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A Note on Profit, Loss, and Social Responsibilityⁱ

Art Cardenⁱⁱ

JEL Classification: B53, D63, L21, L26, P11, P12, P14, P17

Abstract: This short note discusses the role of profits and losses in organizing information. I explore the ethical status of a firm earning losses and argue that to earn a loss reveals important information about the production plans that are likely to be successful. I further argue that the information revealed in a profit-and-loss economy is socially beneficial.

ⁱ This essay is inspired first by an assignment I give my economics 101 students on profit and loss and second by a discussion that took place in Marshall E. McMahon's business ethics course at Rhodes College on Wednesday, February 7, 2007.

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1 Introduction

Does a business have a social responsibility? Is the pursuit of profit *as such* an activity requiring some form of moral absolution? According to a classic article by Milton Friedman (1970), the answer is no, and business in fact has no responsibility to society except to increase its profits. Nonetheless, such an answer has been found wanting by critics who argue that the profit-seeking firm does, in fact, have a social responsibility. In this note, I consider the question in light of the content and nature of profits and losses. A simple analysis of profitable and unprofitable transactions suggests that business confers social benefit by its nature.

The unit of analysis in this case is the transaction as it occurs in an unregulated, unhampered market. We begin with a set of simple assumptions. It is assumed that private property rights are secure, and it is furthermore assumed that firms follow the libertarian principle of non-aggression against non-aggressors. From this it follows that entrepreneurial profit and loss provide feedback to producers and consumers. What is more, the system itself provides a set of ethical safeguards for the entrepreneur: in the pursuit of profits, one must appeal to the interests of his fellows.¹ This is benevolent in consequence if not necessarily benevolent in intent. Profits and losses arise from the difference between total revenue and total cost, or the difference between the value of what is produced and the value of what is consumed in production. Profit is earned when the difference is positive; losses are earned when the difference is negative.

Consider first the case of the successful entrepreneur who earns a profit. Profit rewards producers for turning inputs into something more valuable. A profit suggests that consumers place a higher value on the output produced by the entrepreneur than they placed on the inputs. The profit-seeking entrepreneur is better off. Consumers are better off. The entrepreneur's employees are better off. All have succeeded in adjusting the structure of production so as to create value.²

¹ On the non-aggression principle, see Block, *Defending the Undefendable*, pp. 9-12. On entrepreneurial profit and loss, see Mises, *Human Action*, pp. 289-293 and Smith, *Wealth of Nations*, pp. 105-115.

² See on this Mises, *Human Action*, pp. 289-293 and Gwartney et al., *Common Sense Economics*, particularly chapter 1 on "Ten Key Elements of Economics."

Consider now the case in which the unsuccessful entrepreneur earns a loss. A loss is the market's punishment; it is the consumers' way of upbraiding the unsuccessful entrepreneur for wasting valuable resources. We know resources are wasted because people value the inputs more highly than the outputs: the inputs would have been better used in alternative lines of employment. To the extent that the entrepreneur is the sole residual claimant to the losses accruing to his activity – and I acknowledge that these losses may be externalized through political channels – it is the entrepreneur who bears the burden of his mistake and society which harvests the valuable information created by losses. Specifically, losses accruing to entrepreneurs tell future entrepreneurs what *not* to do and, if losses persist, the entrepreneur will eventually be relegated back to the labor market where he can do the most good (or the least harm, as the case may be).

Business in a free market is the practice of purchasing resources, renting labor and capital, combining them into consumer goods, selling the goods, and reaping the reward in the form of profits and losses. The doctrine of the social responsibility of business suggests that somehow this activity conveys upon the businessperson (or business enterprise) some added responsibility – a duty to one's fellow man that did not exist before the creation of the business enterprise.

The idea that a company has a social responsibility outside of their contractual obligations to shareholders places a positive obligation on businesspeople, entrepreneurs, and managers. This places the businessperson in the same category as the criminal, who owes a positive duty to society for his crimes. And yet it seems unreasonable to suggest that someone engaged in a strictly Pareto-improving activity is to fall in the same moral category as someone committing identifiable crimes.³

2 Profit and Responsibility

It has been written that “From everyone who has been given much, much will be required.”⁴ While this seems to be a plausible justification for business “social respon-

³ On the relevance of Pareto's unanimity rule for evaluating the welfare consequences of policies and actions, see Rothbard, *Toward a Reconstruction*.

⁴ Luke 12:48 (NASB).

sibility,” one may contest the fundamental premise: that something has been given to the businessperson, and that this something enjoins upon her a positive obligation to her fellows.

The idea of social responsibility suggests positive duty: the businessperson with a social responsibility is, somehow, bound to either perform actions for the benefit of others, or to refrain from actions of which stakeholders do not approve. Similarly, the legal doctrine of tort (under strict liability) also requires legal restitution: it creates an obligation on the part of the tortfeasor to the victim. But there is an important difference between tort and voluntary exchange. Tort is the involuntary extraction of property by one person against another. Profit, on the other hand, is the reward enjoyed by the entrepreneur who successfully adjusts the structure of production to better fit the tastes of consumers.

What, one might ask, could these additional actions consist of in a market economy? The profitable entrepreneur does well by society in that he takes resources and converts them into something more valuable. The unprofitable entrepreneur does poorly by society by wasting resources; nonetheless, even entrepreneurial losses provide valuable information about market conditions and the range of employments of labor and capital that are (or are not) profitable. Profitable entrepreneurs show us what to try. Unprofitable entrepreneurs show us what not to try.

