves little. True enough, only a market economy can produce a wide variety of consumer goods efficiently. But what if the government does not care about this? It may demand that consumer tastes be sacrificed (pp. 120–21).

Machan quite correctly notes that not all regimes aim at consumer welfare. But the calculation argument does not assume the contrary. It applies as much to a dictatorship that wants tanks as it does to consumers who demand video games. The nub of the argument is that only a market can efficiently operate a structure of production. It deals with "higher order" goods rather than consumption.

If Mises is right, the efficiency argument case for the market has more strength than Machan allows. So long as the goals of people living in a modern society do not require economic chaos, their establishment of a socialist economy is irrational. If this is regarded as an argument against socialism, certain value judgments are assumed; but they hardly seem controversial. To make an economic case for the market, one need not put material wealth first. To accord it some weight suffices. (I have placed to one side the case of socialist regimes that can use the prices of capitalist economies.)

Several other remarks in the book seem dubious. Arrow's Theorem does not merely contend that intransitive preferences are possible: it sets forward certain conditions that *cannot* be mutually fulfilled (p. 126). Thomas Sowell's *Marxism* is not, except for its final chapter, anti-Marxist; Sowell defends Marx against Böhm-Bawerk's criticism (p. 10). Thomas Nagel does not contend prudence is irrelevant to morality. The principal argument of *The Possibility of Altruism* is that if prudence is rational, so is morality.

Although Machan sometimes errs in detail, his main contention in *Capitalism and Individualism* strikes home. Economists who reject moral objectivity need to examine their premises. Machan's hard-hitting book is a good place to begin.

David Gordon
Ludwig von Mises Institute

Swimming Against the Tide in Contemporary Philosophy. By Henry B. Veatch. Washington, D.C.: Catholic University of America Press, 1990.

In the past several years a number of economists centered at George Mason University have claimed to find an affinity between Austrian economics and certain types of Continental philosophy. Their views have not gone uncontested: Murray Rothbard and Hans Hoppe have assailed the "hermeneuticists" with characteristic vigor. I fear I am no unbiased witness, as I have played a minor part in the controversy.

Henry Veatch, a distinguished Aristotelian philosopher, advances in this excellent book an interpretation of modern philosophy which illuminates the controversy over hermeneutics. In addition, he presents a carefully conceived defense of Aristotelian ethics. Economists interested in welfare economics will find Veatch's discussion of ethics of substantial albeit indirect help to them. Often welfare economics conceals utilitarian premises, and Veatch subjects this ethical system to penetrating scrutiny. Although the book is a collection of separate essays, it is remarkably unified.

Like his master Aristotle, Veatch proceeds by a dialectical method. He means by this an analysis of the insights and errors of non-Aristotelian philosophers in order to "remove the obstacles" to what he deems the correct position (p. 6). It soon transpires that the rival philosophies contain much more error than insight.

Since Descartes, modern philosophy has refused to use as its starting point commonsense knowledge of the world. Descartes's methodic doubt changed the criterion of truth and had the effect of "transforming the everyday world . . . into a world that is largely unrecognizable by the commonsense and common experience of mankind" (p. 38).

The Review of Austrian Economics Vol.6, No. 2 (1993): 153–58
ISSN 0889-3047

Descartes and his rationalist successors failed in their quest to prove the existence of the external world and discover its nature through the use of deduction. Their empiricist counterparts were equally unable to show how one can gain knowledge of the real world if one is restricted solely to ideas or sensations.

Philosophy faced an impasse. Immanuel Kant claimed to have found an escape that would end the stagnation of philosophy and permit it to progress as a science. Veatch believes that the transcendental turn, as he calls Kant's proposal, was a disastrous mistake. Nevertheless, it has dominated subsequent philosophy.

In brief, Kant thought that we cannot know things as they are in themselves. Instead, the mind imposes a grid consisting of the categories and the intuitions of space and time upon reality. Although we cannot know the real world, we can know appearances, since our minds have created them.

Veatch finds in this turn to the subject the basis of relativism and irrationalism. Kant thought that everyone used the same categories. He claimed to derive them by a "transcendental deduction"; if he was right, people have no choice in their application of concepts to experience.

Kant's successors made the categories changeable and relative. This more radical form of the transcendental turn has an unbreakable hold on modern philosophy. Veatch uses the turn to explain Quine's philosophy and, more generally, contemporary philosophy of science. A "theory or hypothesis in science is accepted, ultimately, for scarcely any other reason than that it enables us to introduce at least some sort of order and intelligibility into what otherwise would be a sheer welter of experience" (p. 53).

