Volume 3 Number 2

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2007

ISSN: 1801-0938

ISSN 1801-0938

New Perspectives on Political Economy
Volume 3, Number 2, 2007, pp. 129 – 138

Saving and Investment: A Praxeological Approach

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JEL Classification: E2, E21

Abstract: Clarity in language in the sin qua non of any intellectual pursuit. If we cannot communicate accurately with one another, there is no hope of progress in scientific endeavor. Nowhere is this more true, at least in economics, than with regard to such concepts as real, as opposed to financial, saving and investment. The present paper constitutes an attempt to clarify the sometimes confusing dialogue that often ensues in this arena when sufficient care is not taken to distinguish between these very different topics. To wit, it is our hypothesis that while financial saving and investment may indeed and often do diverge from one another, the same is not at all true of real saving and real investment. In the latter case, real saving does not precede real investment; rather, it is *coincident* with it.

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1 Introduction

Science requires, *inter alia*, precision and consistency with respect to its fundamental concepts. One problem of long standing that sets economics apart from the natural sciences is the equivocal and inconsistent use by economists of expressions intended to convey a technical meaning. This paper considers difficulties involved with the concepts and uses of the terms "saving" and "investment."

In section II we discuss saving and investment, in an attempt to dispel some of this confusion, and move toward systematizing matters in this regard. We conclude in section III.

2 Saving and Investment[1]

Much confusion in economic theory arises because of an unscientific failure by economists to use words and terms consistently and unambiguously. In the case at hand, we focus on the failure to distinguish between "real" saving and investment and "financial" saving and investment. As soon as one understands leisure to be a form of consumption and exchange a form of production,[2] it is obvious that all one can do as an economic actor is produce or consume. There is no other alternative, though it is possible to produce and consume at the same time, and some people do so not infrequently.[3] But that raises some interesting questions. For example, what does "he saved" or "he invested," or "saving precedes investment," mean?

We begin with saving. It is clear that saving is not consumption. It is, after all, a temporary renunciation of something enjoyable. Therefore, it must be production.

[1] We eschew, throughout this paper, any consideration of the concept of "human capital" and its relation to saving and investment.

[2] For an argument that exchange is not a category of action separate from production, and, that, therefore, money is a capital good, see: Barnett and Block (2005).

[3] For example, a farmer enjoys planting crops. He is engaged in production (placing seeds in the ground is a necessary step in the direction of creating food for sale), and also in consumption (he takes pleasure in this process at present.) Or, a professional musician performs in a concert, or an athlete in a sporting event; they do so for pay, to be converted into future consumption, but they also directly gain utility from engaging in these activities.

The real meaning, in this context, of "to save" is "to prepare for the future;" i.e., to arrange for future acts of consumption that are expected to be greater than otherwise would have been the case, though the specifics of the future consumption are not necessarily predetermined. Alternatively, saving is the difference between physical production and physical consumption, this is what is, or rather should be, meant by real saving.[4] "To consume," in this context, means to act so as to directly satisfy a want; i.e., consumption is an act intended to directly satisfy a present desire. The standard textbook definition of saving is in terms of foregoing consumption (Samuelson and Nordhaus, 1985., pp. 52 –53; Mankiw, 2001, pp. 274-275).[5] But, as we have seen, the only way one can forego consumption (act in a way that does not directly satisfy a want) is to *produce*; i.e., the only alternative to consumption is production.

Production is action that is expected to add value; i.e., it is expected, in the ex ante sense, to in the future increase human want satisfaction, directly or indirectly. Alternatively, it may be thought of as action that transforms goods from a higher (earlier) to a lower (later) order. Goods[6] can be categorized as consumers' goods[7] or producers' goods (capital goods). Consumers' goods are used to directly satisfy wants; capital goods are used in the production of yet other goods, either consumers' or capital. Production, then, consists of producing consumers' services, tangible consumers' goods, capital services, or tangible capital goods.[8]

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[4] Although real saving is often taken to be the monetary value of saving (i.e., financial saving) adjusted for changes in the price level (i.e., the purchasing power of money), because of problems with the data, not to mention the more important conceptual problems involved, such a measure is problematical, at best.

[5] It might be argued that not to use up all or a portion of a preexisting stock of goods is to save. However, to fail to do something is not an act and, therefore, irrelevant to economics. Moreover, that would trivialize the concept, for then any preexisting good would constitute an infinite amount of saving. For example, if one had a can of corn and did not consume it instantly, the can would be continually saved and, therefore, the quantity of saving would be potentially infinite. The stock of preexisting goods constitutes *savings*, and the flow of newly produced goods that are not consumed constitute *saving* and adds to the stock of savings while the using up of preexisting consumers' goods and the physical depreciation of capital goods subtracts from the stock of savings. Net saving which augments savings, then, is saving minus the using up of preexisting capital goods including the physical depreciation of capital goods. And, although saving can never be negative, net saving certainly can be.

[6] Throughout, "goods" also refers to intangibles, i.e., services, and leisure as well as tangibles.

[7] Leisure is both a consumption and an intangible consumers' good. (Not all goods are produced, for example, apple trees growing in nature.)

[8] Examples of each are, respectively: a concert, leisure clothes, legal advice in a business matter, and construction of a factory.

Production of capital services and tangible capital goods is saving; or, alternatively expressed, one can (attempt to)[9] save by producing capital services and tangible capital goods, and one is saving when one is producing such goods. As with goods, all services are either consumers' services or capital services. The former are intended to directly satisfy a human want, e.g., a haircut, where the recipient desires this service for reasons having to do with his role as a consumer, not as a producer. The latter are intended to cooperate in the production of other goods, thereby indirectly satisfying a human want, e.g., the professional services of a petroleum engineer employed by an oil company. But the production of capital services and tangible capital goods is precisely what is referred to as real, in contradistinction to financial, investment. Financial investment consists in exchanging an asset, usually money, for the title to another asset.[10] Therefore, at least insofar as capital services and tangible capital goods are concerned, the act of saving is the act of production of those goods, which is, in turn, the act of investment in those goods. This type of saving and investment is referred to as capitalist saving and investment.

But what of the production of consumer services and tangible consumer goods? Here matters are a little more complex. The reason is that all production is forward looking; we produce now to consume in the future, no matter how short the time span between the production and the consumption. This is true even with respect to those acts of production that are also acts of consumption for the producer, i.e., for the producer/consumer. See footnote 3, supra, for examples.

Moreover, all tangible consumers' goods are durable to a greater or lesser extent. This leads to an arbitrary, but analytically very useful, distinction. Tangible consumer goods may be categorized as either consumables or durables based on the greater or lesser extent of their useful lives.[11] The arbitrariness necessarily arises because durability is a matter of degree, and, therefore, no objective criterion or criteria exist that can determine where the line that separates consumables from durables is to be drawn. It is tempting, because of the term "consumables," to think in terms of criteria

[9] Because all action is forward looking, one can never be sure that the end aimed at will be achieved by the means chosen.

[10] The only production involved in such exchanges are the actual capital services involved, e.g., a broker's services.

[11] Here "useful life" refers to economically-useful life, i.e., the time-span during which it can be used to satisfy, directly or indirectly, human wants.

related to the physical using up of the good in the process of consumption. However, this also would entail subjectivity, as all tangible consumers' goods are, sooner or later, used up in the consumption process. However, as what is of interest is a good's ability to satisfy wants in the future, whether or not it could also satisfy them in the present, it would seem that perishability or physical durability is the key criterion. Again, there is no objective way to determine the length of time beyond which a consumers' good's continued existence qualifies it as a durable rather than a consumable. Production of consumables as well as of consumer services is not considered to be preparation for future consumption. Rather, these goods are produced for consumption in the "extended present." Therefore, such production is not properly considered an act of saving. Production of consumer durables is, however, preparation for future consumption, and, therefore, is an act of saving. Insofar as durable consumer goods are concerned, the act of saving is the act of production of those goods and is also the act of investment in those goods. This type of saving and investment is properly referred to as plain saving[12] and investment.

We have now established that real saving and real investment are the same thing: production of goods intended to satisfy wants, directly (in the case of plain saving and investment) or indirectly (in the case of capitalist saving and investment); but in either case, they are both intended to satisfy wants primarily in the more distant future, or long run, rather than the extended present, or short run, i.e., "later" rather than "now."

Thus, real saving does not precede real investment; rather, it is *coincident* with it, consisting in the very same action. However, yet other questions are raised by these answers. Consider only two: what does it mean to save or invest one's money or funds, and how then can saving be greater than or less than investment? These questions relate to financial, not real, investment.

Before we can analyze these issues, it is first necessary to come to an understanding of the nature of money as a good. Money comes into existence as the transformation of an existing durable consumers' good or of an existing capital good to money, which is itself a form of capital good. In either case, part of the stock of savings, i.e.,

[12] See on "plain saving" Mises (1996, 531; http://www.mises.org/humanaction/chap19sec2.asp); Rothbard (1993, 40; http://www.mises.org/rothbard/mes/chap1d.asp).

the stocks of capital goods and durable consumers' goods, has been converted from some non-monetary use to a monetary use. Therefore, an act of saving is necessarily prior to the evolution of money. Fiat money, for all practical purposes, is created ex nihilo (Barnett and Block, 2005; Hoppe, et. al, 1998).

There are only two types of goods: capital goods and consumers' goods; these two are exhaustive.[13] If this is so, it then follows logically that either money is a capital or a consumers' good.[14] Moreover, as we have seen, all that one can do is either produce or consume. Therefore, "trade"[15] is either an act of production or of consumption. But trade, even in the case of the individual for whom the trading process itself is an act of consumption, is also an act of production, Mises and Rothbard to the contrary notwithstanding.[16] Therefore, because money is "the" quintessential trade good, i.e., the medium of exchange *par excellence*, it must be a capital good. Now, as monetary

[13] But not mutually exclusive. A fishing rod may at-one-and-the-same time be both a capital good and a consumers' good.

[14] Although money qua money is always a capital good, specific items of money, e.g., a beautiful, gold coin, may simultaneously be a consumers' good, at least for some individual whose want for aesthetic gratification is satisfied, at least in part, by the coin in his possession before he spends it. Then, of course, there is the mother of all examples in this regard: Scrooge McDuck pouring money all over himself in a delirious paroxysm of joy.

[15] "Trade" here refers to all exchanges of rights, barter as well as those involving money. This is to prevent any confusion that might arise because of Mises's (1996, pp. 97-98) use of the term "exchange" to refer to all actions; i.e., every action is an attempt to exchange a less desirable for a more desirable state of affairs.

[16] Rothbard (1993, pp. 60-61) states: "Goods being directly and presently consumed are *present goods*. A *future good* is the present expectation of enjoying a consumers' good at some point in the future. A future good may be a claim on future consumers' goods, or it may be a capital good, which will be transformed into a consumers' good in the future. Since a good is a way station (and nature-given factors are original stations) on the route to consumers' goods, capital goods and nature-given factors are both future goods." He also avers: "In the monetary economy, since money enters into all transactions, the discount of the future good against the present good can, in all cases, be expressed in terms of one good: money. This is so because the money commodity is a present good and because claims to future goods are almost always expressed in terms of future money income" (Rothbard, 1993, p. 298). Therefore, for money to be a present good it must be "directly and presently consumed" in mediating a transaction. This obviously is not the case. For if money is not a present good, it must be a future good, of which there are only two types: claims on future consumers' goods or capital goods. But any asset can be used as a claim on future consumers' goods. That is, the category "claims on future consumers' goods" is so broad as to be almost meaningless. Therefore, Rothbard contradicts himself because inasmuch as money is not a present good, it is, it must be, a capital good. On this point, see Barnett and Block, 2005. It should be noted that Mises's and Rothbard's concept, "future goods," is praxeologically meaningless because action, whether production using capital goods or consumption, takes place in the ever changing present and can only involve existing goods. Goods are means, and as such either exist in the present or not at all.

gold (gold in the form of coins or bullion intended to be used as media of exchange) may also satisfy consumers' aesthetic wants, it may be, and is for the relevant consumers, simultaneously, a consumers' good. Nevertheless, though money may be concurrently a consumers' good, it must always and necessarily be a capital good.

Consider, then, what it means to "save" or "invest" one's money. There are two ways to "save" one's money.[17]

First, one can refrain from spending it on *anything*. This is referred to as hoarding.[18] Of course, *not spending* is not an action – it is neither production nor consumption. During the time one is abstaining from spending, one is necessarily doing something else. Therefore, hoarding is not saving; it is merely the non-action of re-

[17] St. Paul (1 Timothy 6-10) famously said, "For the love of money is the root of all evil..." This is extremely dubious. But as far as economic analysis goes, money is indeed the root of much confusion. The easiest way to see this is to investigate the essence of an economic phenomenon. In such cases, we ask if it would/could exist in a barter economy. If so, then money cannot be of the essence of the matter. More important, any definition of the phenomena that involves money is, obviously, inadequate, in that, at best, it is misleading, but usually confusing, thereby causing faulty analysis. For example, untold time and ink has been squandered developing the theory, and empirical estimates, of "the" demand for money. However, correct analysis concludes that there is no such thing. Money qua money is one side of every monetary transaction. Therefore, in the market in which X trades for dollars, the price of money is in terms of X/$; i.e., it is a quantity of X paid for a unit of money. Of course, in the market in which Y trades for dollars, the price of money is in terms of Y/$. There is then no "the" demand for money. Rather, in every market in which some good trades for money there is *a* demand for money; i.e., there are thus demands for money, but not *a* demand for money. Of course, the foregoing comments apply equally to "the" supply of money. It should be noted that some Austrians, including the present authors, fall into this trap when they are not careful, e.g., when we speak of an increase in "the" supply of money, rather than in the stock of money. That Mises and Rothbard speak in terms of "the" demand for, and supply of, money is proof positive of this problem, especially as Salerno (1993, 133-134) maintains that such analysis is of the essence of monetary economics. Perhaps the beginning of the understanding of "money" is the realization it is the only necessarily-barter good in a monetary economy, and that as such there is no "the" demand for or supply of money.

[18] The matter of hoarding raises another issue. Except for the virtually instantaneous period of time in which the title to money is transferred from one individual to another, it is never spent on anything. That is, except for those split seconds in which it changes hands, money in wallets and checking accounts is virtually always being "hoarded." What, then, is the real meaning of hoarding? It is a decrease in the average rate at which money is spent, i.e., a decrease in the "velocity of money" of quantity theory fame. In praxeological terms, an individual hoards when he holds onto his money, in value terms; the longer the period of time he keeps it in his cash balances before spending it the greater is his hoarding. It should be noted that a key source of error in Keynes (1936) was his failure to comprehend the difference between the effects of hoarding in commodity-money and fiat-money systems. On this point, see: Barnett and Block (forthcoming). In common use, "hoarding" consists of holding more money in cash balances than the speaker deems appropriate.

taining title to a pre-existing capital good, money. Second, one can trade one's money for another pre-existing good, e.g., a house or a bond or a share of stock. In this case, the action is trade, a form of production. But, this action does not bring into existence either consumer durables or capital goods; i.e., there is no saving or investment involved. Rather, it "merely" swaps titles to different goods, as the parties to the exchange try to rearrange their portfolios so as to improve their conditions in life. If one offers money to another to entice him to produce a consumer durable or capital good, and the transaction is consummated, there is saving and investment, but it consists in the action of production, not of the trade of money for preexisting goods. The same can be said of the trade of money for newly created financial assets. Neither the creation of financial assets nor the trade of money, therefore, creates durable consumer goods or capital goods; consequently, neither is an act of saving or investment.

3 Conclusion

Austrian economics is based upon a simple theory, simple in the sense of Ockham's Razor, not simplistic: the choices facing the economic actor at any given time are limited to two; praxeology is in effect a binary system (Barnett and Block, unpublished). As discussed in the present paper, one may only consume or produce. There is no third alternative. Moreover, production is either for current consumption, or it is saving/investment.

This, however, is but the tip of the iceberg. The phenomenon runs like a constant refrain throughout the warp and woof of Austrian economics. For example, the only options open to the owner of property are to retain it or alienate it; he may do the latter by selling it, renting it out, giving it away, or abandoning it, but the basic options are only those two. With regard to any two goods, A and B or combinations thereof, one may prefer A to B or B to A. That, contrary to the opinion of the overwhelming majority of economists, is exhaustive of the possibilities. Indifference, a supposed third alternative, is simply not on the menu (for criticism of the viewpoint now being articulated, see Nozick, 1977, Caplan, 1999; for a defense of it see Rothbard, 1993, Block, 1980, 2003, Hülsmann, 1999). Why not? Because there is no possible way to *demonstrate* such a choice in actual human action, and the latter is the bedrock of

economics from the Austrian perspective. This, of course, is not to deny that the word "indifference" has a perfectly understandable referent; merely that it cannot past muster as a matter of technical economics. Moreover, there are only two types of goods: consumers' and capital goods. And one may only engage in labor or leisure.

This binary insight applies to barter and monetary economies, despite the fact that in the real world we typically find an admixture of both. The point is there is not any third option completely divorced from either.

When placed in such a context, the thesis of the present paper tends to become, if not more acceptable to non-Austrian economists, at least more comprehensible. It is not a stand-alone contention. Rather, our thesis is embedded in a nexus of similar binary phenomena.

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ISSN 1801-0938

New Perspectives on Political Economy
Volume 3, Number 2, 2007, pp. 139 – 184

The Roots of our Liberties: On the Rise of Civil Society in the Medieval West

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JEL Classification: N43, N93, O10

Abstract: This article deals with the genesis of civil society in medieval society in the hope that this might elucidate the general conditions in which a civil society can flourish. We are, moreover, well aware that some of the viewpoints espoused have strong contenders with opposed views. We mention them in order to indicate to the reader the major dilemmas, which arise on the concerned historical subject. In order to avoid misunderstandings on the main tendency of our historical analysis, we deal briefly with the notion of civil society as it appears in political philosophical literature because this notion is used with strongly diverging meanings. Then we build a picture of European society at the dawn of the emergence of civil society, during the period 843-1073 . We deal subsequently with crucial factors in the emergence of civil society in the Middle Ages such as peace and labour, associative life, the medieval "nomos", including medieval humanism, the "ius commune" of Europe and the rule of law in the Middle Ages. We conclude with some considerations about the late medieval era, in order to bridge the gap with the modern conception of civil society.

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Introduction

Alexander Kojeve, philosopher and pre-eminent interpreter of Hegel came, whilst still in the middle of his career as a philosopher, to the conclusion that his philosophical master was correct about the end of history and decided because of this to stop his career and become a full-time bureaucrat in the European Commission (Fukuyama 1996, p. XIII). About a thousand years earlier, the Holy Roman emperor Otto III and pope Sylvester II spent New Years' eve praying in the church of St. John of Laterans as they were fearful of the coming apocalypse at the end of the millennium. As ex-post-spectators we know that Kojeve, Otto III, and Sylvester II were wrong.

History did not and will not end because history is not an energy, a process, or a fatality, separated from the action of innumerable human agents. History is driven by the perceptions and preferences of its actors, who affect the decisional context of other actors, present and future, by the intended and unintended consequences of their actions. Pretending to know the end of history, as Hegelian historians do, is, therefore, an act of supreme hubris. It presupposes that we know what preferences and inspirations are the most common and most profound to humanity, and by what mechanisms they will finally triumph over their historical obstacles.

Releasing such strong Hegelian assumptions about the cognitive position of the historian does not necessarily entail extreme scepticism, according to which history is "only a confused heap of facts", as was considered by Lord Chesterfield (Mencken 1991).

Theoretical insights about the human psyche and about relationships between human action and its unintended consequences, do allow us to understand some concatenation of events and compatibilities of different political institutions and social structures. In this way, knowledge, useful for our moral engagement in the present, can be won from the study of the past. Advocates of a free society may learn from history that some strategies, the purpose of which may not have been liberty-driven, resulted, through their unintended consequences, into more freedom. The movement for the "libertas" of the 11th century church, for instance, was not liberty-driven in the modern, classical liberal sense. It may even have had some theocratic traits. Nevertheless, it produced, as an unintended consequence, a less monopolised and

thus freer political context. From this, a classical liberal can learn what kind of political, religious and social evolution, even when non-liberal in its main aim, deserves his support.

From history we can learn the type of institution we should cherish in order to safeguard liberty. The leaders of the medieval "communes", for instance, though driven by aims which were fairly close to modern classical liberal ones, often surrendered their liberties quite easily in an alliance with the king, in order to reap some short-term benefits (Spruyt 1996, p. 86). They clearly lacked insights into the long term value of communal independence.

This article deals with the genesis of civil society in medieval society, in the hope that this might elucidate the general conditions in which a civil society can flourish. We do not pretend to have found the key to ultimate wisdom on this matter. Many subjects remain open to further research. We are, moreover, well aware that some of the viewpoints espoused, have strong contenders with opposed views. We will mention them in order to indicate to the reader the major dilemmas, which arise on the concerned historical subject.

In order to avoid misunderstandings on the main tendency of our historical analysis, we will deal briefly in the first two sections with the notion of civil society as it appears in political philosophical literature because this notion is used with strongly diverging meanings. In the third section we will build a picture of European society at the dawn of the emergence of civil society, during the period 843-1073. In the fourth, fifth, sixth, seventh, eighth, and ninth section we deal subsequently with crucial factors in the emergence of civil society in the Middle Ages such as peace and labour (section 4), associative life (section 5), the medieval "nomos", including medieval humanism (section 7), the "ius commune" of Europe (section 8) and the rule of law in the Middle Ages (section 9). We will conclude with some considerations about the late medieval era, in order to bridge the gap with the modern conception of civil society.