With apologies to Adam Smith, the entrepreneur brings about a socially beneficial outcome which was no part of his intention by seeking his own self-interest. Profitable entrepreneurs are rewarded for creating value, while unprofitable entrepreneurs, though punished for wasting resources, nonetheless confer benefits on society because their unprofitable ventures reveal information about production plans that do not create value. The prospect of profit means that the plan will be tried; the reality of loss means that revealed information will be trustworthy.

James Buchanan once wrote that “order is defined in the process of its emergence.”⁵ Especially in a complex society, we can say the same thing about virtue. This is particularly relevant to the question of entrepreneurial profit and loss. It is impossible to know *ex ante* whether a particular venture will be profitable, but the *ex post*

⁵ Buchanan, “Order.”

revelation of profitability suggests that coherent social structure is also defined in the process of its emergence.⁶

It may be said, then, that virtue is defined in the process of its emergence. There are many cases in which the right thing to do may well be known *ex ante*; in many business dealings, whether one has actually fulfilled his agreements and obligations – say, to maximize shareholder value – will be revealed by the market process.

What of the ethical status of profit and loss? Far from being the “dammage of another,” as Michel de Montaigne called it, profit arises from the alleviation of what Mises called “felt uneasiness.” What is good can be said to be revealed in many cases by the market process.⁷

Human action is fundamentally a question of information. The quality of information available will determine the types of actions undertaken; thus, when markets with well-defined property rights reveal information through profits and losses, it appears that this will bring us ever closer to a more virtuous state of affairs.

A powerful normative view of profit is most clearly expressed in Ayn Rand’s classic novel *Atlas Shrugged*. Rand draws a sharp and careful distinction between her heroes and her villains, and one of the clearest lines of demarcation concerns their view of the role of profit in society. One character, after a lament for how, in spite of his pure intentions, his company was ruined by those who simply wouldn’t play along, sanctimoniously tells Dagny Taggart that he has “never made a profit” in his life. To this Taggart responds that to live life without making a profit is despicable; for the observer, lamentable.

Again, Michel de Montaigne argued that “the profit of one man is the dammage of another.” In a sense, we can agree with Montaigne in that, say, entry by a firm like Wal-Mart will take business from incumbent retailers. However, even this apparent damage ultimately works out to the greater good, for the benefits of higher productivity displayed by abler merchants will redound to the benefit of consumers, to borrow a phrase from F.A. Hayek and Milton Friedman. Moreover, losses will guide

⁶ For a discussion of this in the context of individual utility maximization, see Block, Carden, and Carson, *What Does Rod Stewart Really Know Now?*

⁷ See on this Mises, *Theory and History*, pp. 35-68 and *Human Action*, pp. 289-293.

the unsuccessful entrepreneur to the position in which he or she is best able to serve consumers.

3 Stakeholders Far and Near

The crux of the debate over a firm's responsibility to stakeholders versus its responsibility to shareholders fundamentally concerns the fact that any action by a company will alter the relative prices faced by said stakeholders. But who should we consider stakeholders? It is true that the families relying on a firm's workers may be considered stakeholders, but it is equally true that the firm's customers are also stakeholders. When a firm lays off workers in order to become more streamlined or more competitive, the net immediate result is a transfer from one set of stakeholders to another. Unless there is a non-arbitrary reason why we should prefer one set of stakeholders over another, such a move should be Kaldor-Hicks efficient. One stakeholder's sad state is compensated for by another stakeholder's windfall.

Further, from an ethical standpoint, there is no contract, implicit or otherwise, between a firm and its stakeholders like the contract that exists between a firm and its stockholders. Unless the contract specifies otherwise (as it does in the case of Whole Foods Market, which donates a percentage of its proceeds to local charities), the firm's fiduciary duty is to maximize shareholder value.

In a sense, we are all stakeholders in a society that maximizes productive efficiency because productivity makes possible what we might call the truly important things in life. While money is not everything, and while material possessions are not everything, the things that we find truly valuable – relationships, friendships, et cetera – are most easily enjoyed when basic needs like food, clothing, and shelter have been met.

While negative shocks to some stakeholders are unfortunate and lamentable, they are insurable (albeit perhaps imperfectly), either through saving, through direct insurance, or by investing in networks of relationships (churches, civic organizations, or unions) that might provide income support in the wake of a plant closure or something similar.

Finally, many ethical systems (among them Catholic theology, for example) express a “preferential option for the poor” whereby policies are to be evaluated in part based upon their impact on “the least of these among us.” And so it is that globalization, international trade, and Joseph A. Schumpeter’s gale of creative destruction in fact work to the benefit of the poorest of the poor. While trade liberalization may turn relative prices against some constituencies, in many cases it turns relative prices in favor of the poorest and least-skilled. If we admit the generally untenable assumptions that utilities can be compared across individuals and that there are diminishing marginal returns to income, we can argue that the turn in relative prices against rich western stakeholders and in favor of the global poor represents a net improvement.

Entrepreneurship is an exercise in risk transfer and risk reduction, and those who become entrepreneurs are those with a comparative advantage in bearing risk. We can say that this is ethically laudable: entrepreneurs (and, in particular, capitalist-entrepreneurs) have a comparative advantage in reducing risk and in smoothing out future consumption patterns. It is the job of the capitalist-entrepreneur to advance income to current factors of production (labor and capital) in anticipation of being able to sell output at a future date for more than the costs of production.⁸

Once again we are confronted with a question: what is it, exactly, that obligates the capitalist-entrepreneur to give something back to the community when it is clear that he performs valuable services by smoothing consumption and reducing risk? In a market economy with well-specified, well-enforced property rights, the entrepreneur is fully compensated (with profits) for his risk-reducing and income-advancing activities; however, those to whom the entrepreneur is allegedly obligated (workers and the general public) are also fully compensated. Indeed, at first glance, it appears that the transfer of risk from workers to capitalists provides a far more substantial benefit to the workers than it does to the capitalist-entrepreneur. Rather than exploring the extent to which the entrepreneur is obligated to give something back to society, we perhaps should explore the extent to which we owe entrepreneurs a debt of extra gratitude.