The culmination of the turn lies in the utter irrationalism of the Deconstructionists. He sees this movement not as a mere Continental fad. It carries to an extreme tendencies present in modern philosophy from its inception. Deconstruction totally rejects external control over textual interpretation. The transcendental turn can at last go no farther.

Veatch argues that this movement has malign ethical consequences. Both Deconstruction and the pragmatism of Richard Rorty lead to "that total permissiveness that Nietzsche talked about so confidently and so brashly" (p. 92; question mark omitted).

Veatch's probing account of modern philosophy will seem familiar to readers influenced by Ayn Rand, who gives a similar account of the errors of modern thought. Although so far as I am aware the two did not know or influence each other, a number of Randian philosophers esteem Veatch highly.

Though Veatch's analysis is impressive in its scope and unity, a few doubts—not I hasten to add, Cartesian ones—come to mind. First, one gets the impression from Veatch's discussion that Descartes arbitrarily rejected commonsense beliefs. But would not Descartes respond that the skeptical issue he addressed is a genuine problem? How do we know that our experience gives us knowledge of the real world? Veatch I think would reply that all attempts to justify knowledge which start from doubt of commonsense have failed. Either we take as given that we perceive real things or we wind up in skepticism. *Tertium non datur.*

The effectiveness of this response depends on Veatch's success in showing that once skepticism is allowed in the door, it cannot be expelled. His criticism of Kant's transcendental turn is especially vital, since he sees the turn as basic to contemporary philosophy.

Veatch's evaluation of Kant, however, strikes me as disputable. He takes Kant to be saying, in effect: "We do not know reality: all that we know are appearances." Veatch rightly takes this view to lead to relativism and skepticism.

But this interpretation of Kant depends crucially on the equation of reality with things-in-themselves. Since the phenomenal world includes everything governed by the categories, it might be argued that the phenomenal world just *is* the commonsense world. If so, Kant did not then deny realism but affirmed it. I do not mean to endorse this view of Kant: there is a great deal to be said for Veatch's interpretation. But if the realistic view of Kant is right, Veatch needs to show that Kant's deduction of the categories fails. Otherwise, his indictment of the transcendental turn collapses.

In "Is Quine a Metaphysician?", Veatch attempts to use one of Quine's own arguments against him. The theme of the piece is that Quine has made Kant's transcendental turn. He imagines a Quinean objector who protests against his translation of "Quinese" into "Kantese" on the grounds of the radical indeterminacy of translation, a famous thesis of Quine's. Veatch replies by citing another Quinean view, the inscrutability of reference.

Veatch has misread the passage he quotes from *Ontological Relativity*. He thinks Quine claims that because "it makes sense to say even of oneself that one is referring to rabbits and formulas and not to rabbit stages and Gödel numbers, then it should make sense to say it of someone else" (p. 79, citing Quine, *Ontological Relativity*). But Quine's point is just the opposite. He thinks that because it does *not* make sense to say of someone else what he refers to, it does not make sense for someone to say it of himself.

Veatch also finds contemporary moral philosophy radically unsatisfactory. He draws the customary distinction between teleological and deontological theories. The latter fail utterly; the former require revision along Aristotelian lines.

Veatch approaches ethics with a fundamental assumption. No ethical judgments are self-evident. Claims that people have rights or obligations require justification: they cannot be simply taken as obvious. I wonder whether this is correct. Are there no particular judgments, e.g., "Torturing small children for fun is wrong" that are more clearly true than the premises of any theory supposed to justify them? Veatch is no doubt right that the judgment just given is not self-evident, if by that he means that no logical contradiction results from the statement's negation.

But self-evidence in this sense, and "obvious" truth, are two quite different things. Veatch moves too quickly from one to the other. If we can take our ordinary commonsense judgments to be true in epistemology, why may we not do the same in ethics?

But even if Veatch has insufficiently justified the need for justification, he raises penetrating objections to the particular theories he discusses. Utilitarianism fails because of a flaw in its starting point. Its advocates tell us to maximize happiness, understanding happiness as the satisfaction of desire. But why is it good to satisfy desire? Unless a utilitarian can first establish this, he cannot arrive at an ethic. Appeal to the Principle of Universalizability avails nothing. If someone argues "I want to satisfy my desire; but if it is good to satisfy my desire, it is good to satisfy anyone else's," he has begged the question. *Is* it good to satisfy desire?