1 The Concept of Civil Society in Its Liberal Meaning

Not satisfied with the usual dichotomy market-state, several liberal scholars developed a sociological concept of "society" or "civil society" opposed to the state, but wider than the "naked" market. David Green puts it as follows: "Contrary to the view attributed to Mrs. Thatcher, that there is 'no such thing as society', there is indeed such a thing. But it is not synonymous with the state. It is the realm of 'activity in common', which is at once voluntary and guided by a sense of duty to other people and to the social system on which liberty rests" (Green 1993, p. 3). In his last book "Trust", Francis Fukuyama speaks about "The Twenty Percent Solution", arguing that neo-classical economics is correct, up to eighty percent, in explaining society, but needs to be supplemented by a theory on "social capital", in order to explain the other twenty percent (Fukuyama 1996, p. 13).

Older liberal scholars, such as Hayek (Hayek 1973) and Oakeshot (Oakeshot 1975, p. 313) developed similar notions: Hayek distinguished the cosmos of a great society, resting upon a nomocracy, from the taxis of a constructed order such as the state, directed by teleocratic strategy; Oakeshot distinguished the civil association, based on general rules of conduct, from the enterprise association, set up in pursuit of a common objective.

It seems that all these liberal notions about "society" have two elements in common: 1) their notion of society is about a "horizontalistic" network of interpersonal co-ordinations of individual action; 2) these co-ordinations are voluntary and based on respect for property rights.

The notion is horizontalistic because it covers relationships from person to person, persons to groups (community), or groups to groups, but never a relationship from the single to the whole. The society is just a construction of the mind to conceptualise the broad "cosmos" of interaction in which individuals, groups and organisations are involved and through which actions and strategies of some reflect in an intended and unintended way on the position of others. As a consequence of which, it would be absurd to conceive a relationship between an individual and "society". It is

even more absurd to speak about "duties" of the individuals towards society. In a civil society, within the liberal meaning, individuals have duties towards other individuals or groups, according to values, which may be shared by most actors in society. This fact, however, does not allow us to substitute dyadic relationships among actors in society for a dyadic relationship of actors with society.

To put it differently: the liberal notion of society is non-holistic and by this, also non-organic. This latter point is not unimportant with regard to the discussion about the conception of society ("universitas", "societas") during the Middle Ages (see below section 5). Society, in its liberal version, is not constructed as a whole but develops either by the deliberate social constructions of groups and organisations, or by spontaneous (unintended) adaptation.

The horizontalistic character of society in its liberal version also implies that it has no formal borders such as membership (groups, corporations, political parties) or territorial borders (nation-states). If we try to visualise it, it would not look like an organisational structure, but rather like a nebula, with thicker and thinner areas, according to the intensity ("close knittedness", Ellickson 1991) of interaction. The informal and gradual borders of a society in its liberal version are influenced by several factors, be they natural (e.g. innavigable oceans), religious and cultural (e.g. xenophobic tradition), or political. The latter ones do not only concern radical measures such as erecting Iron Curtains, but also policies such as linguistic and monetary policies intended to obstruct interaction between subjects of different states.

Besides the structural feature of horizontalism, society in the liberal sense also requires two normative elements: voluntarism and respect for property rights. The notion of voluntarism should here be understood in its widest sense; it covers deliberate as well as spontaneous co-ordination. Deliberate co-ordination occurs through the discipline of conventions (e.g. Victorian "manners and morals") (Himmelfarb 1995, p. 21), contracts and firms. Spontaneous co-ordination occurs through processes in which actors adapt their behaviour to changing social environments, while the actions which caused these changes were not aimed at these adaptations of behaviour. The latter form the unintended consequences of the former. Patterns of spontaneous co-ordination are the subject of study by economists par excellence,

while sociologists and historians tend to focus more on the various forms of deliberate co-ordination. Both traditions can contribute to the understanding of the working of civil society. Moreover, processes of spontaneous co-ordination and acts of deliberate co-ordination do not occur in isolation from each other. The fact that a specific deliberate co-ordination, or a class of such co-ordinations appear at a certain moment in society, can be often understood as an unintended consequence of other patterns of human action. Thus, the notion of civil society within its liberal meaning, offers not only room for the different disciplines of social sciencebut also a context for co-operation and mutual enrichment.

Finally, it has to be remarked that both normative elements of civil society, voluntarism and respect for property rights, constitute only the most basic characteristics of it. This does not endorse the claim that both characteristics suffice to uphold a civil society in the longer run. Several authors, qualified by Green as "civic capitalists" (Green 1993, p. 12), emphasised the need for a constant moral effort in order to protect civil society against its "demoralisation" and thus, degradation.

According to Macedo, Tocqueville was the pre-eminent civic capitalist because he emphasised "the stable moorings of religious belief, a caring sphere of family life and a variety of ties to intermediate groups" as the prerequisite for the development of individual confidence and pride (Macedo 1989, p. 133).

These viewpoints of "civic capitalists" are, however, positions about the workability and stability of a civil society. It is also conceivable to deny these positions of civic capitalism by claiming that a legal order of individual rights and the elimination of all obstacles to individual freedom, suffice for the constitution of a stable civil society and that consequently all the "values" talk of civic capitalists is historically contingent and morally paternalistic. Hence, by including the moral values of "civic capitalism" within the definition of civil society we would already give a positive answer to the question, raised by civic capitalism. It remains an open question whether moral values, such as family-mindedness, self-confidence, pride, honesty, reciprocity, decency, etc., are prerequisites for civil society or just consequences, which will probably be produced in a society, based on voluntarism and respect for property rights.

2 Civil Society: Other Meanings

This outline of a liberal concept of civil society allows us to contradistinguish it from other current and often radically different meanings. To cover the most important ones, we will deal briefly with the concept of civil society in social contractarianism in the Hegelian line of thought and in neo-corporatism.

In social contractarianism civil society is opposed to the state of nature, a (mostly) hypothetical state without institutions and without social bonds stretching beyond the natural family. Civil society on the contrary is a state with developed political institutions and established political, legal, and religious authorities. Because the picture of the state of nature varies widely across the many social contract-theories, civil society, the outcome of the contracting process out of the state of nature, also takes a different shape depending on the concerned authors. So, the monarchist civil society of Hobbes differs substantially from the liberal-constitutional civil society of Locke, while the latter differs again from Rousseau's civil society of popular democracy.

It should be emphasised that the concept of civil society in the social contractarian context is not necessarily politically hostile to the development of civil society in the previously outlined liberal sense. Lockean civil society for instance, with its stress upon limited government and individual rights, is particularly conducive for such a development, as the history of eighteenth century England and nineteenth century America shows.

Both notions of civil society differ, however, in their expository status. The liberal notion conceptualises the possibility and the value of a broad, non-planned but ordered cosmos of human interaction in opposition to social theories, denying or neglecting spontaneous co-ordination and advocating a deliberately created and imposed order in society. In this way, the liberal notion is a substantive part of a deep analytical and normative debate. The social contractarian notion on the contrary, has only a formal status. It is a step in the form of argumentation about the foundation of political authority and political institutions. This difference between substantive and formal expository status explains why the meaning of both notions can be politically reconcilable.

Within the tradition of social contractarianism no distinction is made between civil society and the state (here in the sense of a political institution). Civil society as a stage in the hypothetical genesis of institutions encompasses the institutions of the nomocratic cosmos (civil society in the liberal sense) as well as the institutions of the state (the holder of the monopoly of organised violence within a given territory). Moreover, the borders between the different civil societies in the social contractarian sense correspond with the borders of the state territory. Civil society in its social contractarian sense is as much "national" as civil. Through the equation "civil = national", social contractarianism, especially in its Rouseauan version, contributed a lot to the violent nationalism of the nineteenth and early twentieth centuries.

Closer to the liberal notion of civil society is the Hegelian one ("bürgerliche Gesellschaft"). According to Hegel, the life of the individual should evolve on three levels: 1) the family, in which natural solidarity prevails, 2) the civil society, in which individualism and selfishness ("das Prinzip der Persönlichkeit") dominates, 3) the state, in which the individual acts as a "citizen", i.e. oriented towards the common interest of the whole political community (Hegel 1820, par. 181). Being familiar with the works of contemporary authors such as Smith, Say, and Ricardo, Hegel realised that most individual action on the level of civil society benefits the well-being of others through the mutual benefits of exchange and the division of labour (Hegel 1820, par. 243). Moreover, Hegel did not consider civil society as a jungle, as Marx did. Hegel realised very well that a well functioning civil society required an institutionally protected discipline of respect for individual rights and property rights, and respect for mutual promises ("pacta sunt servanda"). Hegel evaluated the genesis of the civil society as an immense progress in human history and rejected strongly a return to the "Staat des Altertums", in which individuality was suppressed for the sake of common interest. He did not consider, however, the emancipation of the individual on the level of civil society as the ultimate realisation of freedom. In civil society, the person remains narrowly constrained by the horizon of his self-interest. Limiting our lives to the levels of family and civil society would make of us crippled personalities. In order to be really free, the human being needs a third level, the state, on which he can join his own possibilities with the ones of his fellow citizens ("citoyens", not "bourgeois") in order to realise the common good of all members of the state (Hegel 1820, par. 257-259).

When we compare the Hegelian notion of civil society with the liberal one, as outlined above, we remark at least two important differences. Firstly, the liberal notion encompasses the family, the Hegelian does not. This difference is not merely conventional. By isolating the family from civil society, Hegel "demoralises" the latter level, for few will deny that the family is a solid source of natural solidarity and as such is a hotbed for wider forms of voluntary solidarity. Secondly, the Hegelian tripartite distinction overlooks systematically the possibility of voluntary associations, aimed at non-selfish goods (charity, philanthropy, mutual aid, solidarity, etc.). Hegel restricts the associative capacity of human beings to the level of the state. It is true that between state and civil society Hegel situated the so-called "Korporation" (Hegel 1820, par. 201-208). But these associations ("Stand des Gewerbs", "Handwerksstand", "Fabrikantenstand", "Handelstand", "allgemeiner Stand", i.e. civil servants) are half-political institutions, established to cater to the link between state and civil society.

By locating our moral capacities of altruism within the family and within the state, only a "demoralised" shell is left for civil society. As for Hegel himself, an excuse can be found in the fact that he did not experience the amazing flourishing of voluntary associations in the second half of the nineteenth century (for instance, the Friendly Societies in England) (Green 1993, p. 89). Such an excuse does not exist, however, for the numerous authors who continued to rely on the "demoralised" notion of civil society of Hegel, and to use it as an argument for the nationalisation of solidarity.

In order to minimise the risk of confusion about our notion of civil society, we should also mention the usage of the notion in its present, "neo-corporatist" sense. Traditions of thought, such as "corporatism" and "neo-corporatism", are much more popular in continental Europe than in the Anglo-Saxon West. This is due to several factors, such as the survival until deep into the nineteenth century of pre-modern, corporatist economic (guilds) and political ("die Standen") institutions and the pre-eminence of the Catholic Church, which advocated often corporatism as a "third way" between capitalism and socialism (see the Encyclical "Quadragesimo Anno", 1934). In general, corporatist thought favours the organisation of the population into several bodies, which are not directly initiated by or dependent on state authorities, but do,

however, perform tasks, which are of public interest and may, by this, have compulsory characteristics. The corporations are not a part of the state, but act "loco" the state.

Although a complete failure in its main aim to constitute a third way, corporatist thinking left its traces within the organisation of the welfare state in continental Europe. Often the collection of contributions to welfare and social security-institutions and the payment of social allowances are handled, not by state agencies, but by associations with a voluntary pedigree (mutual aid-organisations, professional associations, labour unions). Furthermore, the regulations of certain professions (doctors, pharmacists, architects, lawyers) are left to corporate bodies, independent from the state but enjoying a monopolistic protection from it.

The wide and often very heterogeneous collection of such intermediate bodies between state and individuals are also called, in present political literature in Europe, civil society ("societé civile", "middenveld"). The champion of "global governance", Riccardo Petrella and The Group of Lisbon, pretends to rely on the "global civil society" in order to accomplish his dream of governance of the world through different social contracts (Petrella 1993, p. 173). The advocates of the welfare state shrewdly presented the neo-liberal attack on the welfare state as an attack on "civil society" and as a relapse into brutal atomism, in which the isolated individual was put naked before the state and private enterprise. By this, the debate about present welfare statism was perceived by the majority of public opinion, not as a choice between compulsory and voluntary solidarity and mutual aid, but as a choice between co-operation and isolation, the group and the atomised individual, the warm group-solidarity and the cold market mechanism. The way how the debate about welfare-statism developed during the last decade, especially in continental Europe, illustrates well how important it is to define "civil society" in its wide and rich liberal sense.

3 At the Dawn of Civil Society: Europe between 843-1073

During this period the European West touched the absolute bottom of its social, economic and cultural evolution. During the same period, however, the seeds were sown

for the spectacular revival of the 12th century. Economically and demographically the European West must have looked during the 9th and 10th century like one vast wilderness with only small spots of habitation and cultivation. Total population around 1000 is estimated at about 12 million, the population of the present greater Paris area. In 1200 the population had risen to about 50 million, an increase of more than 300% (Cameron 1993, p. 54). Rome, once a city of two million inhabitants, was now inhabited by only 20,000 people, living amidst antique monuments, which were gradually falling into ruins.

Militarily, the European West was constantly plagued by internal civil wars and by outside threats of barbarian invasions. Especially France, the former heart land of Merovingian and Carolingian Empires, was the theatre of dynastic wars between the Carolingians and Capetians, and countless battles between the lesser castle nobility (Duby 1978, p. 178). Very probably, the deep incursions from invaders into the Western heartlands were made by small and unorganised bands. Nevertheless, public power was too weak to ward off these dangers. In 854 the flower of chivalry in France had to be mobilised to repel an attack of Normans on Paris.

Only in 912, by the treaty of Claire-sur-Epte, Norman invasions came to an end by ceding them the territory west of Paris, the later duchy of Normandy. Between 889-972, Saracens occupied the fortress Fraxinetum in the neighbourhood of Marseille, from which they organised raids up to the lake of Constanz. In 972 count William of Provence was finally able to chase them out of the south of France. The south of Italy and the western part of the Mediterranean Sea was dominated by Saracen pirates. Emperor Otto II was killed in a campaign against them in southern Italy.

Only during the 11th century with the conquests of Sardinia (1022), Sicily (1058-1090), and Corsica (1091) was the Mediterranean Sea cleared and did it become open for trade with the East. The German Empire was attacked from the east, first by the Avars and then by Magyars. The defeat of the latter at Lechfeld in 955 finally ended this threat. Large parts of England were occupied and terrorised by Vikings and Danes until they were finally expelled in the second half of the eleventh century.

As this overview of wars and raids shows, it would not be exaggerated to say that Western European civilisation was threatened, during the ninth and tenth centuries

with virtual disappearance. The social structure during this period reflects all but that of a civil society in its classical liberal sense. The picture of society during this period is far from the broad network of interactive co-ordination based on exchange, the division of labour, and free association. Due to the constant threat of war, trade had virtually disappeared and economic agricultural life retreated to the small unit of the manor. Within the already mentioned dichotomy, made by Oakeshot and Hayek, these manors should be qualified as "enterprise associations" or "taxis" rather than as "civil associations" or "cosmos" of a great society.

The "enterprise association" character of the manor was particularly reflected by the status of the unfree tenant, who was tied to the land and restricted in his personal rights, such as the right to move and to marry. The unfree tenant belonged to the enterprise of the manor. The rule of the lord over the unfree tenant coincided totally with the management of his estate. It was a rule of men on men in the most literal sense (Duby 1978, pp. 173-195).

This stringent inequality of rights within the early medieval manorial economy found itself expressed in the image of the three orders. The bishops Gerard of Cambrai and Adalbero of Laon represented the ideal society as an organic body with three functional parts: the praying and thinking part, i.e. the clergy ("oratores"); the fighting part, i.e. the military ("bellatores"); the working part, i.e. the vast majority of agricultural labourers ("plebs", "populus"). Clergy here referred more precisely to secular clergy, i.e. the hierarchy of archbishops, bishops, members of chapters, parish priests. The status of the top-layer, especially of the bishops, was in many respects similar to that of the fighting nobility. Bishops too had the status of manorial lords. They were linked within feudal relationships of lord and vassal and were recruited from the sons of landed aristocracy. They were regarded as real "church princes". It is important to note this, because, as we will see later, the other clergy, i.e. the regular one of the monks, played a crucial role in the disturbance of this three order image of society.

Within the prevailing political theory of these centuries, church and secular political institutions were hardly considered as separate entities. The church ("ecclesia") was not conceived of as a well outlined and organised body, with its own legal entity, but as the vast collection of Christian people ("populus christianus"). At the head

of this "populus christianus" stood, not "the bishop of Rome", but the king, considered the Vicar of Christ. Because his body was permeated with the Holy Unction, his mind was permeated with wisdom, "sapientia" (Duby 1978, p. 26). As a king he did not only protect Christianity by arms, he was also considered as the moral head of it. This theory of sacred kingship is well developed in the famous Norman *Anonymus*, a book written in 1100 in reaction to the new developments triggered by the papal revolutions. The theory of sacred kingship had its impact on political practice. The German emperors, considering themselves as the supreme head of Christianity, required the pope on his election to swear an oath of loyalty to the emperor. Of the twenty-five popes who held office during the century prior to 1059, twenty-one were directly appointed by emperors and five were dismissed by them (Berman 1983, p. 91). By this thorough merger of secular and spiritual power in the person of the king or emperor, religion remained a tool in the hands of the powerful in order to legitimise their privileges and to control the intellectual life of the rest of the people. Being faithful meant for a large part recognising without any sign of resistance the power of kings, lords, and bishops and resigning to their humble position, determined by birth.

However dark these centuries were from a civil society viewpoint, two prevailing factors should be mentioned, which would contribute to the dramatic change in the twelfth century, i.e. feudalism and Christian universalism. Both factors as such did not trigger social change. They would, however, do just this when combined with other factors such as the papal revolution, the booming of associative life, and the development of the rule of law.

The notion of feudalism is taken here in a narrow sense, i.e. as a system of recognised relationships between members of the ruling military or cleric order. The duties stipulated in the feudal contracts between lords and vassals could encompass elements of a private and public character as well. With reference to private character we should mention: the granting of a benefice ("beneficium"), that is land or other property such as cattle (the German term "feod" originally meant cattle, as the German word "Vieh" indicates, Berman 1983, p. 298). With reference to public character we should mention the pledge of fidelity by the vassal ("hommage"), the obligation of the vassal to render military service to the lord and the granting of the exercise

of offices (manorial justice, taxation, service monopolies) by the lord to the vassal (Berman 1983, pp. 295-313; Heirbaut 1997; Ganshof 1982). We can distinguish feudalism from the manorial system, which relates to the relationship between the lord of a manor and the peasants, working on the manor under different statutes, such as free tenants, serfs and slaves. Of course, the feudal and the manorial system were related. The manor was often a benefit ("beneficium") within the feudal relationship and obtaining a feudal benefit was attractive due to the dominant position the lord held within the manorial system (Berman 1983, p. 316).

The narrow sense of feudalism is to be preferred for analytical reasons, for it is possible that a manorial system persists without a feudal system. After the emergence of the monarchic states during the 15th and 16th century in Europe, feudalism was gradually hollowed out, especially of its public content, while the manorial relationship persisted in many parts of Europe, especially the more eastern ones. Within Marxist thinking the notion of feudalism has even acquired the status of a universal stage in the history of mankind, i.e. the stage between slavery or the Asiatic way of production and capitalism. This obliges the Marxist historian to distinguish feudal stages in the historic development of non-western cultures. As a result, the notion of feudalism receives such a wide meaning that it loses all analytical capacity. Marxist historians are, as Berman pointed out (Berman 1993, pp. 296, 541), by no means able to explain why the political "superstructure" of western feudalism differed so radically from that of the east. The Marxist historian Perry Anderson has well perceived this problem and attempted to save the Marxist notion of feudalism by arguing that the distinction of superstructure and infrastructure is not applicable to feudalism. The mode of production and the mode of exercising political and legal power are, according to Anderson, completely intertwined in feudalism (Anderson 1979, p. 400). This position, however, threatens the whole distinction between super- and infrastructure, which is vital for Marxist economic materialism. By the same token, we can question the distinction between superstructure and infrastructure within capitalism. As the Marxist legal theorist Pasukanis argued, institutions such as property and contract also belong, in fact, to the capitalist infrastructure because a capitalist mode of production is not thinkable without circulation of commodities and this circulation presupposes legal institutions, such as property and contract (Pasukanis 1970).

Feudalism, as we understand it in its narrow sense, was indeed a pillar of the "old order", the one prevailing in the tenth and eleventh centuries. Through feudalism the military class organised its dominance on the rest of the population. Through feudalism some order prevailed after the total collapse of the Carolingian state. The effect of feudalism was, however, not only conservative.

First of all, feudalism allowed for a more or less ordered decentralisation of political power. Western Europe of the eleventh century was, especially in the heart-land, France, a patchwork of innumerable small political entities. According to the theory of federalism (Tiebaut 1956, Inman and Rubinfeld 1998) decentralisation allows for beneficial effects such as voting with the feet, the submission of political power to some competitive pressure, and institutional competition, allowing political entities to learn from each others' experiences.

Voting with the feet under feudalism occurred in many ways. The most important movement concerns the constant escape of serfs from the manor to the emerging cities (Bouckaert 1997). Often lords, but especially monasteries, attracted serfs from other manors by offering them a better legal status. The coastal area of Flanders, for instance, only had free peasants, because the abbeys, which undertook the winning of land on the sea, offered them this status.