⁸ See on this Rothbard, *Man, Economy, and State* pp. 463-469.

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Mengerian Causality: The Case of the Entrepreneur

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JEL Classification: B13, B25, B41, D02

Abstract: Modern economics is filled with models using simultaneous equations to explain economic behavior. One common model, the circular flow diagram, is found in many principles-level textbooks, and is offered as the basic way in which economies function. The entrepreneur, if included at all, is relegated to being a part of the box labeled “firms.” Carl Menger argued, however, that economic behavior is best understood using the idea of cause and effect. Further, economic behavior is temporally directional. Thus, causation and time are missing in modern analyses, leading to a superficial role for the entrepreneur. This article uses the example of the entrepreneur to highlight Menger’s method of cause and effect.

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1 Introduction

In 1871, Carl Menger and William Stanley Jevons ushered in the marginal revolution, followed in 1874 by Leon Walras. In doing so, they helped move the focus of economics from macro issues (e.g., the wealth of nations) to micro issues. However, as has been well documented, the three marginalist pioneers were engaged in very different analyses.¹ Simultaneity played a large role in the paradigms of both Walras and Jevons, leading to a substantial role for modeling systems using simultaneous equations.

Menger, however, preferred the Aristotelian approach of cause and effect. In fact, the very first sentence of Menger's first book states, "all things are subject to the law of cause and effect."² Using this method, economic logic dictates a linear approach. There is a beginning to economic activity, to wit, a human need, and this need causes a series of events to unfold which culminate in the satisfaction of that need.

In addition to series of simultaneous equations which permeate Neoclassical general equilibrium economics, nowhere is the idea of simultaneity more prevalent than in the circular flow diagram. In this diagram, no single variable can be said to cause a reaction in another variable. Economic actors become aggregate groups of consumers and producers where goods and money flow from one group to another through the mysterious production function. Simpson and Kjar argue that the circular flow obscures the entire function of the market economy—the allocation of scarce resources among unlimited wants—because of its circularity. The circular flow has no beginning or end, and misses the cause and effect evident in Menger's analysis. The most important ingredients in the allocation problem, the entrepreneur and monetary calculation, are left out of the simultaneous circular flow.³

¹ See James Bonar, "The Austrian Economists and their view of Value," *Quarterly Journal of Economics*, Volume 3, no. 1 (1988), pp. 1-31; George Stigler, "The Economics of Carl Menger," *Journal of Political Economy*, Volume 45, no. 2 (1937), pp. 229-250; William Jaffé, "Menger, Jevons, and Walras De-Homogenized," *Economic Inquiry*, Volume 14, no. 4 (1976), pp. 511-524; Sandra Peart, "Jevons and Menger Re-Homogenized: Jaffé After 20 Years," *American Journal of Economics and Sociology*, Volume 57, no. 3 (1998), pp. 307-325; and Robert Hébert, "Jevons and Menger Re-Homogenized: Who is the Real 'Odd Man Out'?", *American Journal of Economics and Sociology*, Volume 57, no. 3 (1998), pp. 327-332, for examples of these differences.

² Carl Menger, *Principles of Economics* (Grove City: Libertarian Press, 1994), p. 51.

³ Barry D. Simpson and Scott A. Kjar, "Circular Flow, Austrian Price Theory, and Social Appraisalment," *Quarterly Journal of Austrian Economics*, Volume 8, no. 4 (2005), pp. 3-13.

In this paper, we elaborate on the linear causation featured in the Menger-Mises theory of the entrepreneur. In section 2, we consider the forward-looking behavior of the entrepreneur which leads to monetary calculation. In section 3, we discuss the production and supply of consumer goods by entrepreneurs. Section 4 shows the *ex post* implications of entrepreneurial successes and failures. In the last section, we draw conclusions about the entrepreneur, time, forward-looking behavior, and simultaneity.

2 Consumers to Entrepreneurs

Entrepreneurs perform a critical temporal function in markets. Since humans experience time as a linear phenomenon, the entrepreneur's function creates a linear causality which leads to the rational allocation of scarce resources among unlimited wants. The first step of the process is the entrepreneur's response to human needs.

Entrepreneurs are essentially forward looking. Their job is to anticipate the needs of consumers. So, entrepreneurs begin by forming expectations of the future. These expectations concern particular consumer goods which the entrepreneur believes consumers will demand. However, the entrepreneur must deem these consumer goods profitable before they commence production. Therefore, entrepreneurs engage in monetary calculation.

Monetary calculation consists of an *ex ante* decision-making process, and an *ex post* evaluation of previous decisions. Three components form the decision-making process. First, the entrepreneur calculates the present costs of the factors of production. Second, the entrepreneur judges future consumer good prices and market conditions.⁴ Third, based on these calculations, if the entrepreneur estimates that the total revenue from the future sale of the stock of goods produced exceeds his total costs by more than the prevailing interest rate over the production period, then he deems this particular production method and consumer good profitable, and he begins the production process.