Deontological theories fare no better. "[T]here is no basis whatever for the rights claims that are the very basis and starting point of modern teleological ethics" (p. 111). Kant's categorical imperative lends no help, because it is a purely formal principle. Gewirth's principle of generic consistency suffers from a failing like that of utilitarianism. Even if Gewirth is right that the nature of action compels us to claim certain rights, we cannot generate an ethics by universalizing the claims. The rightness of the original claims has not been shown: without an "ought" from which to begin, nothing is available to universalize.

Some theories are in even worse shape, since their advocates advance no arguments at all in their defense. He includes Robert Nozick among this group.

What then is the answer? Veatch locates it in "obligatory ends" (p. 101). These are desires that an individual ought to have. They qualify as ethical by passing the "Euthyphro test": one desires

them because they are good. They are not good because they are desired.

Now the question of course becomes: how are obligatory ends established? Veatch once more returns to Aristotle. Human beings have a nature, and what perfects that nature is an obligatory end. Once one obtains, "I ought to perfect my nature," the Principle of Universalizability does the rest. Everyone ought to perfect his or her nature. Thus ethics has been established on a rational basis.

Veatch's relentlessly pressed case arouses both admiration and doubt. As with epistemology, the form of his argument is this: approaches *A*, *B*, — etc. will not work. If, then, we want an objective ethics we must proceed in the way Veatch specifies.

But to argue that unless one adopts his view, one will end up on an unwanted position begs the question. If one accepts Veatch's contention that ethical judgments are not self-evident, why take for granted that an objective ethics can be derived?

Veatch might deny that he has argued solely by elimination of alternatives. On the contrary, he has argued directly for the truth of his view. But the system of natural ends he favors depends on a controversial principle: a human being ought to fulfill his natural end. Though I cannot now argue the point, I think the principle requires more defense than Veatch gives it here or in his earlier books.

Veatch also is open to objection for not being Aristotelian enough. Why does he combine his natural-end ethics with the Principle of Universalizability, a Kantian device? It is not obvious that a moral system must use this principle, nor is it a truth of logic. Veatch recognizes that some libertarians have challenged the principle, but he discusses only those who abandon morality altogether along with universalizability. He never considers genuine moralities lacking this feature (pp. 183, 186–87).

With characteristic independence of mind, Veatch maintains that all rights are negative. There is "no warrant for supposing that as human beings we have any positive rights at all" (p. 326). This is well said, but, unfortunately, Veatch's argument for negative rights fails. He then is left with no justified rights at all.

His defense of rights is that if "I ought to do something then I have a right not to be interfered with" (p. 325). How can this be justified on Veatch's own ethics? He argues that each person ought to pursue his natural end. But nothing in this principle forbids someone from interfering with someone else's pursuit of his end.

The principle also fails without reference to Veatch's ethics. Suppose one has a duty to make the best use of his talents. Someone

correctly decides that obtaining a job as a bouncer at the W. D. Ross Bar will be a major step forward. Does this prevent others from competing for the job?

He makes one or two other dubious claims about moral theory. He argues that amoralism is self-referentially inconsistent if the amoralist tries to give reasons for his refusal to pay attention to morality. If the amoralist says he ignores morality because there is no such thing, is he not claiming justification for his conduct (p. 189)?

He is indeed, but he need not claim moral justification. To assume that justification must be moral begs the question. The amoralist can view his ignoring morality as analogous to the denial unicorns exist. He is an amoralist, not an arationalist.

Also, Veatch's account of Philippa Foot is inaccurate. She claims that certain terms, e.g., "courageous" or "rude," can be applied only in particular circumstances. Avoiding the cracks in the sidewalk while walking could not be courageous, if this is all there is to the story. Veatch agrees with her but thinks her argument rests on "mere linguistic rules" instead of a genuine connection with reality (p. 147). This imputes to her a conventionalist view of language she takes pains to argue against. Also, he wrongly supposes that she accepts universalizability.

As will be apparent, I do not invariably agree with Professor Veatch. But he is sometimes profound, usually first-rate, and always provocative.

David Gordon
Ludwig von Mises Institute

The Review of Austrian Economics, the predecessor to the *QJAE*, was founded and edited by Murray N. Rothbard and functioned as the premier Austrian School scholarly journal between 1987 and 1997. After 1995, it was edited by Walter Block, Hans-Hermann Hoppe, and Joseph T. Salerno. Published first by Lexington Books and later by Kluwer Academic Publishers, the journal played a central role in attracting a new generation of economists to the theoretical foundations established in the work of Carl Menger and Ludwig von Mises.

Ludwig von Mises Institute | Mises.org