Learning by competition also occurred in feudalism. The reaction of feudal lords to cities was, at the beginning, very hostile. Ivo of Chartres for instance, advised the bishops, who were forced to concede liberties to revolting communes, to retract them because they were made under threat (Pirenne 1925, p. 128). Some feudal authorities, such as the Flemish counts of the house of Alsace during the twelfth century, pursued a "supply side" policy towards the cities by granting them many freedoms in the hope of getting tax returns. This attitude spread quickly. According to Spruyt, the alliance between king and cities laid even the base for the emergence of the French nation-state (Spruyt 1996, p. 153).

Secondly, feudalism was crucial in the later development of the rule of law. This remark, probably surprising for many, deserves some qualification. In its major characteristic feudalism is indeed a flat negation of the rule of law, for it favours the emergence of numerous concrete legal arrangements between lords, vassals and their

subjects, characterised by inequality and diversity. The emergence of a more abstract rule of law, adequate for a broad abstract order, would occur entirely at the expense of the different concrete feudal legal orders (Macfarlane 1987). Yet, feudalism contained one feature, crucial for the expansion of the rule of law, namely its character of reciprocity. Lord and vassal had reciprocal duties. When the lord did not fulfil his duties, the vassal could consider himself to be freed from his. He even had a right of resistance towards acts of his lord, which were contrary to the feudal agreement. Consequently, the power of the lord was not absolute. Moreover, the vassal had the right to defend himself against misdeeds of his lord. Such a reciprocity is completely absent in the later, emerging theory of state sovereignty. The reciprocity of feudalism is clearly at the base of the famous founding document of the English constitution, the Magna Carta. The freedom of the barons against the kings articulated in it were later on gradually extended to all citizens of the kingdom. In Flanders, at the beginning of the twelfth century, the cities revolted against Count William of Normandy, the political favorite of the French king. Their spokesman, Iwein of Aalst, claimed that William had broken his contract with the cities so that they were freed from their political obligations towards the count. William of Normandy was killed in battle during the following civil war in Flanders and Dirk of Alsace, a pro-city-count became the new count. Both events, crucial for the respective countries, show that the reciprocal element within feudal law was invoked as a legitimate base to claim initially and to extend gradually the rights status of the vassal to broader layers of the population (Heirbaut 1997, p. 225).

The second element, which contributed to the dramatic change in the twelfth century, needs much less explanation, for it is less contested. Whatever the complicity of the church authorities with the secular political authorities, the church has to be credited with upholding the idea of Christian universalism and, more or less linked with it, the cultural legacy of Roman antiquity. Thanks to the existence of the church and the however limited intellectual activity within it, the total spiritual decomposition of the West into tribal or local mini-cultures was prevented. The church not only "saved the books" during this period, but was also able to maintain the idea of the Latin West ("l'Occident"), a culture with a common destiny and common overarching values. The revolutionary potential of this idea remained only latently present

during this period, due to mentioned factors. As soon as these obstacles would waver, the power of this idea would be soon unleashed.

4 Peace and Work

Few will question that war is detrimental to the development of civil society. War not only causes the destruction of economic and cultural wealth, but it often affects profoundly the relationships between rulers and ruled, between state and civil society. War tends to turn a civil association, to use Oakeshots' terminology again, into one gigantic enterprise association. War disrupts familial and voluntary relationships and drags large parts of the young male population into the machine of military massification. Examples of the profoundly "decivilising" effect of war are not hard to find. The rather peaceful and libertarian political relationships within early Anglo-Saxon tribes were pushed into an authoritarian direction by the constant wars with the Vikings and the Danes (Benson 1989, pp. 1-81). As mentioned already, the retreat of the early medieval economy into the manor was due to the threat of constant warfare, by which peasants sought refuge under the umbrella of armed protection of the knights. The endless wars of the monarchist states between 1450 and 1750 triggered the rise of taxation and the formation of a state bureaucracy (Webber and Wildawsky 1986, pp. 228-298; Tilly 1975). The First World War disrupted entirely the emerging civil society in Russia and provided Lenin with the revolutionary masses he needed for the realisation of his totalitarian plans. In more liberal and democratic societies, such as the US and Western Europe, the world wars led to upswings in state regulation and central planning, which could only be partially reduced after the war (the "ratchet" effect, Higgs 1987).

How did war evolve after the disastrous era (843-1077) outlined above? By about 1050 all external threats to the Latin West had been warded off. However, internal warfare by the armed knights continued, causing enormous terror and damage to the labouring peasant population. Indeed, fighting remained, even without external military threat, a part of the life style of the large class of knights inhabiting their fortified castles across the West, especially in the heartland, France. Among Germanic peoples

honour ("die Ehre") ranked high in the value scale, especially among the elites. As a consequence, the slightest feeling of insult or humiliation could trigger a feud ("faida, Fehde, vete") between knights (Heyn 1982, p. 24). It is unnecessary to add that these "wars of honour" created very unpleasant spill-over effects to the peasant population: harvests were burnt, serfs killed, women raped, churches and monasteries pillaged. In the German Reich, which was ruled during the tenth and eleventh centuries by powerful emperors, knightly warfare was quite successfully reduced by a policy of "Landesfrieden". The emperor convened on regular time intervals with the "Great" of the Reich in order to take oaths of peace. The "Great" in turn tried to do the same in their stemduchies (the Landfriede of 1084, Ronkalisher Landfriede of 1158, Rheinfränkischer Friede of 1179, Reichslandfriede of 1234, Bayerischer Landfrieden of 13th century; see Heyn 1982, pp. 26-32).

In France ("West-Francia" still at that time), no royal power was able to impose such a peace. The early Capetian kings (987-1180) ruled effectively only in the area between Paris and Orleans. Especially the south of France, escaping totally from royal control, was plagued by vehement knightly wars. In these regions the movement of the Peace of God ("Pax Dei") arose. Contrary to the imperial Landesfrieden, the French peace movement rose from the lower layers of society. Special attention should be paid, however, to the role of the monks. Since the tenth century, the monks manifested themselves more and more as a power, independent from secular clergy and the knightly class. They did so mostly by putting themselves under the direct supervision of the pope. They must have thought it better to have a remote ineffective overlord than a petty but close, and hence, effective one. The leading monastery in this respect was no doubt Cluny, founded in 910 and exempted from local supervision in 998. This exemption was later extended by pope Benedictus VIII to all dependent monasteries. As a result a whole network of intellectually and economically flourishing enterprises spread in Europe, escaping totally from local control. Unarmed but quite wealthy, the monasteries were easy prey for the warring knights. As a result, the monasteries took the lead in the peace movement in France during the tenth and eleventh century. They organised large, regional meetings, on which the local population gathered, and during which series of war restrictions were voted (e.g., meetings of 989-990 in Charroux-Poitou, 990 in Narbonne, 994 in Limoges, Le Puy

and Anse-Lyon) (Duby 1978, p. 158). The Pax Dei forbade all violent actions of a knight, including pillage and rape, against unarmed people, under which the clergy, monks and peasants were understood. During the eleventh century, in a second wave of the peace movement, the Truce of God (treuga Dei) was promoted, which provided a total ban on warfare from Wednesday evening to Monday morning, during Lent and Advent, the three great vigils and the feasts of the Blessed Virgin and the twelve apostles. Not much time was left for fighting. At the meeting Verdun-sur-le-Doubs in 1016, it was provided that all knights had to swear oaths to comply with these rules. These provisions were at the base of the ethos of chivalry.

This mass movement for peace, energised by the monastic movement, did not last very long. After the eleventh century its heyday was definitively over. Gradually, the task of providing peace was again taken over by strong secular rulers, such as the king of England, the count of Flanders (Van Caenegem 1993) and by local princes in Germany after the collapse of the First Reich.

The peace movement did not ban war from European history. The military energy was refunneled to outside wars, especially to the crusades during the twelfth and thirteenth centuries. From the fourteenth century on large dynastic wars started, such as the Hundred Years Wars between French and English kings in the fourteenth and fifteenth century and the wars between Habsburg and Valois in the sixteenth century. During the seventeenth century the west became the theatre of religious-dynastic wars, during the nineteenth century (till 1918) of national wars, and during the twentieth century of ideologically inspired wars.

Nevertheless, we can credit the medieval peace movement with some lasting consequences for Western civilisation.

Few will question the beneficial economic consequences of it. The drop in warfare made travelling much safer, allowed more long-term investment in industry and agriculture, made peasants less dependent on the military protection of their lord, allowed the expansion of large non-militarised settlements, which were devoted to trade and craft. It is certainly not a coincidence that the total population started to rise steeply from the twelfth century onwards, whilst the urban component in it rose even faster (Cameron 1993, pp. 54-62; Bairoch 1988). Rather timidly during the last

half of the eleventh century, but tempestuously from the first decades of the twelfth century, trade associations multiplied, fairs were organised, artisans were attracted to cities, monetary circulation soared, risky ventures (the "commenda") were set up. The proximity in time between the reduction of warfare and the revival of trade and urban life is too obvious to deny its causal relationship.

In order to reshape society, trade and industry not only need to be done, but should also be regarded in society as respectable, even honourable activities. As long as trade and craft are just tolerated by the leading clerical and military layers of society as wealth producing machines, their long-term stability is not guaranteed because short sighted political leaders may be tempted then to exhaust trade and craft for short-term benefits.

Moreover, when social respect for trade and craft is lacking, the elites of the trade community will be steadily skimmed off in order to become part of the more respected elites. This certainly happened often in continental Europe until the French Revolution. Merchants, once well off, often tried, sometimes in a piteous way, to enter into the nobility, for instance, by marrying their daughter to an impoverished aristocrat (Baechler 1975, p. 70).

About the question when and how a change to a positive valuation of trade and work in general occurred in the West, two strongly diverging views prevail. Max Weber places this turn in the sixteenth century with the advent of Protestantism, especially its Calvinist-Puritan component. Due to their strong belief in predestination, they developed a work ethic, conducive to the foregoing of short term benefits and preference for long-terminvestments (Weber 1967). Weber, who studied thoroughly the historic evolution of the West, was, of course, well aware of the dramatic increase of trade in the twelfth and thirteenth century. According to Weber, however, the ethic of the Middle Ages remained basically hostile to trade, craft and entrepreneurship in general. The trader, even when tolerated for economic reasons, remained a foreign element within the medieval value system. Only within the protestant countries such as the United Provinces, England and northern Germany, a social ethic rating such activities positively developed. As a result, the constant skimming off from the merchant class by the nobility ceased. On the contrary, the merchant class became the politically dominant class on its own merit.

Whether Weber was right about the religious origin of the commercial success of countries like England and Holland is a question falling beyond our scope. We have to deal with the other contention of Weber, i.e. the negative, or at least diminishing attitude towards trade and work before Protestantism. Weber's view probably holds for the early medieval period, let us say, until 1100-1150. Most written sources of this period, especially the biographies of saints (the "vitae") treat commercial life with disdain. Take, for instance, the "vita" of St. Godric of Finshale. This poor peasant son, born around 1080 in Lincolnshire, started as a beachcomber, accumulated a little capital as a peddler, went as a "dusty feet"-merchant from market to market, fair to fair, town to town. With his profits he started, together with other merchants, a shipping company, and engaged in coastal trade along the shores of England, Scotland, Denmark and Flanders. After some years, Godric had become a very rich man. In the present day U.S., Godric would be praised as an example for the American dream. The "vita" has, however, another happy end. Godric, moved by grace, suddenly understood the vanity of his fortune. He turned over all his possessions to the poor and became a hermit (Pirenne 1956, p. 82, see also other examples about the "ignobilis mercatura" in Pirenne).

On the other hand, sources from the same period indicate a positive attitude towards a life of work and earning profits. The texts collected by Gratian (c. 1140, De Matrimonio and Decretum) define the status of laity as men, righteously married, tillers of the soil, capable of adjudication amongst themselves, and with rights to pursue their own affairs as possessors and users of worldly goods (Coleman 1988, p. 609). In the same period, the well known theologian Ivo of Chartres (c. 1040-1115) implicitly rejected the three ordersview by holding that "God created man in his own image and rescued him from his pain, the one as well as the other. Both, the poor and the rich, are equal in His love 'and' for Jesus Christ there is no freeman nor serf, because all the ones who participate in His sacrament are equal" (Van der Ven 1968, II, p. 39).

These texts reveal a positive view towards earthly life and towards the third, working order in general, which was no longer regarded as a mere food provider to the two higher orders. During the thirteenth and fourteenth century a much more elaborated positive evaluation of trade and artisanship specifically would become predominant.

The craftsman had allies in theology. Jesus was after all a carpenter's son and apprentice. Moral theologians began to regard manual work as no longer a penalty for sin, but a positive means to salvation (Black 1984, p. 15).

Between Aquinas' view on man with reason and hands, who had to meet his need by some industry, and the later Renaissance cult of business ("negotium", "homo" "faber") there was only continuity (Black 1984, p. 16). Sombart, the most famous opponent of the Weberian thesis, is very convincing when he points to the flourishing literature in northern Italy, upholding without any hesitation classical middle-classvalues, such as hard work, profit making, long term perspective, prudence and sobriety (Sombart 1915, pp. 103-124).

Thomas Aquinas' writings in the thirteenth century still show a static view on the position of each man and the wealth he deserved accordingly. Later schoolmen, however, such as cardinal Cajetan, held that every man ought to have the possibility of working himself up and becoming richer than he was (Sombart 1915, p. 246). Unlike in the "vita" of Goderic, the merchant, who had become rich, could keep his fortune without any remorse, provided he had made his profits in an honest way.

Sombart seems to be right when he advocates that these later schoolmen had more sympathy for and understanding of capitalism than the 17th century zealot preachers of Puritanism (Sombart 1915, p. 244). The aforementioned opinions show that from the twelfth century on a deep intellectual revolution took place concomitant with the economic evolution, by which the values of military honour, subjection, and fatalism were replaced by respect for peace, work, trade, and individual progress.

5 Medieval Horizontalism: The Rise of Associations

Civil society in the classical liberal sense is a non-organic notion. According to this view, the organic picture of society as a teleological body in which individuals and groups perform static functions towards the whole is misleading. Individuals and groups do, of course, perform functions within society. Such functions are often deliberately conceived and performed by individuals in their interaction towards others.

Sometimes such functions are perceived only ex post, by social understanding, when actions of some have unintended consequences for others. In both cases however, individuals or groups do not function "for society" but for benefits and values, perceived ex ante or only ex post within their mutual interaction.

Did medieval man conceive his individual or group-life as organic towards the whole? Since the eighteenth century Enlightenment, most social theorists and historians answer this question affirmatively. The Enlightenment, with its preference for mechanistic explanation and individual emancipation, blamed the Middle Ages for its organicism. Nineteenth century romanticism on the contrary, glorified the Middle Ages for it. Modern corporatist thinkers, such as Otto von Gierke (1841-1921), Ferdinand Tönnies (1885-1933) and Emile Durkheim (1858-1917) found their inspiration in the warm organic group life of the Middle Ages, which was contrasted with the cold rationalistic and atomistic life under liberal capitalism (Black 1984, pp. 210-236). Even contemporary authors, such as the socio-linguist Michaud-Quantin, assume the existence of a communitarian ethos in order to understand medieval social language (Black 1988, p. 588).

There appears to be some weight to this view on the Middle Ages. In its thinking about society, the medieval church used organic categories. The Catholic Church, the extension of the invisible and eternal in time and place, was depicted as the body of Christ, in whose mystery all faithful participated. The members of this body were functionally related to the whole by their duties, their "officia". Individuals only entered the picture as occupants of these "officia". The individual as such, as denuded from his "officia", was never opposed to the whole of society (Black 1988, p. 592; 1992, p. 15; Bouckaert 1991, p. 156).

The organic analogy was also used for smaller entities, such as cities. The city was often rather seen as a close community, as a near family, rather than as a civil, political association. Henry of Ghent (c.1270) sees the city as "... men living together in civil society and communion; for this could not exist unless bound together by supreme friendship, in which each considered the other as a second self, by supreme charity, by which each of them loved the other as himself, and by supreme benevolence, by which each of them wished for the other what he wished for himself" (Black 1998,

p. 597). Parties ("pars, partes") were regarded with a bad eye, because they divided the body. According to Remigio de Girolami (c. 1319), the city is a whole which the parts love more than themselves and to which they are more closely joined than to themselves (Black 1998, p. 597; Skinner 1992, p. 65).

These opinions leave us with a picture of an organicist society, in which people defined themselves merely as an element of a group, in which they were locked in beyond their free will.

Against this picture, which has seduced so many social theorists, we must oppose, first of all, the legal doctrine about associations, and secondly, some features of medieval community life, as it probably was.

The medieval lawyers, especially the glossators of the Roman law, mostly took a liberal position towards the question of the founding of new associations. The original texts of the Digest provided that craft workers could only form a college by permission of senate or emperor, with the exception of some listed crafts (Digest 3.4.1 pr). The medieval glossators circumvented this legal obstacle by considering this latter list as indicative, and thereby legalising all craft-guilds, without any further requirement (Black 1984, p. 19). The same view was adopted by Pope Innocent IV, who also defended the "individualistic" position that corporate bodies could not be punished (Black 1984, p. 21). Innocent IV and Bartolus, perhaps the most famous lawyer of his time, both affirmed the right to freely enter and leave voluntary colleges. Bartolus also opposed any regulation, by which the exercise of a craft was restricted to some persons (Black 1984, p. 23). As far as medieval legal opinion was concerned, no static or organic view on the formation and evolution of associations was exposed. On the contrary, their views were quite close to the later liberal views on the freedom of association. Also their legal concept of an association was all but holistic. Bassianus for instance, considered an association ("universitas") as "a collection of several bodies distinct from each other". He considered the "universitas" neither as "an individual", nor as a "species", but simply as a notion to indicate separate bodies which were joined together (Black 1988, p. 598).

Though influenced by Aristotelian holistic thinking, Thomas Aquinas also rejects holism when he says, "man is not related to the political community as to his whole

being and everything that is his, and therefore not all his actions need be classified as praiseworthy or blameworthy in relation to the political community" (Black 1988, p. 600).

When considering the evolution of associations in medieval social history, one cannot deny its astounding dynamism and variety. Twelfth century Europe was the theatre of a real explosion of associations, not only in number but also in kinds. With regard to teaching and scientific research there was the rapid spread of universities from south to north, west to east. With regard to trade, there were the merchants' guilds, springing up in every city, organising fairs and providing a very effective adjudication system (Benson 1997, p. 43; Trakman 1983, pp. 7-21).

On the political legal level, we have to mention the boom of new cities, which mostly had a voluntary origin in the famous communes (Bouckaert 1997). On the social level, we have to mention the founding of numerous hospitals and other religious charities (Strayer 1985, p. 292).

This tremendous explosion shows that associative life in the Middle Ages was not static at all. Apparently, social entrepreneurs were busy in all niches of society. One should compare twelfth century Europe with a thrifty social laboratory rather than with a static, organic entity.

When considering the relationship of individuals with their association, one also should be cautious of presenting too static a picture. Firstly, most individuals must have been members of several and very different associations. One could be a member of his city, of his guild, of his confraternity, of his chapter, of his university, etc. It is too simple to argue that one was born and died within his group. Usually, urban citizens participated within a very varied group life. Secondly, demographic studies point out that mobility, especially among intellectuals, but also among artisans, was quite high (Berman 1983, p. 123).

It is true that often one or more sons became an apprentice in the same craft as their father, and because of which one business remained sometimes within one family for generations. Other children, however, had to look for other job opportunities, which they often found in other crafts, in trade, or within the wide ranks of secular and regular clergy, which was, of course, not family based at all in its recruitment.

It is true that medieval political literature emphasised the role of the community in the life of individuals and the duties of them towards the community. This does not imply, however, a holistic political philosophy, according to which the individual is considered nothing more than the ephemeral manifestation of a collective entity. The emphasis on the community was mostly related to the need for a joint effort in order to preserve some goods, especially "liberties", for individuals, which they cannot preserve by their isolated efforts (Black 1988, p. 596; 1992, pp. 18-41). The good of the community ("bonum commune") was not perceived as something distinct from the good of the individual. Remigio de Girolami expressed the relationship between the individual and the common good as follows: "Let the citizen, however poor in himself, strive to make his commune flourish, for in this way he himself will flourish" (Black 1988, p. 596). John of Viterbo said about the city: "A city is called the liberty of citizens or the immunity of inhabitants ... for that reason walls were built to provide help for the inhabitants. City means: you dwell safe from violence. Civitas, id est ci (tra) vi(m)(hab)itas. For residence is without violence, because the ruler of the city will protect the lowlier men lest they suffer injury from the more powerful" (Black 1992, p. 19). Such statements about the community and the common good do not reflect holism at all. It would be easy to "translate" them in modern methodological individualist notions such as economies of scale and public or collective goods.

To conclude this section, it must be argued that neither medieval social history, nor medieval political theory provides us with a picture of a static organic society, in which the individual was virtually nonexistent but considered himself only as an epi-phenomenon of the group to which he belonged. We perceive rather the emergence of a society, in which the medieval individual became gradually conscious of his possibilities to use the dynamism of joint efforts in order to improve his status ("libertas") and his material wealth. Group life had, of course, another outlook than in the modern liberal society. It was far more religiously tainted and had often monopolistic traits. All this does not justify, however, the picture of medieval organicism. This seems rather to be a myth made up for nineteenth century anti-liberal, ideological purposes.