We can trace, therefore, a linear timeline of causation that begins with consumer needs and flows directly to the expectations of entrepreneurs. Entrepreneurs are con-

⁴ Guido Hülsmann, "Knowledge, Judgment, and the Use of Property," *Review of Austrian Economics*, Volume 10, no. 1 (1997), pp. 23-48.

sumers too; however, they are also part of the intellectual division of labor that encompasses all producers and consumers and gives rise to the structure of present input and output prices that are used in calculating expected future profits⁵

3 Entrepreneurs to Factor Owners

Production occurs in stages over time. First, the entrepreneur must bid for factors of production based on his calculations of expected profitability. Since factor owners will sell to the highest bidders, entrepreneurs select how the scarce resources will be allocated among consumer goods. These factors/resources are higher-order goods which will be combined with other higher-order goods such as machinery and labor to form consumer goods. Since resources and production methods are substitutable, the expected profits based on current factor prices lead the entrepreneurs to make the most rational choices for resources and methods. Moreover, the exchanges between entrepreneurs and factor owners cause prices for factors of production to emerge.

Once the resources and methods are selected, the consumer goods are produced. This may be a simple and short process, or it may be complicated and long. Since the interest rate figures into the entrepreneur's calculations, the best possible choices (from the entrepreneur's point of view) are made. Once the consumer goods are produced, entrepreneurs supply these goods to consumers. Thus, the existing supply of consumer goods is always based on past entrepreneurial decisions.

The prospective actions of consumers cause entrepreneurs to act. Now the monetary bids of entrepreneurs cause factor owners to act. The exchanges between entrepreneurs and factor owners not only cause factor prices to develop, but also leads our timeline of causation into the production process.

Knight criticizes Menger's linear exposition of the production process.

Perhaps the most serious defect in Menger's economic system, if we may so call his position as a whole, is his view of production as a process of converting goods of higher order into goods of lower order. This involved a fallacious view of the economic process and in particular of the role of time. In the first place,

⁵ Joseph Salerno, "Postscript: Why a Socialist Economy is Impossible," in Mises (1990).

there is in fact no such serial sequence. It would call for the existence of goods of a supreme or highest order, not produced by other goods, and in the economic means, there are no such goods.⁶

This, however, is an odd position for any respectable economist to adopt. After all, while all capital goods are certainly produced by higher orders of goods, it is erroneous to assume that land and natural resources are so produced, or that time is so produced, or that entrepreneurship or labor are so produced.⁷

4 Entrepreneurs to Consumers

As entrepreneurs supply goods to consumers, the exchanges between the two groups cause prices of consumer goods to develop. These prices are based on the previous decisions of entrepreneurs and the subjective valuations of the consumer goods by consumers. This process allows entrepreneurs to perform an *ex post* evaluation of their past decisions. This evaluation is based on realized profit and loss.

Profit is a reward to entrepreneurs who correctly anticipate consumer needs. Thus, correct entrepreneurs, having been rewarded by the market, will have more financing available to make even more decisions concerning allocation of scarce resources and how they are used for the production of consumer goods. Entrepreneurs who suffer loss, having been punished by the market, will subsequently have fewer financial resources available to them. Hence, their decision-making power regarding scarce resources is diminished. Entrepreneurs who continue to suffer loss will eventually be driven from the market. Therefore, by purchasing or refusing to purchase, consumers select the entrepreneurs who allocate resources in a way that correlates with consumer wishes.

Profit and loss also allow entrepreneurs to modify their expectations and judgments within their decision-making process. They may choose different factors or production methods in an effort to cut costs, or make any other number of decisions which factor into the expected profitability of their venture. Thus, our linear timeline

⁶ Frank Knight, "Introduction," In Menger (1994).

⁷ Rothbard's (1970, pg 286) exposition of the stages of production includes a payment for "original factors."

of causation, which began with consumer needs, returns to consumers through the production of consumer goods. Since wants are unlimited and ever changing, entrepreneurs may begin the decision-making process anew, incorporating their modifications.

5 Conclusions

Vaughn suggested that, in many ways, Menger was a Classical economist, in that he was trying to answer the fundamental question posed by Smith: what are the causes of the wealth of nations?⁸ However, Menger reached a different answer than did Smith. Smith's key was the idea that the division of labor was the main source of economic progress. Menger criticized this and, while he built on Smithian capital themes, suggested instead that forward-looking behavior and intention were the keys. These ideas are scant, if extant, in Smith.

“The greatest improvement in the productive powers of labour,” says Adam Smith, “and the greater part of the skill, dexterity, and judgment with which it is anywhere directed, or applied, seem to have been the effects of the division of labour.” And: “It is the great multiplication of the productions of all the different arts, in consequence of the division of labour, which occasions, in a well-governed society, that universal opulence which extends itself to the lowest ranks of the people.”⁹

Menger contrasts an Australian tribe that has completely and efficiently engaged in the division of labor but which produces no capital, with that same tribe that has now engaged in capital acquisition. Menger argues that with each additional order of goods, the tribe becomes more productive. Such additional orders of goods require forward-looking behavior by individuals planning to meet future needs. In other words, it requires entrepreneurs.¹⁰

Incorporating the entrepreneur allows us to draw two major conclusions from this paper. First, it is possible to encapsulate the theory of the entrepreneur within a lin-

⁸ Karen Vaughn, *Austrian Economics in America: The Migration of a Tradition* (Cambridge: Cambridge University Press, 1994).

⁹ Menger (1994, pp. 71-72).

¹⁰ *Ibid.*, pp. 72-75.

ear, time-wise causality of market processes. The theory of the entrepreneur begins with a decision-making process geared toward the future. The production process itself is a linear process which occurs over time, from resources and higher-order goods down to consumer goods of the first order. The evaluation process based on profit and loss continues the selection process and aids the entrepreneur in a further decision-making process. Because appraisalment is a process, it occurs over time; therefore, a line of causality can be marked from beginning to end. According to Rothbard:

[T]he mathematics of simultaneous equations, dealing in physics with unmotivated motion, stresses mutual determination. In human action, however, the known causal force of action unilinearly determines the results.¹¹

Once this linear causality is delineated, another argument against the Neoclassical circular flow is highlighted. Of course, there is no time in the circular view of the world. But time is certainly a factor of production and even in the function of the entrepreneur himself. Menger's appreciation of cause and effect, and the Austrian incorporation of time into economics is still valid and defensible.

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¹¹ Rothbard, *Man, Economy, and State: A Treatise on Economic Principles* (Los Angeles: Nash Publishing, 1970), p. 279.

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**The Praxeology of L. von Mises and the Theory of Action of
Alfred Schütz**

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JEL Classification: A12, A14, B41, B53

Abstract: The aim of this article is to investigate the relationship between the praxeology of L. von Mises and the theory of action of Alfred Schütz. Because of the importance that Mises' theory has had on economics it is interesting to highlight the coincidences and synergies which exist between the two authors. In the first place, it is interesting because the praxis as a theory of the action is being more and more diffused in the social sciences and in the second place, because the importance which the work of A. Schütz and the direct pupils, especially Thomas Luckmann has had on sociology.

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1 The aim and structure of the paper

The study of the action is the aim of the social sciences. The object of social study is man and his actions, his social relations and the cultural framework which he constructs. Thus human life is social life. A person does not live in isolation. He is not merely an isolated, independent individual, for whom the relations with other people are something external and circumstantial.

In reality, social relations are a basic constituent of the individual personality. So, following Husserl, we can define man as a “being-with” (*mit-Sein*). As Husserl states: “humanity in general is by its essence about being a man in humanities linked by generation and sociability” (Husserl, 1954, p. 16). By this expression he means that the being of man is open to other men as well as the culture and the social institutions. That is, he is a being open to this symbolic world, which constitutes the world of life, to which he belongs (*Lebenswelt*).

It is in this context that the work of Alfred Schütz acquires its real importance. His first book and principal work, is called *Der sinnhafte Aufbau der sozialen Welt* (Schütz, 1972). The aim of this book is to advance the methodology of Weber applying it to the study of social action and by contributing two new theories to this: the phenomenology of E. Husserl and the philosophy of H. Bergson. Alongside the author’s explicit contributions, the stamp of L. von Mises can be discerned from the first pages, which is not surprising since Schütz was an assiduous member of the *PrivatSeminar* which Mises maintained in Vienna during the 20s and 30s, and knew, at first hand, Mises’ theoretical developments, which were to lead to the formation of his theory of action or praxis, which culminated in his book *Human Action* (Mises, 1996).

Because of the importance that Mises’ theory has had on economics it is interesting to highlight the coincidences and synergies which exist between the two authors. In the first place, it is interesting because the praxis as a theory of the action is being more and more diffused in the social sciences and in second place, because the importance which the work of Schütz and the direct pupils, especially Thomas Luckmann (Luckmann, 1992) has had on sociology. Besides this, one should bear in mind the recognition by authors such as J. Habermas of the importance of Schütz’s work on the development of their own ideas.

So, taking Mises' work as a starting point, the aim of this brief exposition is to show the theoretical parallelism between Schütz's work and the Misian praxeological categories in two essential aspects:

1) The categories developed by Mises as the basis of human action: rationality, will, choice, causality and temporality are developed in Schütz's work.

2) Mises uses the praxeological categories in order to explain market exchanges or catallactics as a particular case. So for Mises economics or catallactics is a branch of praxeology. And economics is grounded in a general theory of action. In Schütz's case, the method is parallel. It starts from an explanation of individual action endowed with meaning and in a subsequent development, he analyses social inter-relations and uses, as an example of his theoretical analysis, market exchanges or catallactics. In this way, the importance of the analytical categories of Praxeology and Catallactics has a wider field of application than is generally recognized, especially on the part of the neo-classical economists.

The structure of the present article is as follows. In the second section, there is a succinct presentation of the elements which constitute Mises' praxeology. In the third section there is an exposition of the constituents of individual action for Schütz. In the fourth section there is presented the development of the inter-subjective comprehension which explains the social interrelations in the work of Schütz and which give rise to the social world.

2 The theoretical structure of Mises praxeology¹

Mises explains market phenomena or *catallactics* from a general theory of action. For the explanation of market phenomena it is necessary to construct a general theory of action. The first two parts of *Human Action* are dedicated to this task. The remaining five parts are deductions of economic laws. As he says himself, any extension of his theoretical system of action is the basis for improving the economic theory and its methodology. The structure of the first part of the book is an analysis of the action. The starting point of Praxeology "is not a choice of axioms and a decision about

¹ For a detailed explanation of Misian praxeology, Aranzadi (2006) is particularly useful.

methods of procedure, but a reflection about the essence of action” (Mises, 1996, p. 39). The method is to reflect on the components, which are present in every action, so that the said action arises. What then is the irreducible cause for which the action is produced? It is the category of action itself. If a person wants to deny this principle he is making a conscious volition. By definition all conscious conduct is an action. Therefore concludes Mises that this person has acted in denying the category of action. The action is an axiom; it is irreducible to other causes. It is a necessary condition of our knowledge. Mises’ theory of human action is constructed on that human action is an irreducible presupposition. The whole theoretical edifice of Mises starts from this assumption. It is a self-founding principle.