6 Is There a Medieval "nomos"?

Order within civil society rests upon a set of common rules, which do not force individuals into a specific, goal-directed strategy, but which allow individuals to pursue in an orderly and peaceful way their own goals. Such rules are subservient to a multitude of very diverse goals, plans and life-styles within a free society. We perceive such rules and their supporting institutions in the traditional bodies of private law, articulated on the European continent in written codes and contained in common–law countries by a body of precedent law. Though these traditions show national differences, they are, nevertheless, subservient to one gradually globalising order. They rest upon similar principles, while the national differences are overcome by the tradition of the law of legal conflicts (international private law). Perhaps this perception of the modern liberal "nomos" is too legalistic. Modern sociological and economic literature stresses the importance of underlying values and ways of social interaction, which may be as important as the formal rules of the law. Fukuyama, for instance, stresses the importance of trust (Fukuyama 1996), Ellickson the importance of basic social moralities (Ellickson 1991), Haberman the importance of conventional rules in Confucian China (Haberman 1995, p. 73), Macauley the importance of reputation in business relationships (Macauley 1963). How the legal component relates to moral components within the "nomos" of modern society is a question beyond our scope. There is, however, a large consensus to perceive such a cluster of legal rules and moral values as underlying the modern global civil society. The question is whether there was something similar in the Middle Ages. Again, much seems to point to the opposite.

Many parts of the medieval legal order reflect more a "patchwork quilt"-type of a small, concrete legal mini-order rather than a broad "nomos". This seems to be the case for the manorial law, which affected, needless to say, the daily life of the vast majority of the peasant population. The rules could differ from manor to manor, while the jurisdiction on demesne matters rested entirely with the lord of the manor. According to his whims, the practice of the manorial courts could differ from manor to manor. Manorial law concerned very practical regulations of the management of the realm, such as the use of the commons, of monopolised goods (pond, woods, mills, mines); the rules about manorial labour, duties or rents; easements between estates,

etc. The property of the peasants was not submitted to the abstract rules of markets, but rather to internal family rules such as the "retrait lignager", obliging the vendor of land to offer it first to family members. It looks as if the bulk of the population was caught in the small cages of very restricted and concrete legal orders, looking much more like Oakeshots' enterprise associations than a civil association. From a sociological viewpoint medieval society can be qualified overwhelmingly as a "peasant society", i.e. a society in which the local community (parish, village, manor) is the central economic, ritual, cultural, and social control unit and in which relationships among the inhabitants are based on personal contacts (for an overview on the "peasants' society" literature see Macfarlane 1978, pp. 7-61).

Even the cities, though the most dynamic actors in medieval society, appear rather as closed and concrete legal orders. Each city had its own, sometimes very detailed regulations on trade, taxation, the use of the public domain, the entry of crafts, etc. They acted, in fact, as a large artificial family, thereby subduing their subjects to severe social control. Cities intervened deeply in economic life, such as, for instance, through the so-called staple rights ("vente aux étapes), according to which shippers of vessels of wheat could be obliged to cede a part of their load (one sixth or one quarter), to be sold later after an interval of some weeks. By doing this the city disposed of permanent reserves of wheat (Bouckaert 1997, p. 234).

The absence of an abstract "nomocratic" rule, allowing individuals to pursue their own goals, is perhaps most obvious in the religious practices of the Middle Ages. The tolerance espoused by the church authorities had a meaning totally different from the later modern, liberal principle of tolerance developed by John Locke and John Stuart Mill. Medieval tolerance consisted of a virtue to be practised by the Christian faithful, imposing on them a certain moderation in their battle against evil. Often one had to tolerate evil, i.e. not to intervene violently when even having the means to do so, because the harm of intervention could be worse than the evil one wanted to eradicate. Tolerance was a "permissio comparativa". It was the outcome of a balance made by the Christian ruler between the evil to repress and the evil of repression (Berjczy 1997).

The strategic character of medieval tolerance is clearly shown by the attitude of the church towards heretics. They were excluded from any policy of tolerance, unlike

for instance Jews, Muslims, or prostitutes. The evil of heresy, including the danger of splitting the community of the faithful ("universitas fidelium") outweighed apparently the evil of violent persecution and repression.

The evolution concerning religious tolerance has deeply affected the general perception of the Middle Ages and the periodisation of history. It is very common to outline post-medieval history on this matter as follows: the religious totalitarianism (theocracy, hierocracy) of the Middle Ages led, after some shattered attempts of reformation during the fifteenth century ("conciliarism" of Constanz), to a split in Christianity and to the many religious wars in the sixteenth and seventeenth centuries; a real "civil society"-solution finally emerged in England, where strong religious diversity created the dilemma of either endless civil war or tolerance as an overarching constitutional principle.

When we add together what we mentioned about the medieval "peasant society", about the strictly controlled cities, and about the lack of religious tolerance, we must conclude that the emergence of a "nomos" of a liberal civil society was only enabled by a total breakaway from medieval conceptions and social structures. We will contend this belief in the following three sections. Although the mentioned elements, picturing the Middle Ages as the opposite of a civil society rest upon many historical facts, we see more of a continuity between the philosophical, legal, and political traditions in the Middle Ages and the later emergence of a flourishing civil society in the eighteenth and nineteenth centuries, than a real breakaway.

7 Medieval Humanism

As we mentioned already at the end of section 3, the church had been able, during the preceding centuries (500-1000) to integrate the invading pagan, Germanic, Slavic and Hungarian tribes within a culture of Christian universalism. Unlike the pagan religion of the barbaric tribes and antique cities, the Christian gospel taught that salvation was possible for the whole of humanity because everybody can participate through his faith in God's love. In this way Christianity constituted in the culture of the West a profound anti-tribal and anti-racist intellectual tradition. If Christianity was profoundly tolerant of accepting people to its womb, the question, however, re-

mained how tolerant Christians would be towards the ones who preferred to remain outside Christianity (Jews, Muslims, pagans), and the ones who espoused religious views regarded as heterodox (heretics).

Although no stable constitutional practice of religious tolerance originated during the Middle Ages, the philosophical bases of it on which later liberalism would build were developed during this era. Two doctrines should especially be mentioned with regard to this, i.e. the doctrine of natural law and the distinction of crime and sin.

Natural law theory, brought to its medieval heights by Thomas Aquinas, implied that man, as a rational creature, was able to discover by reasoning and by experience alone basic moral truths necessary for a viable society. In order to open himself to the mercy of God one also had to learn the divine law revealed in the bible and ecclesiastical tradition (Aquinas 1952, pp. 208-209, 221-223). The distinction between natural and divine law provides a "natural" base for a constitutional rule of tolerance, for it implies that faith, however necessary for salvation, is not necessary for an orderly society. Provided they respect the rules of natural law, heathens, Jews, Muslims, and Christians should be able to live together peacefully. This distinction also provides the philosophical base for the later separation of state and religion, allotting to secular authorities the maintenance of at least the natural law-order and to church-authorities the preaching of the Gospel, including the divine law.

Building further on the teaching of the medieval Schoolmen, the Dutch lawyer Hugo Grotius split natural law from theology by stating that natural law was also valid for people who did not believe in God at all ("etiamsi daremus quod sine summo scelere dari nequit, non esse Deum...", Grotius 1993, p. 10). Locke, exiled from England, lived in Holland as a guest of Philip of Limborch, a member of the liberal Arminian party, to which Grotius belonged also. This probably provides us with the historic link between medieval natural law thinking and modern liberal tolerance.

Parallel with the distinction of natural law and divine law, medieval philosophers, especially Abelard and Petrus Lombardus, distinguished crime from sin. All crimes were sin, but not the inverse. Many sins, such as, for instance, thoughts of disbe-

lief, can only be judged by God and not by human jurisdictions, neither secular nor canonic. All acts and thoughts, which are not sufficiently externalised towards others ("operationes ad alterum") should, therefore, remain beyond the reach of criminal sanctions. Eventually, they could be administered by the priest by his sacramental power and be sanctioned by penitence, but not by secular sanctions (Nemo 1996, p. 281). However unclear the distinction between "forum internum" and "forum externum" might have been, it provided the intellectual base for the distinction between mere immoral and illegal acts, between moral, religious and social sanctions and criminal sanctions, and finally as well as for our much cherished freedom of thought.

The question remains, however, why these humanistic tenets within medieval Christian philosophy did not develop into constitutional practice. The answer must be sought in the interaction between principles and self-interest. Principles will only prevail in practice when the actors perceive some self-interest in the preservation of the principle. The principle of respect for property finds numerous defenders into the wide ranks of individual owners, who experience from day to day the benefits of property and can themselves imagine how bad life would be without respect for property rights.

During the Middle Ages society was homogeneously Christian, while the authority of the church as such was seldom contested. In these circumstances it was hard for church leaders to perceive some interest in a policy of tolerance. The use of violence, willingly offered to the church by secular rules, was a very easy solution in which no harm for the church itself was perceived. Only later would more and more Christian thinkers, like Erasmus of Rotterdam, become aware of the fact that this created the opportunity for rulers to abuse religion and church authority for their own political purposes. In protestant countries the threat of constant civil war created a self-interest in tolerance for the different religious parties. In Catholic countries we have to wait until the nineteenth century before the church perceived, as a result of the teaching of catholic liberals such as Lammenais and Montalambert, the many opportunities of a liberal constitution.

8 The Ius Commune of Europe

With regard to the development of law, the Middle Ages were thoroughly polycentric: legal rules, notions, theories, and procedures were developed in many centres, often without territorial monopoly power. Such centres were the papal curia for canon law, the universities for Roman law, the secular rulers for feudal law, the city magistrates for urban law, the consular courts for commercial law, the manorial courts for manorial law. It is puzzling how such a panoply of law-producing centres could lead towards a general and consistent cluster of legal rules constituting a "nomos" for an abstract order (see above, section 6). Most legal historians, however, agree that during the concerned period (1073-1400) a legal tradition, common to the whole Latin West ("ius commune") came about (Berman 1983, p. 120; Van Caenegem 1988). However paradoxical this may sound, the formation of the body of a European legal tradition originated because of this polycentrism and not against it. The paradox can be explained by two major features of medieval legal polycentrism: 1) some centres of law production were of a non-territorial character, so they were in a constant competitive relationship with other law producers; this was the case for canon law, Roman law and commercial law; 2) the territorial law producers were so manifold that ample room was left for experiment, innovation, and imitation; this was the case for urban law, manorial, and feudal law. We will show this by briefly dealing with canon law, Roman law, urban and manorial law.

From the beginning of the twelfth century, the production of canon law developed at a greater speed. The popes enacted decretal after decretal, but even more important were the efforts to systematise the already past decretals into one coherent body of canon law. This was especially the result of the patient work of Gratian, leading to the Decretum in 1140. This work, generally recognised as the authoritative statement of the canon law, was later on constantly glossed and commented, giving birth in this way to a very rich and consistent body of law (Berman 1983, p. 202). This legal revolution is of course a by-product of the more fundamental papal revolution, which started in 1073 with the papacy of Pope Gregory VII, the famous Cluniac monk Hildebrand. This pope profoundly altered the image of the church and its relationship with the secular world. Under his papacy the church appropriated itself an image

of a well-structured body, separate from secular power, with its own hierarchy and discipline, and with a strong commitment to change the world according to the Christian gospel. The papal revolution had deep political consequences. From then on a strong transboundary power was constituted, limiting the power of secular rulers, even in non-spiritual matters. The papal institutions claimed to be the head of the "respublica Christiana", in which they exercised legislative power, while the secular rulers within this "respublica" acted only as executive agents, owing obedience to the authority of the pope. For two centuries (1100-1300) this papal supremacy was a political reality. Counts, dukes, kings and emperors feared the dictates of the pope. Popes could plunge a whole country into disorder and civil war by their decisions. The popes succeeded in annihilating the power of the German emperor. They only had to bow for the much more efficient and less scrupulous power of Philip The Fair, the French king who submitted the papacy to his political strategy (Spruyt 1996, p. 96).

Besides this political effect, Nemo attaches a more profound meaning to the papal revolution and the ensuing growth of canon law. According to him, this revolution brought about a reconciliation between the Roman legal tradition, based on reciprocity, corrective, and distributive justice, and the Christian faith based on infinite compassion ("misericordia") with those suffering in the world (Nemo 1996, p. 272). Through changes in theology, such as the introduction of purgatory, many moral Christian notions were rendered measurable. Penitence became apportioned to the gravity of the sins. A faithful Christian was able to expiate his sins and to assure his salvation by a virtuous life and giving sacrifices to the church. In short, the papal revolution realised the Christianisation of the legal legacy of antiquity and the juridification of Christian morality. In this way Western civilisation was enriched by a fusion of Rome and Jerusalem.

Within the sphere of legal practice, the courts of canon law arrogated themselves a very wide jurisdiction. First of all, they claimed exclusive jurisdiction on all church matters, which constituted an important part of social activities when taking into account the immense properties of churches and abbeys. Secondly, they claimed jurisdiction on all matters of lay people, which had a religious dimension. Examples of this were marriage law, because marriage was a sacrament; testamentary cases, because a will was seen as a religious act; all cases of contract and property in which a breach of

pledge of faith was involved; criminal cases such as adultery, assault against a cleric, sacrilege, sorcery, usury, fornication and homosexuality (Berman 1983, p. 261). Because of these "materiae mixtae", litigants had often the choice to bring their case for a canonic or a secular court. Due to their intellectual superiority, the legal opinion espoused by canon law gradually spread throughout most courts of Europe and became a part of the "ius commune". Examples of this are: 1) the doctrine "pacta nuda", relieving contracting from formalities and holding that a contract is concluded by mutual expressions of will alone; written documents are only necessary eventually for providing evidence; 2) the peaceful possessor of a good cannot be dispossessed from it in a violent or surreptitious way even when the dispossessor was the true owner ("actio redintegranda"); 3) with regard to evidence law, ordeals were forbidden for priests at the Council of Laterans (1215), which in turn led to the entire disappearance of ordeals; 4) wills can be made nearly without formalities, even orally, provided a witness (e.g., the priest, who heard the last will) can testify to it. Many of these innovations still prevail in present civil law.

During the same period of the papal revolution, a complete copy of the Corpus Iuris Civilis of Justinian was discovered in northern Italy. The texts of Justinian were awarded a status on law which was equivalent to the status of the Bible in religion. They were studied and discussed systematically at the medieval universities ("universitas magistrum et scholarum"), which originated in northern Italy (especially Bologna), and spread rapidly during the twelfth and thirteenth century throughout Europe. The Roman law studied by medieval professors and their students was in fact a "dead" legal system. It was not practised at all in eleventh century society, except in some regions in a very primitive way ("vulgar Roman law"). Yet it was seen as "the law", the product of human reason. The nearly biblical authority of the Roman law, of course, stimulated its spread throughout legal Europe. Two other elements, far more of a structural kind, should be mentioned in this respect. Firstly, Roman society of the classical era (0-200 AD) had important similar traits to the medieval world of the twelfth and thirteenth centuries. Both were worlds of an intense commercial and social interaction within a very broad geographical and cultural space. The abstract rules of the Roman law, especially of its "intertribal" component, the "ius gentium", were consequently very useful for the nascent great society of the me-

dieval "pax Christiana". Secondly, the Roman law was not handled as a series of texts with a fixed meaning. The scholars of Roman law cherished the idea of the law as a "corpus", i.e. as a coherent body with underlying principles. Apparent contradiction could thus be solved by reasoning towards these principles, by which some statements in the Roman texts could be put aside (Berman 1983, p. 140). Especially the second generation of scholars, the "post-glossatores" or "commentatores", took a lot of liberty in interpreting the texts of the Digest. This allowed the scholars to adapt the Roman law to present needs, while at the same time using the prestige of antiquity of the Roman law. We mentioned earlier (section 5) the subtle way by which "glossatores" such as Bassianus reinterpreted the regulation on permissions to found an association.

Another example of the inventiveness of the "post-glossatores" is seen within the crucial notion of individual property. Roman law itself did not provide a definition for a property right. It did not even know the notion of a right itself. "Ius" meant rather a collection of rules and not a right. In feudal and manorial law, nothing similar to a property right existed. All entitlements on land were implicated within a complex web of reciprocal duties between lords and vassals, and between lords and (free and unfree) tenants. Yet in the beginning of the fourteenth century, through reasoning and discussion, the "post-glossatores", more particularly the famous Bartolus, defined property as a right to use, enjoy, and dispose freely over a good, provided the owner did not act against another legal rule (Bouckaert 1990, p. 785). This definition of property triumphed finally with the introduction of the Civil Code in 1804, in which it is nearly literally adopted in art. 544. The Roman law view on property was during the preceding centuries constantly promoted in legal discussions before courts, which greatly helped to erode the feudal-manorial property regime on land.

While canon law and Roman law relied on the transboundary, religious and intellectual authority of the church, the medieval urban law relied on the territorial authority of the city magistrates. During the urban revolution in the first half of the twelfth century, many cities succeeded to be granted in charters the right to legislate on a wide series of subjects (public administration, private law, procedure, criminal law) (Bouckaert 1997, p. 221). This thorough decentralisation in law-making did not evolve, however, into the legal "patchwork quilt" we might expect at first sight.

Among the different urban laws, mostly codified within charters, one can discover wide "families of urban law", within which strong similarities of rules and procedures prevailed. In Flanders, for instance, most charters of the cities, granted in the twelfth century, were modelled after the charter of St. Omer, granted in 1127 by count William Clito (Berman 1983, p. 370). In the German empire about eighty new cities took over, without being forced, the laws of Magdeburg. This city on the Elb had been granted a charter in 1188 (Berman 1983, p. 376). Apparently the cities perceived the benefits of a more or less similar body of rules between the different cities. This bottom-up harmonisation of urban law also allowed for a process of constitutional learning. In the cities of Flanders, which originated quite early, the city constitution did not provide for a distinction between legislative and administrative power on the one hand and judiciary power on the other. All power was concentrated in the hands of powerful aldermen ("scabini"), recruited from the wealthy patrician class. This led, during the fourteenth century, to bloody class struggles between patricians and guilds and among the guilds themselves. In the duchy of Brabant, however, cities were younger and provided in their charters for a separation between legislative, administrative power and the judiciary. They also provided for much more democracy in the election procedures. Apparently, Flemish cities "learned" from this, and introduced similar systems at the end of the fourteenth century (Bouckaert 1997, p. 233).

Manorial law was probably the least nomocratic legal order during the Middle Ages. Yet, the picture we touched upon in section 6, i.e. manorial society as a collection of cages in which peasants were locked in, has to be amended substantially. Manorial law itself evolved thoroughly during the twelfth and the thirteenth century. The rights of the tenants were strengthened by changes either brought about through royal intervention (e.g. the Statute Quia Emptores in England; the enfranchisement of serfs in France by Louis X and Philip the Long) or by the fact that serfs had an easy route to the cities ("Stadtluft macht frei"). Manorial justice, a prerogative of the lord of the manor, evolved gradually to participatory adjudication, by which other, often elected, inhabitants of the manor acted as judges (Berman 1983, p. 325). Around 1450 serfdom was completely abolished in Western Europe. Peasants could freely leave the manor and were rarely submitted to labour duties. The erosion of the subjection of the peasantry, the reciprocal and participatory character of manorial law, and the

many routes of escapes from the manor also destroy the picture of the Middle Ages as a "peasant society". Based on ample social data, such as appearing from parish registers, court rolls, deeds, etc., Macfarlane shows, very convincingly, that medieval England (13th-15th century) was a rather open society, which had a mobile population, a flourishing market for land, an individualistic system of heritage and a free status for the individual tenant (Macfarlane 1978). One can question whether this individualistic character of English agriculture was as unique as Macfarlane suggests. Probably also other parts of Western Europe would fit this picture too. In the west of Flanders for instance, in an area called "Franc de Bruges", all farmers enjoyed a status of freemen, granted to them by the abbeys, in exchange for help in winning troughs and marshland from the sea. It is true, however, that this liberalisation of the peasantry did not occur in Eastern Europe, where lower urbanisation offered fewer escape routes and the nobility was given free reign by the emperor, spending all his energy in Italy pursuing his Roman dream (Spruyt 1994, p. 109).

9 The Rule of Law in the Middle Ages

A civil society not only needs a "nomos", imposing some basic ethical and legal standards to the interaction of, for the rest left free, individuals. It requires also as its constitutional cornerstone rules and institutions which prevent political power from destroying the nomos instead of upholding it. This constitutional cornerstone, usually called "rule of law", "limited government", "Rechtstaat", "état de droit", only appeared as a systematised doctrine in the seventeenth and eighteenth century, with the works of John Locke and Montesquieu. Again, the question arises whether this doctrine owes its origin to post-medieval roots and experiences, such as the religious wars, Puritan-Calvinist constitutionalism (p.ex. monarchomachs, Althusius), the Levellers' movement and the Enlightenment; or can we trace it further back into the Middle Ages. Again the answer is positive: between (some currents in) medieval political thought and the later "rule of law"-theory, there is continuity, not a break. The medieval roots of the rule of law should be sought in the tradition of natural, canon, Roman, and feudal law.

According to natural lawtheory, the ruler is bound to the principles of natural law. Lack of respect for them entitled his subjects to a right of resistance. This right could be active (revolt) or passive (non-payment of taxes among other things). According to Aquinas, this right had to be used with prudence. When a revolt against an unlawful ruler would create an even greater harm to the common good, restraint was to be recommended.

This limitation of power and "ius resistendi" was elaborated by Gratian in canon law. With regards to the question whether the prince acted according to natural and divine law, the pope was considered the supreme judge. The "ius resistendi" expressed also a power relationship between popes and secular rulers. The canonists, however, were quite consequent by holding that the "ius resistendi" was opposable to the pope himself too (Berman 1983, p. 145). The pope was also subject to natural and divine law. The canonists did not elaborate formal procedures to materialise this right of resistance against the pope. For this, we have to wait until the fifteenth century with the movement of conciliarism in Konstanz. Nevertheless, it is clear that since the twelfth century a theory of limited government was developed within the most dynamic institution of that time. In this respect, the doctrine of the Renaissance political theorist Jean Bodin of "Princeps legibus solutus est" rather seems to be a break from the awakening rule of law tradition (Nemo 1996, p. 284).

The tradition of Roman law is often blamed for having promoted the absolute power of kings and emperors by taking the Byzantine emperor Justinian as its constitutional model (Ullman 1975, p. 85). This is undeniably true. However, the theory of "iurisdictio", developed by the Roman law scholar Azo (1198-1230) contributed also to the rule of law-doctrine. "Iurisdictio" is the publicly established power and duty to pronounce judgement and to establish justice. As such, "iurisdictio" means the use of power according to the "ius", i.e. legitimate power. "Imperium" or "dominium", i.e. the power of the sword, is a species of "iurisdictio". "Iurisdictio" contains "imperium" and not vice versa. This means that the power of the sword can only be exercised according to the law ("ius").

To the question what was the source of the lawmaking power of the ruler, Azo answered that the source was in the "corpus", the "universitas", the "communitas".

Jurisdiction, consequently ascended from the people to the emperor and not vice versa (Berman 1983, p. 292).

As already mentioned earlier, by far the most effective promoter of the rule of law was the feudal structure of political power based on the idea of reciprocity. Unlike many canon law and Roman law theories, the feudal law affected very practically the power relationship between the effective local rulers, such as dukes and counts, and their subjects. During the twelfth, thirteenth, and fourteenth century, the feudal principle of reciprocity between lord and vassal was gradually extended towards the relationship between ruler and subjects in general. The Magna Carta provided not only that the government of the king had to be in consent with the barons, but it provided also general liberties for all freemen in the kingdom. For instance, it states that "...no free man shall be taken, imprisoned, diseased, outlawed, exiled or in any way destroyed except by the lawful judgement of his peers or the law of the land". The Hungarian Golden Bull of 1222 granted rights and liberties, similar to the ones mentioned in the Magna Carta, to the bishops and the higher and lower nobles of our realm. This in fact meant a respect for the rule of law towards all free men in the kingdom. In the duchy of Brabant, the famous charter of the Joyous Entry of 1356 granted extensive liberties to all free citizens and a government based on the consent of the most important organised bodies (cities, church, guilds, nobility) within the duchy.

The feudal roots of the rule of law, which were based on reciprocity, and the canon law roots of the rule of law, which were based on respect for natural and divine law, were probably merging with each other during the thirteenth and fourteenth century. The "ius resistendi" appears in very important law books such as the "Sachsenspiegel" of Eike von Repgau (early thirteenth century) and the "De legibus et Consuetudinibus Angliae", ascribed to Bracton (Berman 1983, p. 293). It is difficult to say where these authors found their inspiration: in canon law or feudal law? Probably in both. It is, however, difficult to deny that a rule of law-doctrine was in the making during the Middle Ages. The rise of absolutism and state sovereignty would interrupt this process in most European countries. This is, however, another story.

10 Conclusion

"History is a gallery of paintings, with few original works and many copies", said Alexis de Tocqueville in his analysis of the causes of the French Revolution. Are we able to compare some characteristics of our time with those of the Middle Ages? Are some situations in our time only copies of medieval pictures? Answering such questions is a very speculative business. In order to stress the relevance of our views on the medieval roots of our civil society and also to stress the fragility of the latter, we must take the risk of making some comparisons.

After the collapse of the socialist totalitarian world, the present international world looks medieval in two respects.

Firstly, on the international level a relative stability persists thanks to the so called "pax Americana", clothed or not clothed in a United Nations envelope. The United States, as a military power, is able to exert a certain hegemony on the world but is not able to (and hopefully not willing to) dominate and rule the world. On one hand, we are left with a polycentric international system (many sovereign states) which does not fall, on the other hand, into a Hobbesian war-like situation due to U.S. hegemony. The medieval counterpart of this has to be sought in the "respublica Christiana" during its effective period (1073-1300). The hegemonic power of this era was, without any doubt, the pope and his powerful bureaucracy, disposing, not over armies, but over an immense religious-moral authority to keep the most powerful candidates for domination, especially the Holy Roman Emperor, under control.

Similar to present day "pax Americana", the "respublica Christiana" provided some international order and containment of conflict, without real international domination.

Secondly, the numerous political entities of our time (ca. 200 nation-states) coexist in a world of growing interaction between individuals, enterprises, and voluntary associations. This puts the nation-states under strong competitive pressure for investments in capital goods and probably, in the near future, for skilled labour (human capital). The nation-states who either have given up largely liberal constitutionalism or have never known it, are by this competitive pressure forced to factually liberalise

their policies. This picture can be compared to the medieval patchwork of political entities, in which duchies, counties, bishoprics, cities, and city-leagues coexisted in a world of increasing interaction with merchants, artisans, lawyers, artists, clerics, and scientists across the borders of their polity. The gradual emergence of a wide civil society within the "respublica Christiana" also forced many rulers to adopt a policy of economic tolerance and fiscal restraint. While we live in a "globalisation" of human interaction, the Middle Ages certainly lived in a Western European "continentalisation" of human interaction.

These two parallels between our time and the Middle Ages make it very interesting to look for the main causes of collapse of the "respublica Christiana" after the thirteenth century. This may enable us to watch with particular attention any similar evolution in our time which might endanger the ongoing process of "globalisation".

Basically, the medieval order of the "respublica Christiana" collapsed because one player, i.e. the king of France, was able to break the power of the arbiter of the order, and to reduce the arbiter to a tool of his policy. This happened during the fourteenth century, when Philip the Fair and Guillaume Nogaret overpowered Pope Boniface VIII and brought the papacy to Avignon (Spruyt 1994, p. 153). The elimination of the arbiter and the gradual weakening of a supranational code of behaviour ("ius naturae", "ius gentium") plunged Europe into an open Hobbesian situation, pushing each country into a war-taxation-bureaucracy cycle (Tilly 1975). The wars between the castle nobility during the tenth and eleventh centuries, suppressed by the Peace of God and the "Landesfrieden", were now replaced by a war between powerful monarchist war machines. This was most pronounced in France, Spain, Sweden, and Prussia. Countries like England and Holland, which preserved large parts of their medieval "rule of law" tradition, were able to stop the war-taxation-bureaucracy cycle. This led gradually, after many wars and revolutions, to the "pax liberalis" of the nineteenth century (1814-1914).

Can we perceive similar tendencies in our time comparable with the factors which brought the "respublica Christiana" to its collapse in the fourteenth and fifteenth century? The danger that the present hegemonic power, the U.S., turns into an imperialistic one, trying to rule effectively the whole world, like was the ambition of the medieval Holy Roman emperors or of some popes, is very unlikely. Internal and external

opposition to such plans is far too strong. A dash for power by other national states is even more unlikely, as other states will form counterbalancing coalitions.

The major danger for the present international order and, consequently, for the continuation of the global civil society probably resides in the formation of strong regional blocks like NAFTA and the EU. Such blocks, which originated paradoxically as free market areas and contributed a lot to the formation of transboundary civil societies, may evolve into superstates in which local autonomy is entirely suppressed. The emergence of even one such block, for instance the EU, may have the same effect as the dash for power of Philip the Fair and France at the beginning of the fourteenth century. It would, on one hand, destroy the international discipline now provided by the U.S.-hegemony. On the other hand, such blocks would be able to limit the competitive pressure on national states by reducing the number of political decision centres from the present two hundred to, say, five. Such an oligopolisation of political power would not only stop the emergence of global civil society, but also trigger a dangerous logic of war.

"A historian is a prophet in restrospect," said the German philosopher and historian Wilhelm von Schlegel. Let us hope that the scenario, mentioned in this conclusion, proves to be a false one.

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ISSN 1801-0938

New Perspectives on Political Economy
Volume 3, Number 2, 2007, pp. 185 – 204

Regulation and the Wealth of Nations: The Connection between Government Regulation and Economic Progress

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JEL Classification: D00, H10, O12

Abstract: Adam Smith's main message is that when unregulated, undistorted rewards are higher in one activity than another, economic progress is usually promoted if resources flow toward the high-return use. And resources would flow that way if we are left alone to pursue our happiness. When regulators do things that change those market signals or prevent us from responding to them the nation as a whole usually ends up poorer. There is much wisdom in Smith's view, but I shall argue that it gives an incomplete picture of the connection between regulation and the progress of opulence. Smith is emphasizing the conflict between regulation and economic progress. I would propose to add to Smith's view an analysis of a way in which market forces and prosperity often undermine the effects of regulation. I shall discuss two ways in which this happens. One is that the regulation often induces changes in behavior that go against the intended effects of the regulation. The other, more subtle kind of undermining occurs because unregulated progress often produces the intended benefits of regulation, though more slowly and quietly. The last part of my paper tries to answer a question about the wealth-destroying regulation that troubled Smith. How does such regulation survive politically? The answer is that progress can often hide the bad effects for a long time and thereby immunize the regulation politically.

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Delivered in November 2007 in Prague as the Liberalni Instiute's Annual Memorial Lecture.

I am deeply honored by your recognition of me and by your invitation to speak about economic regulation. This talk poses considerable challenges that give me some hesitation. I have spent my professional life studying and analyzing regulation. Many of my distinguished predecessors in this award have actually done something about regulation in the political arena. Further, most of what I know is about regulation within a democratic market economy. Indeed, the specific examples I will discuss and the academic research behind these examples are all from the United States. Many of you have experienced regulation in a much different historical and institutional context than I have. Let me then apologize for my focus on American examples and American academic research. However, my talk will be about broad principles that apply in your country as well as mine. So, I hope you will find some of what I have to say useful.

My title, of course, alludes to Adam Smith and his great work *An Inquiry into the Nature and Causes of the Wealth of Nations*. Smith was deeply curious about the conditions that foster economic progress. And my talk tonight will be about the interaction between government regulation and economic progress. Smith waits until Book 3 of his great work to confront this interaction directly. He does so in the first chapter of Book 3, entitled "Of the Natural Progress of Opulence." Even to a native English speaker of today this title sounds strange. "Opulence" means "wealth" in today's English. If he were writing today perhaps the title would be something like "How Do Economies Become Wealthy."

The specific subject of this chapter is the allocation of capital between cities and the countryside. Smith tells us that a nation's economic progress would be faster and more durable if its capital were at first mostly invested in agriculture and then followed by a gradual development of industry and trade in towns and cities. Moreover, he argues that just such a sequence of development would emerge if investors were left alone to seek the greatest return on their investments.

He observes, however, that in the Europe of his day "this natural order of things" is "entirely inverted." It is the towns that grow first and the countryside that develops only later. So how does he explain this inversion? Smith has no doubt about the answer – it's because of those regulators in London whose rules and taxes artificially raise rates of return on non-agricultural investments.

As in much of the *Wealth of Nations*, the point Smith is making here is more general than the specific issue he is talking about. The larger question Smith is addressing is about long-run economic growth. Why does per capita income gradually grow in some societies and stagnate in others? He understood, as did few before him, that the key to opulence is progress – that nations achieve lasting prosperity not by discovering a pile of gold but by establishing conditions that foster steady growth.

The 'natural' part of his chapter title conveys an important part of Smith's answer to the mystery of steady growth. His message is that when unregulated, undistorted rewards are higher in one activity than another, economic progress is usually promoted if resources flow toward the high-return use. And resources would flow that way if we are left alone to pursue our happiness. When regulators do things that change those market signals or prevent us from responding to them the nation as a whole usually ends up poorer.

There is much wisdom in Smith's view, but I shall argue that it gives an incomplete picture of the connection between regulation and the progress of opulence. Smith is emphasizing the conflict between regulation and economic progress. If he were writing an essay for the Liberalni Institute on this topic, the title might be *Regulation: the Enemy of Progress*.

However, I would propose that the Institute should think about publishing two more essays, and I will use this talk to describe them.

Progress: the Enemy of Regulation would be an essay about the way in which market forces and prosperity often undermine the effects of regulation. I shall discuss two ways in which this happens. One is that the regulation often induces changes in behavior that go against the intended effects of the regulation. The other, more subtle kind of undermining occurs because unregulated progress often produces the intended benefits of regulation, though more slowly and quietly.

The last essay, called *Progress: Friend of Regulation*, would try to answer a question about the wealth-destroying regulation that troubled Smith. How does such regulation survive politically? The answer would be that progress can often hide the bad effects for a long time and thereby immunize the regulation politically.

It is entirely understandable that Smith would have emphasized the clash of regulation and the natural progress of opulence. The conflict between the two is almost definitional. We might have different opinions about the wisdom of a specific regulatory policy. But all economic regulations were created to reject and disrupt the natural part of the progress of opulence – regulation looks for the gold mine instead of accepting the results of the gradual progress produced by unregulated choices. How then, precisely, does natural progress overcome this rejection?

I have mentioned one method – that regulation creates incentives for behavior that offsets some or all of the intended effect of the regulation. This is sometimes called "offsetting behavior," and I will provide three examples of it.

These are based on the work of many different economists, including me. My examples are drawn from what has come to be called "social" regulation. But, as I will indicate, the principles apply to other forms of regulation as well.

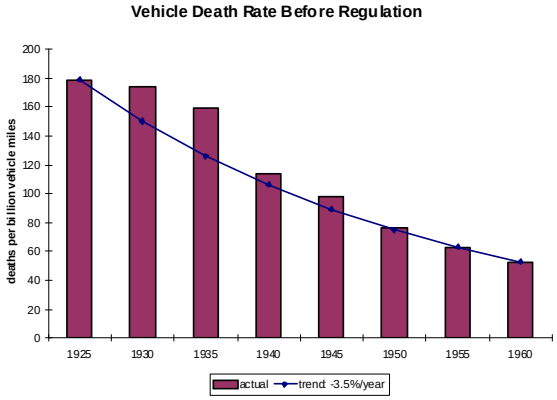
The three regulatory changes I will discuss are the auto safety legislation that began in the 1960s, the Endangered Species Act of the 1970s and the Americans with Disabilities Act of the early 1990s. They seem on the surface very different, but I hope to show you that a powerful common current runs through all of them. And it is that offsetting behavior has undone some, all or in one case more than all of their intended effects.

The general point about offsetting behavior has been around a long time. One of the first lessons we give to beginning students is about government price controls, a subject which this audience perhaps has more experience with than our young students. We tell the students that if the government enforces a price below the market clearing price, there will be an excess demand. Buyers will then have to spend time waiting in line or spend other valuable resources to move themselves to the head of the line. These expenditures are, in economic terms, just like a price increase, and thus they offset the government's desired price. Indeed, in this case, simple economics suggests that the full price – the bargain regulated price plus the value of the time spent waiting or perhaps the bribes paid not to wait – can exceed the unregulated price. That is, the behavior of buyers can more than completely offset the effects of the regulation.

This simple story tells us something important about all kinds of regulation. Regulation seldom changes the basic forces that were producing the particular result the regulators seek to change. So we need to ask whether regulation really changes the result or only the form in which market forces assert themselves.

1 Auto Safety Regulation

Let us see some answers to this question. I begin with auto safety regulation – more specifically with a number: 3.5 percent. I want you to remember that number, because I will come back to it later. As you can see, it is the annual rate of decrease in deaths per mile driven on US highways from 1925 to 1960. This period begins when the mass market for automobiles developed, and it ends just before the political agitation for safety regulation began.



This number -3.5 percent is important, because it tells you that there was considerable progress in auto safety before there was comprehensive regulation of it. That early progress was not marked by any dazzling breakthrough. It was more the product of small advances on many fronts – auto and road design, drivers' knowledge, medical techniques and so forth. In other words, you might say that the advances came from the working of the natural progress of opulence: our growing wealth was producing growing demand for personal health and safety, and markets were finding ways to meet the increased demands.

This particular example of natural progress had a regulatory or governmental component. Governments, after all, built the highways and streets, made the rules of the road and policed them. Those areas of government activity were also evolving over this pre-regulatory period. I want to mention this because neither Smith's concept of natural progress nor my borrowing of it excludes a role for government, even a role for government regulation. Instead the concept of natural progress that I, and I think Smith, would favor is one in which matters like auto safety are mainly led by the steady evolution of market forces in a world that gradually becomes wealthier and also smarter. In such a world the government role is mainly to complement or complete these market forces, and this government activity evolves gradually as the market forces change. I think that fairly describes the pre 1960s world in which the auto fatality rate was declining steadily.

The contrasting case is one in which the government role becomes central, both in the political and operational sense. The matter is deemed too important to permit market forces or even the lower levels of government to figure out what might best suit their local circumstances. Rather a unified view of how best to promote the desired goal is articulated by the central government and then imposed on the market. That I think fairly describes the world we have been living in with regard to auto safety in the US since our Congress passed the Motor Vehicle Safety Act of 1966, and most of the rest of the developed world has copied this system since then. It is the suddenness and comprehensiveness of the institutional change that I will be mainly referring to when I use the term "regulation" and contrast it to the natural progress of opulence.

The unified view that has inspired auto safety regulation since 1966 is very clear. It is that safety depends critically on design features of cars that protect occupants from the consequences of accidents and that the discovery and deployment of these features is to be centrally determined. There is some room for market forces in this system – for example, to determine the precise packaging of the mandated design features and to exceed minimum standards. But for the past 40 years or so most of the significant decisions about auto safety in the US are initiated in Washington.

Over 30 years ago, I decided to study the first few years' experience with the first motor vehicle safety standards. They mandated installation of seat belts and of steer-

ing columns and windshields that would give way if someone in the car was thrown against them.

I argued that some of the potential benefits of these devices could be offset, because the regulation would encourage greater risk taking, because the greater protection from the required devices had, in effect, reduced the price of risky driving. Let me explain: when you are in a hurry and tempted to drive faster or more aggressively, there is a price to be paid. It is the extra risk of getting into an accident and then suffering injury or even death. The mandated safety devices would reduce this price by reducing the severity of the consequences you could expect if you got into an accident. If those consequences had been sufficiently severe to deter you from fast or risky driving before the regulation came along they were now less likely to do so. So simple economic logic suggested that, in the aggregate, the mandated devices would encourage more risky driving behavior, and this greater risk taking would offset to some degree the safety benefits these devices seemed to promise.

Unfortunately, basic economics cannot tell you more than this. Importantly, economic reasoning cannot answer the crucial question: by *how much* will the potential safety benefits be offset? It could be partial, complete or even more than complete. So, most of my old paper on the subject focused on the facts as best they could be ascertained in the mid 1970s. And I suggested that some of the facts seemed consistent with a complete offset of the benefits. Specifically, occupant deaths per accident did indeed fall substantially compared to what might otherwise have been expected. But this was entirely offset by a combination of more accidents and more fatalities to non-occupants such as pedestrians, bicyclists and motorcyclists whom the devices did not protect.

This finding met with considerable skepticism from economists and non-economists. Unlike most non-economists, most of my fellow economists accepted the underlying logic and reserved their skepticism for whether the facts fit the logic. This is the healthiest kind of skepticism, and it has led to a substantial and ongoing empirical literature on auto safety that examines a variety of regulatory changes in a variety of places.

On the whole, I believe that this literature has been kind to the offsetting behavior hypothesis. The studies differ on whether the offset is complete, as it was in my study

or on the specific responses – for example, on whether significant offset is coming from increased non-occupant deaths or from some more general change. But the typical finding is that the actual effect of the safety regulation on the death rate is substantially less than it would be if real people behaved like crash dummies.

A recent example of this research is a paper by Liran Einav and Alma Cohen (2003). It is representative of much of this 30 year research enterprise. They studied the effects of laws requiring the use of seat belts. They did not find increased non-occupant deaths to be an important part of this particular story. However, they did find what most of this literature seems to find: the real world effect of these laws on highway mortality is substantially less than it should be if there was no offsetting behavior. The laws did increase the usage of seat belts. And they are able to estimate that this increased usage should, in the absence of any behavioral response, have saved over three times as many lives as were in fact saved.

It is important to understand that this disappointing result has nothing to do with any technical deficiency of the devices. These devices do seem to work as well as advertised. If you are involved in a serious accident you are much better off wearing your seat belt than not. Rather the auto safety literature is attributing the shortfall of lives saved, either implicitly or explicitly, to an offsetting increase in the likelihood of serious accident.

2 American with Disabilities Act

My second example of offsetting behavior comes from the American with Disabilities Act (which I will call "ADA" for short) of 1990. As with auto safety laws, the US is far from alone in having such a law.

This law prohibits discrimination against the disabled in hiring, pay, promotion, and firing, and it requires the "reasonable accommodation" of disabled workers by adapting the workplace to their disabilities. Thus the law is trying to increase the employment and well being of the disabled.

While I have no precise figures, it is reasonably clear that the natural progress of opulence was producing this desirable result long before the ADA. The gradual

shift of economic activity from muscle power to brain power – from producing goods to providing services – virtually guarantees that employment opportunities for the disabled were increasing over time. As with the highway safety act, the ADA rejects the adequacy of this sort of gradual improvement.

However, two recent studies on the effects of this law, one by Tom De Leire (2000) and the other by Daron Acemoglu and Josh Angrist (2001) show that the ADA did not, in fact, improve employment opportunities for the disabled. Indeed, both studies conclude that employment rates for the disabled fell perceptibly after the ADA was implemented. How could this be? According to both studies the answer lies in the incentives created by the ADA for not hiring disabled workers.

Consider the incentives of a prospective employer, Jan, who is thinking of hiring Jana, who is disabled. Prior to the ADA, Jan might have hired Jana and then watched to see if her productivity compared to her wage plus any special costs of accommodating her disability justified her continued employment. Sometimes Jana would turn out to be a good hire, sometimes not.