Although the action cannot be reduced to another cause, man has to perceive a situation of dissatisfaction before acting. Mises writes: “Acting man is eager to substitute a more satisfactory state of affairs for a less satisfactory.” (Mises, 1996, p. 13). He always has to prefer one state to another. Indifference is only produced in a being, who is “perfectly content with the state of his affairs would have no incentive to change things” (Mises, 1996, p. 13). Even perceiving this unsatisfactory state, the man cannot act. When does this happen? In Mises’ words: “[when the man does not have] the expectation that purposeful behavior has the power to remove or at least to alleviate the felt uneasiness. In the absence of this condition no action is feasible. Man must yield to the inevitable” (Mises, 1996, p. 14). Therefore, with regards to the axiom of human action, Mises considers as an exterior requirement, or rather as a prerequisite these two conditions: the subjective perception of dissatisfaction, and the consideration of certain things as resources for the attainment of an end.

Here then, we have the individual with dissatisfaction. He wants a change in his situation and considers that the means exist for changing it. What things can he use as resources? If a man does not know how to relate to the elements in his environment, he does not know what to expect. He does not have a *ratio*, a measure among things. He does not have any reason to act. He will have to discover the causal relations that provoke changes. Mises affirms: “Acting requires and presupposes the category of causality.” (Mises, 1996, p. 22) The category of means and ends presupposes the cause-effect relation.

Starting from the axiom of action, his prerequisite was the existence of dissatis-

faction and the desire to change that situation. Whoever acts distinguishes between the past, the present and the future. This difference is not adequate in philosophical terms. Every present moment is sunk in the past. There is no more than a tenuous line between the future and the past. Whoever acts distinguishes between a time antecedent to the action, the past, a time of action, and a time consequent to the action, the future. In such a way that the person perceives the causal relation in this antecedent-consequent sequence. If on the one hand, the action implies the desire for change, causality is necessary to interrelate with the recourses, which can produce this change. The action and causality are intimately linked. On the other hand, the causal antecedent-consequent relation is presented in a procedural temporality. Causality and temporality are inseparable. Mises concludes: "The concepts of change and of time are inseparably linked together." (Mises, 1996, p. 23)

The fundamental structure of the Mesian system is almost finished with respect to the first part: his theory of action. The basic element is the irreducible axiom of human action. The second step has been to clarify the prerequisites of the action, preference. The third step was to analyze how this prerequisite implies the causal category in order to know how to distinguish the means-ends relation. The fourth and last step is to explain the sequential character of the causal relation. *The conclusion that Mises reaches is that the action is a perceived temporal preference like a mean-end relation.*

3 The concept of action in Schütz

Schütz begins with the methodological concepts set out by M. Weber (1978). His starting point is the concept of social action. There are two characteristics that distinguish social action from mere human conduct.

1) The action, as such, is characterized by its being significant for the person. This distinguishes it from mere reactive or passive conduct. In Schütz's words: "every action directed towards an object is *ipso facto* meaningful" (Schütz, 1972, p. 15). That is, it is behavior orientated towards an end, to which the actor attributes a subjective significance.

2) The action is characterized as social action inasmuch as man enters in relations with other people. That is to say, in the social relation, the action assumes significance, since the action acquires its sense with reference to a “you”. Schütz: “[the person] must be aware of and interpret the meaning of the other’s behavior” (Schütz, 1972, p. 16). We enter fully into the symbolic world of culture. It is by means of this cultural medium that we shape the significant objectives which each person interprets subjectively in his individual action and which is at the same time interpreted by the people with whom he interacts.

This is the level of the study of the world of life, where the structures which shape our co-existence are formed: language, economy, law and social institutions. Therefore, individual action acquires its full meaning inasmuch it is social. But this latter is constructed on the former, in such a way that it is necessary to analyze how a person constitutes a subjective significance in the stream of his consciousness. We have to pose the following question: what does it mean to say that a person acts with his subjective significance?

When we ask this question we are referring to the anthropological categories which explain individual action. Firstly, the difference between the action and other activities and forms of behavior is that the action is orientated towards the future. From the beginning, Schütz introduced the Bergson’s concept of *durée* (1963). The action takes place in the course of time or rather, human life is in time. So life is flow. In Schütz’s words:

From the point of view of a being immersed in duration, the “Now” is a phase rather than a point and therefore the different phases melt into one another along a continuum. The simple experience of living in the flow of duration goes forward in a uni-directional and irreversible movement. (Schütz, 1972, p. 51)

So, from the beginning, the historicity of the person as a basic anthropological category to understand human action is taken into account. But let us consider again the action orientated towards the future. What does this orientation mean? Does it imply an activity on the part of the person or a mere acceptance of whatever comes along. On this point Schütz offers a very interesting first definition: “Every action is a spontaneous activity orientated toward the future. This orientation toward the

future is by no means peculiar to behavior. It is, on the contrary, a property of all primary constituent processes” (Schütz, 1972, p. 57)

This orientation towards the future or rather the fact that each action necessarily implies the anticipation of the future introduces another basic anthropological category: the project. The project is that human capacity of pro-tension, of tensing oneself prospectively in the future and anticipating desirable ends. Schütz states: “the analysis of action shows that it is always carried out in accordance with a plan more or less implicitly preconceived. Or, to use an expression of Heidegger’s, an action always has the “nature of a project” (Schütz, 1972, p. 59).