After the ADA, the relative costs of hiring and firing change. If Jan does not hire Jana, he is, to be sure, now susceptible to penalties for discrimination. But in our legal system Jana will have to prove that discrimination was the reason for Jan's decision. And if Jan is sufficiently careful about how he looks for employees, disabled people like Jana will not find out about the job in the first place. But if Jan does hire Jana, Jan now faces two kinds of costs he didn't face before. First, the regulators, not Jan, will determine what costs have to be incurred to accommodate Jana and whether her wages are too low. Second, if he fires her now to avoid those costs, he is surely subject to penalties for discrimination. Now it is Jan who would have to prove that the accommodation costs were "unreasonable." So, in a prospective sense, the ADA imposes new costs both for hiring Jana and not hiring her, but the hiring costs (or more accurately, perhaps, the subsequent firing costs) arguably are larger. On balance it is better to avoid hiring Jana than to hire her and face those new costs imposed by the ADA.

The evidence is consistent with this tale. Not only did employment rates for the disabled fall after the ADA, they fell more for young workers who would be more likely

to be seeking employment than older established workers. The fall is concentrated in new hires rather than any increase in separations. And it is heaviest for the less educated, who are now prevented from offering lower costs to prospective employers to offset their lack of skills.

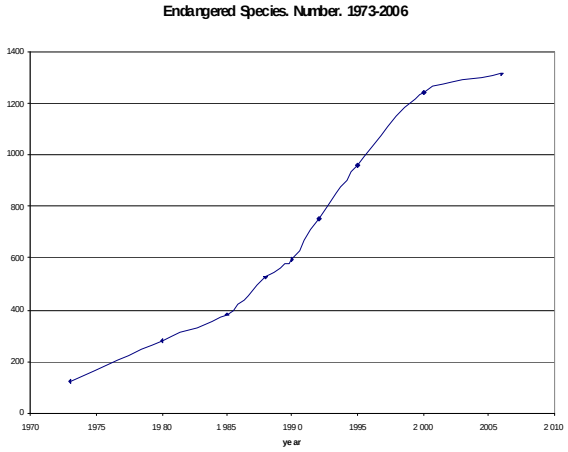
Since employment opportunities for the disabled have been reduced by the ADA, this is a case where the offsetting response is more than complete. You might think the disabled would be pressing for repeal. But the law does benefit some of them. Disabled Martina, who was already working for Jan in 1992, clearly gains – better working conditions, no lower pay, and the possibility of bringing an anti-discrimination complaint before the regulatory agency. Beneficiaries like Martina know who they are. The victims – the Janas who are not hired – often do not know that they are victims. This kind of asymmetry may help explain some of the political appeal of this and similar legislation.

3 Endangered Species Act

My last example of offsetting behavior comes from the Endangered Species Act (ESA) of 1973. As with the other examples, many countries have similar laws. This law is intended to protect wildlife that faces threat of extinction. It is by far the least well-studied of my examples, and so I will not be able to tell you how important the offsetting behavior is in this case. Nor will I have much to say about what was happening to wildlife preservation before the law was passed.

The law tells a regulator, in our case an agency called the Fish and Wildlife Service (FWS), to determine which species are endangered or threaten to become so. Once a species is put on the Endangered Species List private owners of land inhabited by this species cannot alter their land in a way that "harms" the protected species. Why do all this? According to the FWS, "The law's ultimate goal is to "recover" species so they no longer need protection under the ... Act."

Let me compare what has actually happened since 1973 to this stated goal. First look at the number of species on the list.



In 1973 there were 119 species on the list that had gotten there under previous legislation. In the next 30+ years an average of 40 species per year has been added to the list, so that something over 1300 species became listed. (Apparently, there has been an astonishing explosion of zoological knowledge in the last 30 years.) How many species have been removed from the list?

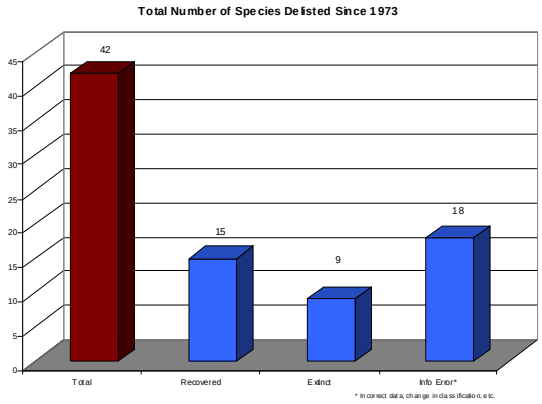
It is 42 – not 42 per year but a total of 42 in 33 years. Of these, 18 were removed for information reasons (a change in taxonomy or erroneous information), 9 became extinct and 15 were recovered. Thus, judged by its own stated goal, this regulatory enterprise has been a colossal failure, having thus far produced a net recovery rate of under ½ percent (6 of 1300+) of listed species. You might conclude that the real purpose of this act is the production of ever longer lists.

Now let me describe the offsetting behavior that is responsible for some part of this failure. It is sometimes called "preemptive development."

There are many stories about this phenomenon. But, as a professional economist, I am here to tell you about two studies that analyze this behavior more systematically.

One is a study of the red cockaded woodpecker by Lueck and Michael (2003) and the other by Margolis, Osgood, and List (2007) is about the pygmy owl. I'll use the first of these to illustrate how preemptive development works to offset the intent of the ESA.

The red cockaded woodpecker is an endangered species that inhabits forests with commercial value. In an unregulated market, such forests are allowed to grow until it becomes economical to cut trees down. Some such forests might ultimately be cut down completely – what is called "clear cutting". Others will be thinned gradually. Some of the clear cut forests will be replanted, others not. The ESA changes all these calculations. If you own a forest which is inhabited by the red cockaded woodpecker you cannot cut down trees. That is good for the woodpecker. But these birds move around, and if you own forest land that is near where the woodpecker lives, your incentive is very clear – cut down all those trees now! If you wait and the woodpecker moves onto your land your chance to sell any wood will be forever lost. This is not good for the woodpecker, but Lueck and Michael find that this is systematically what happened in the North Carolina forests they studied. Forests that market forces suggested would only be partly cut down or allowed to grow a while longer were clear cut when they became potential woodpecker habitat.



The other study by Margolis, Osgood, and List is about developing land for houses near the city of Tucson, Arizona. But the message is the same. Here the endangered species was an owl (the pygmy owl), and the economic decision was whether to develop land now or let it sit for a while. Again, the offsetting behavior was that land which might have been allowed to sit was developed for housing when pygmy owls moved near.

4 The Irony of Smith's Opulence

You may have noticed the irony in my examples of offsetting behavior: the highway safety act promotes reckless driving; the disabilities act disemploys the disabled; the Endangered Species Act promotes environmental destruction. This ironic aspect, I think, accounts for some of the appeal of the concept to economists as well as some of the controversy about it. We economists tend to prefer unexpected results to expected, especially if they illustrate the power of the simple logic of our discipline. But we are also skeptical of unexpected new results, and politicians have resisted new economic insights forever – or at least since Adam Smith was promoting free trade over 200 years ago.

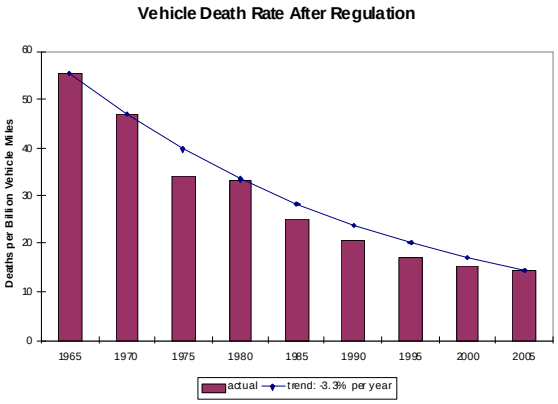
And you should be skeptical. Here I am telling you how offsetting behavior has compromised three significant attempts to improve our lives. Yet each of them is a sacred political cow. Not one is in any serious danger of substantial alteration. Indeed, as I have indicated, all 3 have a world-wide appeal. How can that be? In the case of the ADA I looked to the difference between beneficiaries who know who they are and victims who do not for part of an answer. Perhaps deeper analysis of what we call "political economy" can help us understand the durability of the other cases. But these cases are merely illustrative. It has become routine, especially in this area of social regulation, for economists to find that the benefits of regulation are smaller than expected and often less than the associated costs. There must be a very powerful force that protects such inefficient regulation.

I think I have found the guilty party. It is Smith's natural progress of opulence – the tendency for unregulated markets to contribute to steady growth: I will argue that this very force, which these kinds of regulation reject, also sustains them politically.

This sounds paradoxical. But let me now take you back to the beginning of my talk, and I think you will soon see where I am headed. I asked you to remember a number. If you have forgotten, it is 3.5 percent, the annual rate of decline in highway deaths per mile in the era before regulation.

Now, I want you to guess what the comparable number is in the period since regulation.

The precise answer is that from 1965 to 2005 highway fatalities per vehicle mile declined at 3.3 percent per year. That is, there is essentially no difference from one period to the next. I cannot think of a better way to convey to you the basis for skepticism about the effectiveness of this regulatory enterprise than the essential identity of these two numbers.



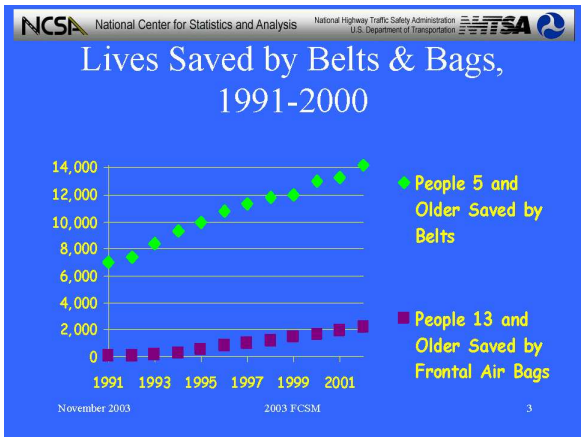
I have given you one reason why highway safety regulation didn't improve safety-offsetting behavior. But I believe that the power of the natural progress of opulence is probably even more important. Progress in auto safety would likely have continued whether or not it became regulated from Washington, and it would not surprise me if the vehicle mile death rate falls at 3-4 percent per year for many years to come, not only in the US but here as well. Indeed, even in vehicle design, Washington's rules may have only speeded up some changes that would otherwise have occurred more slowly. It is, of course, unimaginable that a 1965 car would have a 1925 design. It is also unbelievable that a 2007 model will have only 1960s safety technology. We'll never be able to know, but it is likely that many of the design features mandated by the regulators would have been introduced anyway, perhaps later.

This pattern of gradual progress prior to a major regulatory innovation is common to many areas of social regulation, such as worker and product safety and environmental quality. Careful study may or may not show that the regulation accelerated the progress. The important point is that, in most cases, the gradual progress would

likely have continued whether or not regulation had intervened. In this sense progress promotes many of the same goals as regulation.

But, even if the rate of progress is no different under regulation, as with auto safety, there is a crucial difference. One era of progress happened after the regulatory enterprise was created. That permits the regulators to point with pride to the progress and to claim credit for it.

As you can see, an economist looking at the entirety of the historical record may say, "Regulation has nothing to do with the progress. It would have happened anyway" But this is much too subtle. The fact is there was regulation; there was progress, so why change anything?



There is then a supportive link between the progress of opulence and much regulation, even ineffective or counterproductive regulation. As long as the thing being regulated is seen to be working tolerably well – and that will often be the case in a growing economy – then the regulation is usually safe politically. This would be the argument of my second imaginary monograph, *Progress: Friend of Regulation*.

If I were writing such a work, I would emphasize an important difference between the way economists and most others analyze the effects of regulation. The economic analysis begins by posing what is called a "counterfactual": it means that the economist first asks "What would the world have been like without the regulation?" Then you compare the actual world to this counterfactual. Regulation is deemed success-

ful only if its intended effects are realized to a greater degree than could reasonably have been expected according to the counterfactual benchmark. This is the procedure economists have followed since Adam Smith. Indeed in the brief chapter that inspires this talk Smith does not simply assert the virtues of investment in the countryside, or require you to believe it as a matter of logic. Instead, he compares what mercantilist policy is doing in the England of his day to a counterfactual drawn from the history of places like the North American colonies and ancient Egypt. Smith's descendants use more powerful techniques, but their analytical method is the same as his.

It is hard to think of a significant regulatory enterprise in our time that has been placed in political jeopardy just because it fails to stack up well against a plausible counterfactual. Rather the political process seems to require evidence of malfunction in some absolute sense before there is serious pressure for change. I can illustrate the point with two examples with which I was involved early in my career.

5 The Politics of Reforms

My one brief time in Washington goes back to the early 1970s. I was part of an effort to reform our system of regulating the transportation of freight. I was joined by a large and talented group of professional colleagues. We economists were nearly unanimous about the need for reform. We could show that the regulation, whose main effect was to suppress market forces of all kinds, had been seriously counterproductive probably since our first highway network was built in the 1920s, if not before. We got absolutely nowhere with our reform initiative.

Within five years, however, this regulatory establishment, which had lasted for nearly 100 years, began to crumble. In another decade it would be gone entirely. It sounds like a small version of the events in Eastern Europe 20 or so years ago. And, looking back, the reasons for the sudden change are similar. In the case of our transportation regulation, a major chunk of the railroad industry – which carries around half the freight traffic in the US – collapsed financially in a time of general prosperity. This made continued regulatory-business-as-usual unviable. In this case market

forces had to destroy the foundation of the regulatory system before there was fundamental change.

Consider now the quite different recent history of another regulatory enterprise that I have studied – the Food and Drug Administration's (FDA) regulation of new drug introductions. In our system a manufacturer cannot sell a new drug until it proves not only that the drug is safe but also that it is "efficacious." This means that the manufacturer must prove that the drug will do the things the manufacturer wishes to claim it will do. This "proof-of-efficacy" requirement was added in 1962, and I studied the effects of this legislation a decade or so later. I concluded that the proof-of-efficacy requirement was a public health disaster, in fact promoting much more sickness and death than it prevented. As with my auto safety research, I would not bring this old study up if the conclusion had not been subject to further test by other analysts. But nothing I have seen since has moved me to change that radical conclusion – the disaster of our new drug regulation continues. Nevertheless, there is no realistic chance that this regulation will share the fate of our freight regulation anytime soon.

Let me try to explain how I came to so stark a conclusion, what has happened since, and what I believe to be the sources of this regulation's political survival.

The intent of the regulation is surely laudable: ineffective drugs can waste money and the precious time for more beneficial treatments. But the tests that are required to prove efficacy to the FDA take time, whether the drug ultimately passes those tests or not. In fact, this extra time cost is measured in years, rather than months or weeks.

In some cases, it is a cost well spent. Some ineffective drugs are screened out, and the extra testing catches some drugs that are dangerous as well. But every effective drug that ultimately makes it to market also incurs the time cost, including some that can save lives or relieve the suffering of illness. In these cases, the extra time means that some potential beneficiaries of the drug will die or suffer while the FDA evaluates the test results. My reading of the available evidence was simply that this latter cost far outweighs any benefit. Indeed, the death toll from this regulatory delay can easily number in the thousands per year. By contrast the benefits were small. I found that

the unregulated market was very quickly weeding out ineffective drugs prior to the imposition of the regulation. Their sales declined rapidly within a few months of introduction, and there was thus little room for the regulation to improve on market forces.

The first reaction to this work from the regulatory establishment in Washington was similar to the Soviet reaction to the Prague Spring of 1968 – hostile and defensive. Any change was unnecessary and dangerous. Ultimately, this hard line softened. For one thing, most of the subsequent academic research tended to reach conclusions similar to mine. The regulators ultimately acknowledged that the process should be speeded up. And some changes were made that have made the process a little faster. However, there has never been any real political pressure for really fundamental change, like eliminating the efficacy requirement entirely. I would still have to describe the regulation as one that kills more people than it saves.

I think this harmful regulation survives politically because it is protected by the natural progress of opulence. Medical progress of all kinds continues. Beneficial new drugs, however delayed, ultimately do make it to market. Mortality rates decline on the order of one percent per year, as they have for over 100 years. In this broad context a few thousand extra deaths a year is hard to notice.

And perhaps more important, the deaths of which I speak are counterfactual deaths, not deaths that can be directly connected to any regulatory malfeasance. Imagine what would happen if somehow dangerous poisons were frequently marketed as new drugs, and thousands were killed each year by them. This would be a major scandal. You could directly connect the deaths to the regulatory process, and this process could never survive politically. But the actual victims of this regulation did not swallow a bad pill wrongly approved by the regulator. They merely failed to swallow a good one in time, and they never knew what they had missed. As long as medical progress continues a case for reform built on anonymous victims of regulation, change is going to be difficult politically. Indeed the defenders of the status quo make good use of the progress. They will tell you how much regulation has contributed to the progress and what bad consequences would follow from any meaningful regulatory change.

6 Conclusion

I will conclude with two suggestions about how you might think about the connection between economic progress and regulation. The first suggestion is about old regulation and the second about proposed new regulation:

Regulation usually will be hard to get rid of, even if it is counterproductive. It may require some crisis, either in the regulated industry or in the broader economy, before there is significant change. The recent history of this region is a possible example. You had a crisis that produced profound change, and then more recently, perhaps some reduction in the pace of reform. Both of these are connected to Smith's concept of natural progress. The crisis owed much to the then unrealized promise of natural progress, and the difficulty of further reform owes much to the partial fulfillment of that promise. If you are moving broadly in the right direction it is harder to make the political case for substantial reform.

Proposals for new regulation often seem attractive superficially. They promise to solve public problems without substantial public spending or new taxes. My suggestion here is to be both skeptical and patient when encountering such proposals. Be skeptical that the problem will really be solved, because you should expect people to behave in ways that offset the intent of the regulation. Be patient because natural progress will often do much what the regulation wants to do, perhaps more slowly, but often more effectively and completely.

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ISSN 1801-0938

New Perspectives on Political Economy
Volume 3, Number 2, 2007, pp. 205 – 230

Economic Freedom: A Hayekian Conceptualization[i]

Judit Kapás[ii] and Pál Czeglédi[iii]

JEL Classification: B53, H10, O10

Abstract: In this paper, we develop a conceptual framework for an understanding of economic freedom based on Hayek (1960), and, as a step further we propose a categorization of government actions, which allows us to conceptualize the measurement of economic freedom in a different way from that of the indexes of economic freedom. This method of proceeding, that is "theoretical framework first, and measurement after, if possible" differs from the one adopted by those who have constructed the indexes of economic freedom. An advantage of our concept of economic freedom is that it is compatible with a theory of growth, and this being so, it provides additional insights to a better understanding of how economic freedom leads to growth.

[i] This paper has benefited from supports of ICER (Turin) and the Hungarian Scientific Research Fund (contract no: T 49602). We gratefully acknowledge useful criticism and comments provided by two anonymous referees. The remaining errors are ours.

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1 Introduction

During the past decade the concept of economic freedom, after being for a relatively long period a subject of little interest among economists, has attracted more attention. This is due to the emergence of indexes ranking countries according to a scale running from the least free to the freest. Now there exist two widely accepted indexes of economic freedom: the one developed by the Fraser Institute (Economic Freedom of the World Index, EFW index), and another constructed by the Heritage Foundation jointly with the Wall Street Journal (Index of Economic Freedom). These two indexes are quite similar in terms of what they consider as a plus and as a minus when measuring economic freedom.

The Fraser Institute was the first to construct an index of economic freedom and publish reports on a regular basis. The roots of the index published in *Economic Freedom of the World* go back to a series of conferences hosted by the Fraser Institute and Nobel laureate Milton Friedman from 1986 to 1994. These conferences focused on measuring how consistent a nation's institutions and policies were with economic freedom. These conferences led to the publication, in 1996, of *Economic Freedom of the World: 1975–1995* (Gwartney et al. 1996), in which the EFW index itself was developed.

The whole of Fraser's project has been very ambitious and, of course, important, and it has fulfilled what it projected. Compared to the initial index, the current version (Gwartney and Lawson 2007) is more comprehensive, ratings are available for more countries, and the chain-link version of the index provides for more accurate comparisons across time periods. Clearly, data provided by the Fraser Institute's reports has led to a significant number of econometric studies on how economic freedom affects income and various measures of human welfare.

However, since the explicit aim of the Fraser Institute was to measure economic freedom, this determined the way the concept of economic freedom was formulated: the conceptualization has been largely driven by empirical (measurement) considerations. As Block (2006), one of the fathers of the index, explains, an empirical measurement of economic freedom requires an operational and empirical definition of

economic freedom. The former means that "economic freedom is defined solely in terms of an amalgamation of the empirical indices that together comprise it" (Block 2006, p. 481). The latter refers to the fact that the concept must be quantified, i.e. it is based on statistics.

Clearly, both requirements vis-à-vis the concept of economic freedom are apparent in the definition given by Fraser's scholars (Gwartney and Lawson 2007, p. 3): "The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of privately owned property." In this spirit, the Fraser's index includes five main areas, each broken down into several components and subcomponents, all quantifiable. The areas are as follows: (1) size of government: expenditures, taxes, and enterprises, (2) legal structure and security of property rights, (3) access to sound money, (4) freedom to trade internationally, (5) Regulation of credit, labor, and business.

The operational and empirical character of the conceptualization of economic freedom is taken even more seriously in the case of the Heritage Foundation's index which explicitly considers economic freedom as a composite concept encompassing various kinds of economic freedom (Kane, Holmes, and O'Grady 2007). These are business freedom, trade freedom, monetary freedom, freedom from government, fiscal freedom, property rights, investment freedom, financial freedom, freedom from corruption, and labor freedom.

As opposed to the above method of conceptualizing economic freedom, namely one driven by operational and empirical considerations, we believe that economic freedom is a concept in its own right, and this being the case, a theoretical framework is first needed for a full understanding of the concept. Subsequently, whether this theoretically-based concept may or may not be measurable is another question. Thus, we propose to reverse the direction in which the Fraser Institute and the Heritage Foundation proceed: theoretical framework first and measurement after if possible.

Thus, the aim of this paper is to contribute to the development of a theoretical framework for an understanding of economic freedom. In this endeavor, we will argue for the usefulness of the Hayekian notion of freedom, which can serve as a crucial concept upon which such a framework can be built. Trying to formulate Hayek's ideas on a less abstract level, we propose a categorization of government actions, which gives

us some guidance concerning which government actions hurt and which do not hurt economic freedom. An advantage of this categorization schema, as we show, lies not only in the fact that it can be operationalized – that is, measured – but also in the fact that it can point to a mechanism through which economic freedom may affect income – a mechanism that is excluded when using the above-mentioned two indexes, and consequently which does not appear as an explaining factor in the empirical literature on economic freedom dealing with how economic freedom affects growth.

The paper is organized as follows. In Section 2, we provide and argue for the usefulness of a concept of economic freedom based on Hayek (1960), the rule of law being a core element of this concept. In Section 3, we develop a classification of government actions based on this concept. Section 4, discusses the relevance and empirical usefulness of our conceptual framework of economic freedom based on the categorization of governmental actions. Section 5 concludes.

2 The Usefulness of the Hayekian Concept of Freedom

Hayek developed his concept of freedom in *The Constitution of Liberty*. In what follows we present the Hayekian concept of freedom, whose usefulness consists in the generality of the concept, which, accordingly, can be applied to conceptualize various kinds of freedoms, such as economic, political or civil freedom.[1] Focusing, of course, on economic freedom and relying on Hayek (1960), we show that a core element of economic freedom is the rule of law.[2] As a starting point, we must bear in mind that the concept of economic freedom like other kinds of freedom is related to individuals, and accordingly, it should be interpreted in terms of individuals' actions.

We think, however, it is necessary to make a clarification before trying to conceptualize economic freedom. Since the state is inevitable (Holcombe 2004, Benson 1999, Olson 1993, 2000),[3] our argument is that economic freedom should be inter-

[1] We agree with Friedman (1962) in seeing economic and political freedom as components of freedom broadly understood, so both being ends in themselves.

[2] We argue that additional elements such as freedom of contract, property rights, sound money and political decentralization which were emphasized by Harper (2003) as constituting parts of economic freedom come from and depend on it. Because of a shortage of space we cannot develop this idea here.

[3] For a critique see Leeson and Stringham (2005).

preted under the existence of a state (government). To put it differently, in accordance with Hayek (1960), economic freedom should be understood as freedom under governmental law and not the absence of all governmental actions. Thus, economic freedom does not mean freedom in an absolute sense; some governmental actions must be supposed to exist. The reason for this lies in how the state has emerged in an undesigned, evolutionary process (Barzel 2000, 2002, Benson 1998, 1999, Hayek 1973, Holcombe 2004, Olson 1993): all modern states evolved from extortionist institutions to secure property rights. And in this evolutionary process the state acquired a monopoly over coercion.

Consequently, coercion[4] is a crucial concept for making sense of freedom. History shows that institutionalized coercion by private (nongovernmental) parties is almost never tolerated, but we tolerate governmental coercion (Klein 2007). Why do we tolerate infringements of property and liberty rights by the government? The answer is that the coercive power of the state is useful when it protects our lives and property from outside (private) coercion:[5] "[f]reedom demands no more than that [the coercion of other individuals'] coercion and violence, fraud and deception, be prevented, except for the use of coercion by the government for the sole purpose of enforcing known rules intended to secure the best conditions under which the individual may give his activities a coherent, rational pattern" (Hayek 1960, p. 144).

To sum up, not all kinds of coercive governmental actions are to be condemned; instead it is in our interest to tolerate some kinds of coercion. However, bear in mind that the state, by having a monopoly over coercion, remains the primary threat to freedom. Accordingly, the major question is in which field(s) government monopoly over coercion is allowed and what kinds of governmental actions are not harmful to (economic) freedom. Clearly, not all means are appropriate in order to assure the

[4] "Coercion occurs when one man's actions are made to serve another man's will, not for his own but for other's purpose" (Hayek 1960, p. 133). The coercer can determine the alternatives for the coerced so that the latter will choose what the coercer wants: "in order to avoid greater evil, he [the coerced] is forced to act not according to a coherent plan of his own, but to serve the ends of another [the coercer]" (Hayek 1960, p. 21).
Of course, there are several forms of coercion. The threat of violence or physical force is the most important form of this, and even in this form there are many degrees of coercion.

[5] As Hayek (1960) argued, a paradox is that the only means whereby the state can prevent the coercion of one individual by another is the very threat of coercion, i.e. the only way to prevent one coercion is by the threat of another one.

greatest possible freedom. The only acceptable means, as argued by Hayek in the above quotation, is enforcing known rules.[6] This implies that economic freedom relates to the character, rather than the size of government actions, which, in turn, relates to the issue of efficiency, and these two do not necessarily overlap.[7]

Although Hayek (1960, 1973) does not differentiate between various types of freedom, such as political or economic freedom, his concept still provides a coherent basis for making sense of economic freedom. We argue that the adjective "economic" or "political" determines the fields in which we should narrow or specify the meaning of freedom, understood broadly as absence of coercion except for state coercion, to enforce known rules. In this spirit, when it comes to economic freedom, state monopoly over coercion should be understood as concerning the economic activities of individuals, more precisely their entrepreneurial acts. Economic freedom permits individuals to exploit their productive potential by following their own plans and the opportunities to amass wealth safeguarded against confiscation (Barzel 2000). That is, in an economically free society individuals are allowed to realize their plans on the market. If state coercion goes beyond the limits defined above, economic freedom is hurt. Accordingly, state coercion must be limited. Normative restrictions should be imposed on the coercive power of the government and on the manner in which it exercises its power (Hayek 1960).

The principle that provides us with a criterion according to which we can evaluate freedom is the rule of law.[8] This *ideal* of freedom is best described in Hayek (1960) and in Leoni (1961), and refers to a situation where governmental coercive actions conform to general abstract rules laid down beforehand. In fact, the rule of law is a

[6] Friedman (1962, p. 15) also supports this view: "...government is essential both as a forum for determining the 'rules of the game' and as an umpire to interpret and enforce the rules decided upon."

[7] This implies that, as opposed to what is suggested in a large part of the literature, the concept of "limited government" should not refer to the size of the government *per se*, but rather, to in what fields the state exercises its coercive power. It is worth noting that this serious confusion of two economic criteria, namely economic freedom and efficiency in the literature (among others Carlsson and Lundström 2002, Dawson 1998, 2003, De Haan and Siermann 1998, De Haan and Sturm 2000, Grubel 1998, Gwartney et al. 2004, 2006, Scully 2002, for an overview of the literature see Doucouliagos and Ulubasoglu 2006) is the result of a lack of a coherent understanding of the way economic freedom affects growth.

[8] "Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law" (Hayek 1944[1971], p. 54).

doctrine of what the law should be: "The rule of law is therefore not a rule of the law, but a rule concerning what the law ought to be, a meta-legal doctrine or a political ideal" (Hayek 1960, p. 206). Clearly, the rule of law restricts government in its coercive activities.[9]

The rule of law includes three principles: (1) the certainty, (2) the generality and (3) the equality of the law. The certainty of law is probably the most important requirement for economic activities; according to Leoni (1961, p. 95) it refers to the fact that individuals can make long-term plans, which necessitates that the law is not subjected to sudden and unpredictable changes.[10] The generality of law means that the law never concerns particular individuals, i.e. law is abstract from the specific circumstances of time and place.[11] In other words, to be abstract the law must consist of purpose-independent rules governing the conduct of individuals towards each other and apply to an unknown number of further instances by enabling an order of actions (Hayek 1973). Equality of the law means that all legal rules apply to everybody including to those in power. That is, every individual, whatever his rank, is subject to the ordinary law of the realm. More importantly, laws apply both to those who lay them down and those who apply them. As a result, the state is limited in the same manner as any private person.

In addition to these three principles, as Leoni (1961) proposes, we should add another one, although Hayek (1960) does not qualify it as a principle. This is the fact that administrative discretion in coercive power must always be subject to review by independent courts. What is required under the rule of law is that a court should have the power to decide not only whether a particular action of the government agency was *intra vires* or *ultra vires* but whether the substance of the administrative decision was as the law demanded (Hayek 1960, p. 214). To ensure this there must be some authority which is concerned with the rules, and not with any temporary aims

[9] Note, however, that the rule of law is concerned *only* with the coercive activities of the government. It limits the functions of governments to those that can be carried out by means of general rules, but it does not tell anything as regards the non-coercive activities of the government.

[10] As Leoni (1961) argues, as opposed to this Anglo-Saxon concept of the certainty of law, the Continental idea of the certainty of the law was equivalent to the idea of a precisely worded, written formula. Note, however, that this does not guarantee that individuals would be free from interference by authorities.

[11] British common law is this type of an abstract law, evolved in a spontaneous process. For an overview of its emergence and evolution see, among others, Benson (1998).

of the government, and which has the right to say whether another authority had the right to act as it did, and whether what it did was required by the law.

As stems from the above, the rule of law is an indispensable institution for freedom. As Voigt states, "individual liberty is impossible without the rule of law" (1998, p. 196).[12] We also consider the rule of law a core element in economic freedom since it is this principle that gives us guidance to determine what kinds of actions the government can take in an economically free country.[13] When it comes to economic freedom, as already said, it should be possible for individuals to base their entrepreneurial actions on their own individual plans. If laws conform to the above three (four) principles, then individuals are able to form plans based on their knowledge since laws are data for them, which can be accounted for.[14]

However, the usefulness of the Hayekian concept of freedom understood as absence of coercion except for state coercion to enforce known general rules lies not only in the fact that it is a general concept, and as such can be applied to various kinds of freedom, but also in that it can be operationalized by relying on a single concept, namely that of the character of governmental actions. Below, following the Hayekian line but going a step further, we develop a categorization of government actions on which our theoretical framework for an understanding of economic freedom is based.

3 Economic Freedom and Government Actions: Towards a Clarification

A conclusion from the above is that economic freedom relates to the character of government actions, rather than the volume of government actions. In this respect, we think it is useful to distinguish, on the one hand, between coercive and non-

[12] However, as explained by Cass (2003), we should bear in mind that the rule of law does not assure that laws are wise or just or whatever because the human mind has not been able to devise only wise things. The focus of the rule of law is to assure law-bounded qualities.

[13] We note in accordance with Voigt (1998) that a perfect rule of law has never been realized. Therefore, in what follows, we will refer to this hypothetical perfect state of rule of law as the *ideal* of the rule of law, which will serve as a criterion for reference when taking into account those phenomena which reduce economic freedom.

[14] The rule of law consists of "rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive power in given circumstances, and to plan one's individual affairs on the basis of this knowledge" (Hayek 1944[1971], p. 54).

coercive actions, as we have implicitly done above, and on the other hand, between two kinds of coercive activities of a state: those that are compatible with economic freedom (freedom-compatible coercive activities) and those that are not (freedom non-compatible coercive activities). In what follows we characterize government actions at a greater length in this categorization schema.

3.1 Non-Coercive Activities

Non-coercive government activities, referred to as "services" by Hayek (1960, 1973), by definition, do not concern economic freedom, while they influence the size of the government. On the one hand, there are those services that the government should exclusively provide; that is, it should have a monopoly (services with agreed monopoly). On the other hand, there are those in which, in principle, the government should not have a monopoly (services provided on competitive grounds).

The former set of services includes those government actions that are imperative for a favorable institutional framework for individuals' free acts. Since the institutions in question would not emerge spontaneously, i.e. they need governmental design, the government should have a monopoly over them. Clearly, these services (e.g. various official governmental statistics and information) provide the means for a better execution of individuals' plans.[15]

As far as the second group of services is concerned, here the government is only one of the (many) providers of goods and services and should work on the same terms as individuals. These services may include most importantly various health care services and schooling.[16] However, note that these kinds of non-coercive activities are almost absent or at least very rare since government usually maintains its monopoly, that is, they are not provided on competitive grounds.

[15] We note that the services with agreed monopoly do not coincide with public goods, most importantly because public goods include coercive activities, too. But we think that the crucial problem is that the notion itself is dubious because the criterion economists use to qualify a good as a public good is arbitrary, and reflect beliefs rather than objective measures: the criterion of excludability is only a matter of cost, and accordingly, a matter of degree. See Block (1983).

[16] A good example would be the education voucher system as proposed by Friedman and Friedman (1990).

Of course, nothing guarantees that the government provides these services in an efficient way. However, the important thing is that one should not confuse the issue of economic freedom with that of efficiency. Even the fact that there is an efficiency loss under government provision of these services has nothing to do with economic freedom. Of course, we do think that efficiency loss has to be seen as an argument against the government, but this is an argument in its own right, which is different from arguing against the government on the grounds of economic freedom.

Clearly, this question should not be confused with the question of what method the government adopts to provide these services. Not all methods are acceptable when it comes to economic freedom. For instance monopoly, prohibition, or specific orders are not. In a free society the government can have the monopoly only over coercion, and nothing else, and in other respects it has to operate on the same terms as everybody else (Hayek 1960, pp. 222-223).

In Table 1, we summarize non-coercive government activities.

Table 1: Non-coercive governmental activities
Services with agreed monopoly Services that provide a favorable framework for individuals' decisions (monetary system, statistics, etc.)
Services provided on competitive grounds Services that are provided both by the government and by private firms on the same terms (e.g. schooling, health care, etc.)

A conclusion from the above is that while non-coercive government activities do not hurt economic freedom, they have an impact on the size of the government. In principle, one can imagine such a country where, for instance, many competitive services are provided by the government because people prefer these to those provided by private firms, causing big government, but despite this fact economic freedom is not hurt. In this respect note that up to a certain point the quality of the services with agreed monopoly also depends on financial resources devoted to them: the bigger the government the better the quality of these services. This also supports that there is no direct relationship between the size of the government and economic freedom.

To summarize, both services with agreed monopolies and competitive services can and must be analyzed according to the criterion of efficiency. It may be that there are significant efficiency losses as regards these government actions, which is, of course, an argument against the government actions or in favor of small government. But bear in mind that this argument is not based on economic freedom grounds, but rather, efficiency grounds, which is a different thing.

3.2 Coercive Activities

As regards the coercive activities of a state, we propose to differentiate between freedom-compatible and freedom-non-compatible coercive activities. The former, being predictable, are compatible with the functioning of the market because they allow individuals to make plans and realize them on the market. The essential thing is that these government activities can be accounted for. Opposed to these, non predictable or arbitrary activities make individuals' planning impossible or at least largely uncertain. They are non-compatible with a free market.

Freedom-compatible coercive activities do not hurt economic freedom, provided they conform to the *ideal* of the rule of law. However, as implicitly suggested above, any deviation from the *ideal* reduces economic freedom. Clearly, this issue is related to the quality of the rule of law. Furthermore, one can evaluate freedom-compatible activities according to further criteria such as efficiency.[17] As far as freedom-non-compatible coercive activities are concerned, they reduce economic freedom *per se*; they must be rejected solely on the basis of freedom non-compatibility, and the efficiency criterion does not come into play at all.

A crucial question is thus how to separate those coercive activities that are the pre-conditions for freedom from those that harm it. On a conceptual level, one can apply Vanberg's (2001) constitutional choice argument as a criterion for what is "laid down beforehand." Given that a constitutional choice means an agreement "on rules," the process of this choice defines whether the coercive activities of the government fit the *ideal* of the rule of law. The question to be answered in this case is whether

[17] It is worth noting that Hayek himself talks about "expediency," a concept which is not clearly defined and seems to include such additional criteria as fairness, or justice, or efficiency. Instead of expediency we adhere to the term "efficiency" for reasons developed in Colombatto (2007).

a particular coercive activity of the government passes the test of voluntariness on a constitutional level. Although the practical meaning of voluntariness of the choice of rules is dubious, it is a good conceptual tool for deciding whether a certain government regulation harms economic freedom or not.

Having made these rather general remarks, let us analyze the coercive activities of the government in more detail. Freedom-compatible activities include, on the one hand, those activities that are necessary implications of the monopoly over coercion such as the enforcement of contracts, the security of property rights, or national security.[18] There is no doubt that, for instance, ensuring the security of property rights, while being a coercive activity, does not harm freedom; on the contrary, it is necessary for the rule of law.

In addition to the above activities, there are those general regulations that are laid down in the form of rules specifying a certain type of activity, conforming ideally to the principle of the rule of law. These regulations may concern, for instance, the techniques of production by limiting the scope of experimentation, or by prohibiting some activities for reasons of health, or by permitting other activities only when certain precautions are taken, and so forth. Clearly, these regulations raise the cost of production and reduce productivity, but they do so equally for all who engage in the particular production activity and can be taken into account when making plans. Note that, of course, these regulations must be analyzed according to the criterion of efficiency.[19]

As opposed to these freedom-compatible regulations there are those that are not compatible with economic freedom. These latter regulations include all kinds of controls such as price, quantity, and wage control. Clearly, these coercive activities of the government represent the kind of infringement of the individual's private sphere which is an obstacle to individuals freely contracting with each others. So do, besides these regulations, all kinds of government monopolies for those goods and services

[18] Colombatto (1997) draws attention to the potential inefficiencies associated with providing these activities. In his argument, rent-seeking is the most important source of these inefficiencies. His argumentation is in line with Vanberg (2005, p. 36).

[19] For instance, there is no doubt that compulsory military service or some work regulations must be rejected on an efficiency ground, although these do not hamper individuals in making and following their plans on the market.

which could be otherwise provided on a competitive basis. The services or goods upon which the government does not have an agreed monopoly should be supplied by the government on the same terms as anybody else, otherwise economic freedom is hurt. If government is only one of many providers of these goods and services, this does not concern the issue of economic freedom. Clearly, it is not enough to examine the extent to which government gets involved in production or services; one should also examine whether it has a monopoly.

The third type of freedom-non-compatible coercive activities is government subsidies to particular firms (private or state) and various transfers which arbitrarily differentiate between agents. Transfers and subsidies should be seen as coercive actions because those who get particular subsidies are forced to behave not according to their plans but according to the government's will.

To sum up, freedom-compatible coercive activities can be taken into account and refer to everybody, whilst freedom-non-compatible ones are those that arbitrarily differentiate between individuals and/or cannot be accounted for. Table 2 summarizes the coercive activities of the government.

Table 2: Coercive governmental activities

Freedom-compatible activities	**Freedom-non-compatible activities**
Services that are necessary implications of the monopoly over coercion (enforcement of contracts and property rights, national security, etc.)	Controls • Price • Quantity • Wage
General rules and regulations laid down beforehand conforming to the rule of law (e.g. laws, work safety, and health regulation, etc.)	Services or production without agreed monopoly which should be provided on competitive grounds, but over which government has a monopoly
	Government subsidies to firms and transfers

4 The Significance and Empirical Relevance of Our Framework of Economic Freedom

An advantage of the above categorization schema of government actions, as we show in what follows, lies not only in the fact that it can be operationalized – that is, measured – but in the fact that it can point to a mechanism other than those identified in the literature[20] through which economic freedom may affect income. However, the use of the above-mentioned two indexes makes it impossible to reveal this mechanism.

4.1 Requirements Vis-à-Vis a Concept of Economic Freedom

The requirements a concept of economic freedom should fulfill are, we believe, not independent of what the concept is to be used for. Not surprisingly, the most common use of the indexes of economic freedom is the investigation of the growth of nations, through which one can show whether economic freedom increases growth or not, and how it affects growth. A concept of economic freedom which aims to explain growth should meet three requirements.

First of all, independent ofall other aspects of the analysis, a conceptual framework of economic freedom should be consistent in itself. That is, the system of concepts should be part of an internally logical structure. Secondly, agreeing with Block (2006), we also think that the concept of economic freedom should be broken down into operationalizable and measurable components. Measuring economic freedom means two things. First, it means that one is able to name "variables" to measure. Second, it also means that one is able to define a "mapping" between the values of the variables and economic freedom. To put it simply, one has to know what to measure and how what is measured relates to economic freedom.[21]

[20] Various channels, such as investment in human and physical capital, property rights, changes in inequality, social capital, and trust have been identified by different scholars. See Kapás and Czeglédi (2007) for details.

[21] For example, one has to know that the minimum wage is a variable to be measured, but one also has to know that a higher minimum wage means less freedom.

The above two requirements are general ones which can be raised in the case of any framework designed to understand economic freedom. The third is more specific, but, from our point of view, is at least as important as the above two. We argue that a theoretical framework of economic freedom should possibly be "integrated" into a growth theory by which, for the time being, we mean a theoretical explanation for the (inter)relationship between economic freedom and growth. This implies that before one begins to empirically examine the relationship between economic freedom and growth, one has to have a theory about how economic freedom leads to economic growth.

While the first two requirements are very much interconnected, the third is independent from the other two: those components of economic freedom that are measurable will probably create a coherent concept of economic freedom, but cannot necessarily be integrated into a theory of growth. Our claim here is that the theoretical concept we have just developed meets all the three requirements, and being so, it is a useful starting point for an analysis of the relationship between growth and economic freedom.

However, the empirical projects focusing on economic freedom have not paid sufficient attention to the third criterion. Even if this is understandable, since the aim was only to measure economic freedom, it prevents us from an understanding of economic freedom's contribution to growth. Elsewhere (Kapás and Czeglédi 2007) we argued that the problems the "economic freedom – growth" literature is currently facing are not purely empirical or econometric ones, but theoretical in nature, namely that the concept of economic freedom on which the measurement is based is not consistent with an economic freedom-based theory of growth. Instead, economic freedom is simply seen as a variable which is needed to augment theories of growth that do not work properly in the absence of economic freedom. But if one believes, as we do, that economic freedom should be at the center of a growth theory, the third criterion should be given equal weight with the other two.