In the light of the quotes presented here, the following question arises: does Schütz consider that the action, as he defines it, is rational? That is, is all action rational? The answer is affirmative, as we can prove in the following statements: “Let us recall once again our definition of action. Action is behavior based on an antecedent project. Since every project has an “in order to” or “for-the-sake-of-which” structure, it follows that every action is rational” (Schütz, 1972, p. 239). The following paragraph is more explanatory:

Now let us look at *rational* or *purposive*, that is, action which has a goal of optimum clarity. How does a person acting rationally proceed? The plan or the projection of his action begins with choosing a goal. Next he realizes that, if he is to achieve his goal, he must adopt certain means. This is merely recognition on his part of a certain causal regularity existing between events which that he calls his means and the end event that he calls his goal. (Schütz, 1972, p. 61)

In conclusion, for both Schütz and Mises, all action is rational. Schütz does not call the anthropological categories, praxeological, but the concepts coincide. The core of his theory of action is rationality. There appears the means-end structure, which implies the antecedent-consequent temporal relation and causality. That is to say, we face the same human realities that Mises called praxeological categories.

Mises considered that these categories of human action were a priori. For example, Mises’ axiom of action does not originate in experience, but this is necessary in order to understand the action. These logical principles of any theory are enunciated. They are, according to Kant’s terminology, a priori synthetic judgments. It

should not be forgotten that every scientific theory is bounded by ontology. The basic hypotheses of a model, that is, the a priori axioms or judgments have two essential tasks:

1) In the first place, everything a priori precedes the experience of knowledge. For this knowledge to be produced, it is necessary to apply those laws or structures. Professor Sergio Rábade points out the primary function they serve, is “to make knowledge possible through its application” (Rábade, 1969, 89).

2) The second task of the a priori consists in, imposing on knowledge, certain characteristics, which are not derived from experience: universality and experience. Professor Sergio Rábade says in this respect:

We have to ground these characteristics of knowledge in some constitutive structures, which are at the same time, dynamic. Such structures are responsible for imposing the characters of universality and necessity on our knowledge, in certain conditions. As these structures belong to the constitution of man as such, they have to be complied with in the knowledge of each man, in equality of conditions. (Rábade, 1969, p. 90)

We can conclude by stating that all experimental knowledge has to be based on universality and necessity. Knowing is not only based on what each person wants to add to the process of knowledge. It is necessary to have stronger evidence. Knowledge always has an inter-subjective component of universality. The nature of universality and necessity are constitutive of man and consequently of all human knowledge. One should not think that the pretension of possessing knowledge a priori, or simply the mere enunciation of such a phrase, the claim to believe oneself to be in possession of the only truth, as is perversely suggested by many followers of positivism. The only thing that this statement shows is the pretension to know reality, having access to reality as a source of knowledge and an object of itself. And above all, that this knowledge is communicable.

In this way of the *logos* of reality the scientific *dia-logos* is reached. This scientific pretension is also shared by Schütz:

We do not set as our goal a science of the facts of this inner sphere of appearance, but a science of essence (*Wesenswissenschaft*). What we are thus seeking

is the invariant, unique a priori structure of the mind, in particular of a society composed of living minds. (Schütz, 1972, p. 44).

Having made this brief digression on the significance of the a priori, we will take up again the analysis of the anthropological categories. Schütz defines the action as rational and he adds a note of willfulness to it. So that the realization of a project is a voluntary activity. Schütz states: “the first characteristic that suggests itself as a possible way of differentiating between action and behavior is the *voluntary* nature of the action as opposed to the automatic nature of behavior” (Schütz, 1972, p. 40). And he clarifies this point thus:

Let us turn, then, to the second class of topics included under the heading of “voluntary action”: the problems of choice, decision and freedom. If it is maintained that voluntary action is the criterion of meaningful behavior, then the “meaning” of this behavior consists only in the choice - in the freedom to behave in one way rather than another. This would mean not only that the action is “free” but that the aims of the act are known at the moment of decision; in short, that a free choice exists between at least two goals. (Schütz, 1972, p. 66)

That is to say, in the creation of the project, it is necessary to choose between alternative ends. Once the choice has been made and once the oscillation between alternatives has been resolved, the project acquires a unitary shape of intermediate steps to attain an end. It is a unity that invites the action. But it is not a closed, fixed arrangement. It is a scheme that goes on developing in the course of its execution. Schütz points out:

Naturally, the first is what its name implies, a mere sketch with many empty places and variables in it. These empty places are filled in, and the variables are given values as the action progresses step by step. At any moment we can compare our blueprint with what we are actually doing. (Schütz, 1972, p. 64)

The project is not therefore something that comes to a person but is something to do. In other words, the future is not something that you have to wait for it, something you have to look for. So now, in this process of comparing our project with our direct experience of what we are really doing, there may appear different opinions and re-

developments of the steps to follow. And this implies a restructuring of the ends and the means. As Schütz explains:

Every ordinary purposive action takes within the means-end relationship. Establishing the pattern of such an action simply means seeking out how typical ends and the typical means are related. In other words, the actor's choice of goals, his in-order-to-projects, is determined via ideal-typical construction. Once this is done – that is, once the actor's goal is defined – it is only a matter of selecting those means for him that experience has shown to be appropriate. We can now interpret Weber's postulate of causal adequacy in the following way: In a type construct of ordinary purposive action, the means must be, in the light of our past experience, appropriate to the goal. (Schütz, 1972, p. 233)

Causality appears as a category of human knowledge. It is the rational capability to relate the means to the end, the antecedent with the consequent. But it is the capability that each actor exercises based on his experience. Thus the means-end anthropological category is a private thing for the actor and his circumstances in life. Each actor subjectively perceives and chooses the end, and on the basis of his experiences, he selects causally the pertinent means for the attainment of the end.