Our aim here is to show that our theoretical framework is a good candidate for this. So far (in sections 2 and 3) we have tried to show that this framework is consistent in itself (requirement 1). Now, we come to its empirical relevance by showing that our high-brow concepts derived from the Hayekian notion of freedom can have

practical meanings, making it measurable (requirement 2). Following this then we will point to how it allows us to explain how economic freedom leads to higher income (requirement 3).

4.2 From Theory to Measurement

A crucial point when trying to measure economic freedom is that we should keep in mind that freedom understood as the absence of coercion is defined "negatively." So in fact, what one has to measure is the absence of that coercion which relates to individuals' entrepreneurial acts. We argue that a possible fruitful way is precisely to measure economic freedom in the same (negative) way as it is defined. This implies that we should measure those elements that reduce economic freedom. In our conceptual framework this means that we have to measure those governmental actions that reduce economic freedom.[22] By proceeding along this line, the major difference between our proposition and the measurement concept of the EFW index will be found in the fact that ours excludes economic policy variables.[23]

As already emphasized, non-coercive government activities by definition do not hurt economic freedom, although they may increase the size of the government. So, when measuring economic freedom, we should focus our attention only on coercive activities. We argue that the extent of economic freedom can be reduced from two sides: (1) by the deviation from an *ideal* of the rule of law[24] (freedom-compatible government activities), and (2) by freedom-non-compatible government activities.

Thus the major task is to give a practical meaning to freedom-compatible activities, since the other set of coercive activities, namely freedom-non-compatible ones, includes measurable concepts as we will show below.

As far as freedom-compatible activities are concerned, what is to be measured is thus whether when acting, government relies only on rules laid down beforehand.

[22] We have to note that it is not our intention here to elaborate a precise methodology for this measurement, something which is beyond the scope of the present paper. Rather, our aim is to develop this measurement concept theoretically.

[23] Elsewhere (Kapás and Czeglédi 2007) we provided a detailed critique of the EFW index, and we showed why our conceptual framework of economic freedom refers only to institutional variables.

[24] As already argued above, the hypothetical perfect state of rule of law (the *ideal* of the rule of law) can be used as a criterion for reference.

However, on the other hand, it is equally important to know whether and to what extent, rules, once they exist, are followed in practice. This latter point is important because rules should not necessarily be codified; thus formal rules are not enough for us to decide whether an economy can be said to be governed according to the rule of law. We also need *de facto* practice, and in addition, we need *de facto* practice even if, as an extreme case, a country does not have any written rules. Here the problem we face is that written rules do not necessarily become effective constraints. There may be other factors that make the government behave in accordance with the rule of law.

Clearly, here two aspects of the way governmental actions are taken are intertwined. The first aspect concerns whether the government relies on rules when making decisions, since coercion is admissible only when it conforms to general rules and not when it is a means of achieving a particular aim of current policy. The second aspect relates to the extent to which the government is committed to follow the rules that it itself laid down beforehand. Thus one can imagine such a situation in which *de iure* the government is bound to rules, i.e. in principle it relies on rules, but in practice it does not keep to these rules in every respect. An obvious measurable proxy for the first aspect is the legal procedures themselves. To be freedom-compatible these procedures must pass the test of the Hayekian triangle of equality, certainty, and generality.

Corruption is of major importance for the extent to which rules are followed in a country; thus it is our suggested proxy to describe the second aspect of rule-following by government. Clearly, corruption can be interpreted as a principal-agent problem (Bardhan 1997, p. 1321). The level of corruption is zero if the agent behaves in accordance with those rules the principal (the public) laid down for him or her to follow. This standard understanding of corruption supports our view according to which the presence of corruption indicates the poor operation of the government in the field of freedom-compatible activities.

Although corruption is very often the result of the implementation of an unreasonably high level of regulation which is clearly a freedom-non-compatible action, we still think that corruption has to be a subtraction on the freedom-compatible side. The reason is that enacting regulations and enforcing regulations are different ac-

tions, and bureaucratic corruption[25] is the problem associated with the latter. But enforcing rules (via use of the monopoly in violence) is a freedom-compatible activity once the rules have been laid down. After all, the main reason why we think corruption relates to the freedom-compatible group of government activities is that it is a general measure of the rule-following of the government and the bureaucrats.

To sum up, as a deviation from the *ideal* of the rule of law, we propose to take into account, on the one hand, the legal procedures which reflect whether the legal system as a whole meets the requirements of the equality, generality, and certainty of the law, and on the other hand, the corruption which reflects a departure from the reliance on and commitment to rules (rule-following).[26]

Besides the deviation from the *ideal* of the rule of law, freedom-non-compatible government activities hurt economic freedom, too. Based on the analysis of the government activities we have developed in Section 3, we argue that economic freedom can be reduced in three respects. First, all price, quantity, and wage controls reduce economic freedom. Second, government services and production with a non-agreed monopoly also reduce it. And finally when government subsidizes particular firms or gives transfers, this is also against economic freedom.

What is the most problematic issue of these three is the state monopoly. As we have already argued, not every kind of state ownership reduces economic freedom. State ownership can reduce economic freedom only if it goes together with a monopoly in that sector. Or to put it simply, it is only state monopolies that reduce economic freedom, but not state owned enterprises as such. Thus it is not enough to have a measure of state-owned enterprises. We need to have a measure related to their monopoly power.

All things considered, we think that measuring freedom-non-compatible activities is much less troublesome than measuring freedom-compatible activities. Thanks to the increasing attention devoted to the subject of regulation and growth, there are

[25] It is usual to differentiate between bureaucratic and political corruption, and the more or less widely accepted indexes of corruption capture the former (Bardhan 2006, pp. 342-343).

[26] Note also that nowadays legal procedures and corruption are becoming the subject of measurement (Djankov et al. 2003, Bernd and Voigt 2007, Kaufman, Kraay, and Mastruzzi 2007), but not as elements of a theory of economic freedom.

relatively well-known and widely used datasets for this purpose, such as that compiled by the *Doing Business* project of the World Bank (the latest publication is in 2007), and some components of the two economic freedom indexes can also be used.[27] Although these data sets do not provide data for state monopolies as such, they do make some measurement possible by providing data for state ownership and for those regulatory burdens that reduce competition. All in all, we think that the concepts by which we described freedom-non-compatible activities in Table 2 are measurable in themselves; thus the problems arising when trying to measure what we have in mind are technical rather than theoretical.

4.3 From Theory of Economic Freedom to Theory of Growth

The reason, we believe, why our concept of economic freedom and its measurement is important is connected with the third requirement we stressed in section 4.1. We argue that our theoretical framework of economic freedom can be integrated into a theory of growth. It is perfectly compatible with the theory of entrepreneurship (Kirzner 1973), and it is through entrepreneurship that economic freedom deploys its beneficial effects (Harper 2003). The mechanisms through which entrepreneurship leads to growth are revealed by Boettke and Coyne (2003) and Holcombe (1998, 2003a, 2003b, 2003c). However, as far as the empirical literature on economic freedom is concerned, there is no agreement on the channels through which economic freedom deploys its beneficial effects, and here the benignity of economic freedom is underpinned only on an empirical basis.[28] Nevertheless, it is not empirical work that can tell us whether economic freedom is beneficial or not. We claim that a theory of economic freedom must contain arguments in favor of its desirability.

Arguing in favor of economic freedom means showing that it makes market participants better off; or in other words, it leads to economic growth. In addition, clarifying how entrepreneurship causes growth, at the same time, means revealing the mechanism through which economic freedom explores its beneficial effects.

[27] It must be noted here that the most recent version of the two economic freedom indexes are already making use of the Doing Business data (Gwartney and Lawson 2007, Kane, Holmes and O'Grady 2007).

[28] For a detailed overview of the empirical literature on economic freedom, see Kapás and Czeglédi (2007).

Holcombe (1998, 2003a, 2003c) clearly argues for seeing entrepreneurship as leading to economic growth. The connection between economic growth and entrepreneurship lies in the fact that unnoticed profit opportunities come partly from the activities of other entrepreneurs.[29] The point is that when entrepreneurs are taking advantage of profit opportunities they create new entrepreneurial opportunities for others; that is, "entrepreneurship creates an environment that makes more entrepreneurship possible" (Holcombe 1998, p. 51).

What was said above contributes to the recognition of two facts that are crucial for growth theory (Holcombe 1998). First, knowledge externalities occur, since one entrepreneurial insight may produce entrepreneurial opportunities for others. Second, increasing return occurs because the more entrepreneurial activities take place, the more new entrepreneurial opportunities they create. Recognizing that both knowledge externalities and increasing return are due to entrepreneurship, it becomes clear that the engine of growth is not better inputs, but those institutions which fuel entrepreneurship. That is, in this framework the key element in economic growth is the creation of entrepreneurial opportunities, in which institutions play a crucial role (e.g. Holcombe 2003a, Boettke and Coyne 2003, 2006).

Based on the above, our argument is that the theory of economic freedom must pay more attention to investigating which institutions promote economic freedom by providing incentives for individuals to engage in productive entrepreneurial activities, which in turn causes growth, and how these institutions achieve this. Our categorization of government actions can be useful in this theorizing because the distinction between freedom-compatible and freedom-non-compatible government actions provides us with an unambiguous criterion for qualifying an institution as promoting freedom or not. Note also that the Hayekian theory we laid down is about economic freedom itself and not about efficient economic policy. These two may or may not overlap, opening up the possibility for theoretical and empirical research into the separate effects of economic freedom and sound economic policy on economic growth.

[29] Two other factors that create profit opportunities are as follows: (1) factors that disequilibrate the market, (2) factors that enhance production possibilities (Holcombe 2003b).

5 Conclusions

In this paper, we have developed a concept of economic freedom based on Hayek (1960), and as a step further, we have proposed a categorization of government actions, which allowed us to conceptualize the measurement of economic freedom in a different way from that of the indexes of economic freedom. As we argued, a clear-cut concept of economic freedom is important not only for ranking countries according to a scale, but more importantly, for developing new substantial results as regards how economic freedom affects growth. In other words, we think that empirical investigations are important, but a theoretical framework must come first, and measurement after if possible.

In our view the major problem with the literature on economic freedom lies in the fact that it does not put economic freedom at the center of a theory of growth, something which would be necessary in order to investigate the causes of "the wealth of nations." However, one should have this aim in mind, we argued, even before a measurable concept of economic freedom is developed. This is the fundamental reason why we are currently trying to develop another measure of economic freedom, even though two – in other respects very good – indexes already exist. Because of a lack of attention to the criterion we emphasized, namely that a theory of economic freedom should be compatible with a theory of growth, the empirical investigations into how economic freedom affects growth have only very weak theoretical interpretations, preventing researchers from taking the research further and concluding more than the simple fact that economic freedom increases economic growth.

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ISSN 1801-0938

New Perspectives on Political Economy
Volume 3, Number 2, 2007, pp. 231 – 238

A Praxeological Case for Homogeneity and Indifference

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JEL Classification: B53, D01, D11

Abstract: The purpose of the article below is to explain the concept of homogeneity, the basis for the law of diminishing marginal utility. We will not rely on a psychological definition as Block (1980) does. Instead we offer a counterfactual, hence praxeological, approach to indifference. Recent papers by Long (2006) and Hülsmann (2003) are very helpful in this matter. The paper also clarifies and develops Hoppe (2005).

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The law of diminishing marginal utility states that every additional unit of a good is less valuable than the previous unit, because it is employed to satisfy a less important need (since it is a subsequent need) than the last but one unit (Menger 1981, pp. 125-7). This follows from the simple fact that people choose to do what in their opinion is best for them at the very moment of decision. However, the law of marginal utility can only be meaningful if we can somehow show that two units of a good are units of "the same good". Only then, after introducing the concept of homogeneity, can we derive from the law of diminishing marginal utility. If two units of some good are not homogenous, then we can only say that they are different goods, and there is no point in saying they are part of some wider concept of "supply".[1]

Homogeneity is a central theme to the law of diminishing marginal utility, central to the concept of supply or stock, and the pricing process. We have three possible ways to define it.

The first one is a physical definition. This means that homogenous units are defined just by looking at the physical structure of a good that is controlled by an acting man. Austrian tradition, however, teaches us that the merit of being a good is not derived from the physical nature of a thing, but rather from the human attitude toward scarce resources. This means that two goods may have a perfectly identical structure, but can be treated by human beings in a radically different way. Take the example of a wedding ring. The ring that is given to a girl by her fiancé has a much greater value to her than the exact same ring, when it is given to her by a total stranger on the street. Although physically these two rings might be homogenous, they definitely will be treated as heterogeneous goods. Obviously, then, physical properties of scarce resources cannot be the source of defining homogeneity, if we are to speak of human action and valuation (Rothbard 2004, p. 24).

The second method of defining homogeneity is psychological. We would say that there are baskets of goods towards which people are indifferent. It doesn't matter to them which one is used, because the map of their utility shows indifference towards them. However, this concept of indifference is an imaginary construction that is not connected to action. As many Austrians emphasized, the concept of indif-

[1] The debate on the problem was started by Nozick 1977.

ference is not a proper way of describing human behavior. Every action inherently means choosing some alternative and setting something else aside. That is why indifference cannot be a part of a realistic theory of action, but is rather a part of the murky ideas of psychology, in which the scientific background is definitely less precise than in the case of praxeology (Rothbard 1997).

The last attempt to define homogeneity is the praxeological way, which, as it seems, has not yet been successfully presented. This is an uneasy task, but from the Austrian perspective a very satisfying one. But how is one to define indifference and homogeneity if a man, through action, always prefers something over something else?

Where the Austrians have gone wrong in the analysis of this problem is when they concentrated only on that *which is seen*. Bastiat (1964) (and recently Hülsmann (2003)), however, always warned us that a good economist should also be aware of the facts *which are unseen*. What we see in action is always a preference for something rather than something else. Economic laws, however, are not only about what people do, but also about what people would have done otherwise. Take taxation for example – how can one explain the effects of taxation without referring to what would have occurred if taxes were not collected by compulsory measures? How can one explain that price ceilings cause shortages? If we are to concentrate only on that which is seen, we cannot say that people prefer not to pay taxes. Under the conditions they face, they do prefer to pay the taxes (because otherwise they would go to jail). That is why we refer to other possible scenarios, which are not visible, but can be described in a scientific manner. If one is to concentrate on that which is seen exclusively, then one will not be able to solve many economic problems. The "demonstrated preference" concept has been greatly overemphasized in this field (Rothbard 1997).[2]

Austrians realize that unseen facts are important, but strangely they do not see this in the case of the debate on indifference.

[2] Moreover, in the welfare analysis, the concept is empty without property rights theory. This has been recognized by prominent Austrians, although not always spelled out by them as a critique of Rothbard. See, for example Hoppe, with Hülsmann, and Block 1998, p. 31; Herbener 1997, p. 100; and Hülsmann 1999, pp. 14-6. Those authors point out that one needs a proper theory of property (in Professor Herbener's approach the starting point is "self-ownership"). If so, the demonstrated preference concept is not that important, but rather it is only a derivative of ethics.

What we have to do in order to stay within the field of praxeology is to stick to the Mengerian point – economics is a science of *human needs* (Menger 1981, p. 52). Hence, it easily follows that when one wants to point to indifference and homogeneity, one should do this with reference to human needs.

How can we define homogeneity in this framework? It's very easy – two objects are homogenous *if they both can serve the same end*. If so, it follows these are two units of the same supply, because they are *capable of satisfying the particular need*. From the point of view of an *actor's* particular need they are *homogeneous* and *interchangeable* or *equally serviceable*. It does not have anything to do with psychological considerations or psychical characteristics, but rather with the possibilities of action.[3]

Now, this point cannot be demonstrated through action, and cannot be observed in action. But as we emphasized before, economics is not only about actions, but also about different possibilities of acting toward the satisfaction of human needs. Opportunity costs, comparative analysis, theory of taxation, interventionism and so on – all these important economic theories can be established *only* because we refer to something beyond that which is seen. We refer to different phenomena which are equally important as events actually happening.

It seems it is possible to have a cake and eat it. This solution rejects the neoclassical concept of indifference and saves the concept of homogeneity. Let us suppose while I'm cold, I have a need to wear a sweater. I have two kinds of sweaters available, blue and red. From the Mengerian perspective both sweaters can satisfy the same need. Both blue and red are capable of arriving at the same end. Hence, they indeed are the part of homogenous supply of goods – sweaters.

In some sense, we can even say that *from the point of view of satisfying his particular need* acting man will be *indifferent* toward the two sweaters. This "indifference" will not be psychological, as in the neoclassical analysis, but will be strictly praxeological: both sweaters are equally serviceable in the light of the particular need. In the means-and-ends framework those two become a part of the same supply of goods.

[3] Menger wrote that a *thing* to become a *good* must be capable of satisfying a particular human need. Hence, if we have *two units of a thing* capable of satisfying a particular human need, then it logically follows that we have *two units of a good*. Also, as Philipp Bagus pointed out to me, we must remember that the key element is what an individual actor *regards* as a particular means to attainment of an end.

They are homogenous before action and after action.[4] One person acting and actually choosing one of the sweaters demonstrates his preference for it. But this does not change the fact that *if* the end is to keep one warm, *then* both sweaters are homogeneous and man is indifferent which one will satisfy *this* particular need.

One should not think, however, that this concept of indifference can explain action or that it is similar to the neoclassical concept. All this solution offers is the concept of homogeneity in the Mengerian tradition without falling into the murky waters of psychology. Somebody might ask, if a man is indifferent to the two homogenous sweaters, because they both can serve the same end, how does it happen that in action one is preferred over the other? The answer is also simple: because other factors come into play. The immediate response can be why ignore these factors? Well, the common sense answer is because we want to explain why the prices of these things we call "apples" are different from these things we call "cars" even though by acting, one can make all of them heterogeneous. We, as living human beings, have a rational tendency to group things under different labels. It is as simple as that!

Science is based on abstraction. Take the case of biology. If you analyze the biological function of cows and the fact that they give milk, you abstract from certain characteristics of cows. You ignore their particular color, their place in time and the identity of their owners. Why? Because you want to explain the particular fact which is common to all cows: their capacity to give milk. It does not mean that you want to say that the cow does not have a color, or that it does not exist in time, or that the cow is not owned by somebody. You just *abstract* from those things, which are not essential to the particular case analyzed. As Roderick Long well showed in his recent paper, this is a case of a non-precisive abstraction: you ignore particular factors in

[4] This was the problem with Block's analysis (Block 1980, pp. 424-25). He suggested that goods are homogeneous before action (people are psychologically indifferent, because there is no action taking place), but during action goods become heterogeneous. There are two problems with this approach. First of all, there is no suggestion how to group things into classes (different kinds of supply) and not treat all the billions of billions of goods as homogenous. Since before action all goods are not part of action, then cars can be homogenous with peanuts. The second problem is that in Block's framework homogeneity is psychological and cannot be praxeological. If that is the case, then the law of decreasing marginal utility cannot be praxeological and also must be psychological. But this law should stay within the realm of economics, not of psychology. Otherwise, we'll reach an absurd conclusion that the law of marginal utility applies to the state of non-action and when action is started this law is overthrown.

order to grasp the nature of several things that do have something in common (Long 2006). Every single cow is *unique*, *heterogeneous* – it has its own specific features (time, place etc.). But there are some common things to all cows.

We can see the similar case in economics. We recognize some things as "supplies", because we realized they could *serve the same end*. From the point of view of particular actions all goods will always be heterogeneous just like cows in our example. But between all these things we can find similarities, which will make them homogenous from our perspective. And since economics deals with human needs and actions taken to satisfy them, then this perspective should be satisfying. Some things are homogenous since they can serve the same end, and we can consistently imagine a counterfactual scenario under which some other unit was employed rather than one we saw employed for the particular need to be satisfied. Of course, this cannot explain actions, but *this tool is not supposed to explain a particular action*. It is supposed to explain the concept of "supply" *with reference to the idea of action*. In the case of a sweater, other factors determined that red was chosen over the blue one. But for the sake of analysis of supply we abstracted from those factors and defined the concept of homogeneity which helps us to economically distinguish apples from cars and holy water from soda. This, as in the case of cows, is a non-precisive abstraction. We do not negate the fact that other factors are also important for choice just as we didn't negate the fact that cows are unique in their existence and have their own unique characteristics. For the sake of analysis of the milk industry, we abstracted from those factors. And for the sake of grouping goods into homogenous parts, we have chosen a Mengerian perspective of abstracting from particular choices, but at the same time with keeping an eye on human needs. We did not negate these choices. We abstracted from them without suggesting that this can explain *concrete* actions. It can't. But it can praxeologically explain the concept of homogeneity in the light of *possible* actions.[5]

[5] Hoppe (2005) offered an interesting solution to the stated problem: we can either *say* that we used a "particular unit" or we can *say* more generally that we just used a "unit of supply". This "description" solution, mostly correct, has to be completed, for Hoppe did not precisely spell out what the limit of this generalization process is, and he also did not show how to define the concept of supply. On the highest level we could say that everything is homogenous, because "we did something with something" (we acted). Our paper offers the proper limit of generalization: satisfaction of the particular need – so Hoppe's "preferred description" is here "preferred end". And the definition of supply is

Nozick is right – we cannot explain what supply means if we only concentrate on actions which are taken. But we can explain the concept of supply by seeing that which is not seen immediately and without falling into psychological investigations.

The last question that remains is: how does this differ from the neoclassical perspective? In neoclassicism, people are indifferent to *all the goods*, which basically leads us to a striking conclusion, which cannot be accepted, that people are indifferent to different needs. This, however, seems nonsensical.

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groups of units suitable for the realization of the particular end. This also integrates with Mises' point that ranks of homogenous goods are interchangeable, but not goods themselves (see Mises 1966, p.119; Hülsmann 1999, p.7).

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