Schütz does not understand causality as an external legality for the actor or as physical determinism imposed on the person. The causality of action is something private and internal to the person. It is the constituent element of his personal being. Schütz states correctly: “for when we formulate judgments of causal adequacy in the social sciences, what we are really talking about is not causal necessity in the strict sense but the so-called “causality of freedom” which pertains to the end-means relation.” (Schütz, 1972, p. 231). In short, causality is an anthropological category.

The action is orientated towards the future by means of the project. The person projects himself into the future from the present. Therefore, in the flow of time, Schütz distinguishes two directions in the analysis of the action: the future and the past. As regards the first, Schütz poses the “in-order-to” of the action, the “motive-for”. For example, if we observe a person cutting wood, the question arises, what is he cutting wood for? What is the objective he is pursuing? We ask ourselves, what the woodcutter hopes to achieve in the future. Obviously, the observer is detached from the woodcutter's motive. The observer does not know if the woodcutter is cutting

wood to make a fire or to sell it. In order to know the scope of the woodcutter's project, it is necessary to ask him about it. As Schütz says: "the actor can tell the observer just what the 'span of his project' was." (Schütz, 1972, p. 229) In a second possibility, we can analyze the same phenomenon, from the past and we can pose the following question, why is he cutting wood? What motive is the woodcutter pursuing? In this direction, we ask ourselves about the past experience of the woodcutter, which assures him that cutting wood is the correct means to attain his end. It is the "because-motive" of the action. It presents us with the reasons of the woodcutter. Schütz says:

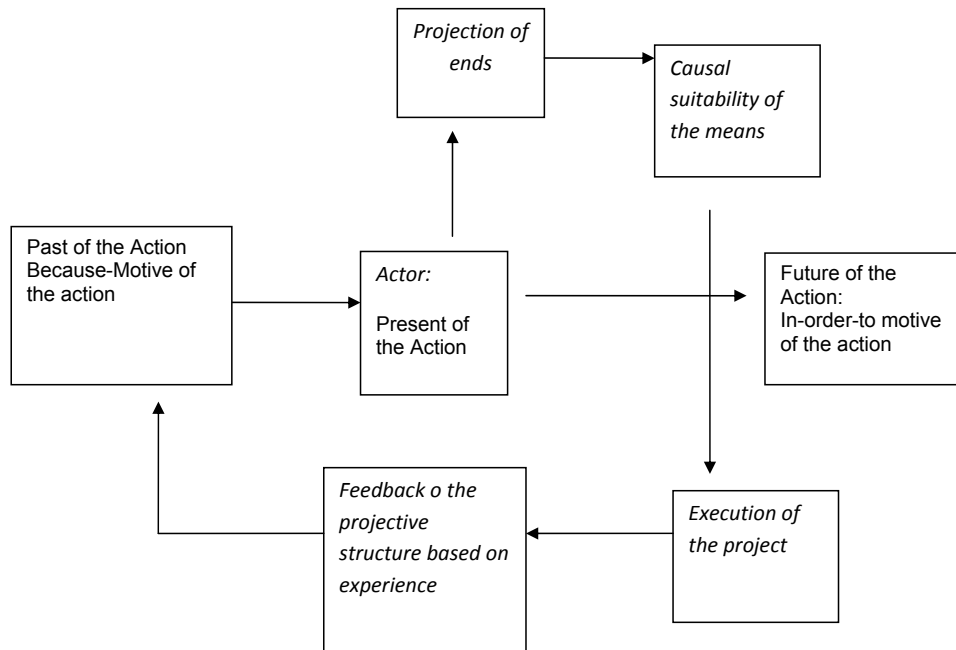
The difference, then, between the two kinds of motive as expressed in our two statements is that the in-order-to motive explains the act in terms of the project, while the genuine because-motive explains the project in terms of the actor's past experiences. (Schütz, 1972, p. 91)

This difference is important as it allows room for human error. With the "in-order-to" no error appears. Looking into the future, the actor uses the means which he considers necessary or correct, given his prior experience. But the confirmation of the inadequacy of the means is made, once the action has been carried out. It is the "because-motive". These two motives show the openings of human action. On the one hand, it is open to the future. Man decides on a course of conduct and organizes himself in projects. And on the other hand, he feeds on and reflects on his lived experiences.

Scheme 1 shows the relations between the anthropological categories of Schütz's theory of the action. The direction of the central arrows, starting from the past of the action towards the future, shows the inexorable flow of time. The actor, from the present of the action, projects his actions into the future and adapts causally the means. This thought-out reality, which directs the action, is the project is the project the person carries out.

The same anthropological categories that Mises develops in praxeology come into play: rationality, time, causality, and the means-end relation. The execution of the project generates experience which enriches the knowledge of the person and allows him to increase his capacity for action, through the elimination of errors. The arrows between the anthropological elements show their very close relation. Each one

refers to the others and only in conjunction with the others does it acquire the full sense of human action. In this scheme, no elements have priority over the others. This diagram shows the interconnection between different overlapping human activities. We can seek to analyze the two motives set forth above. With regards to the future, we ask ourselves about the “in-order-to” motive; with regards to the past, we ask ourselves about the “because-motive”. But these refer to a unique reality: human action.



Scheme nº 1: Structure of Schütz's theory of the action

4 The structure of the world: social reality

In this last section we are going to present and analysis of the second constituent of the action: its social dimension. In the previous section, we expounded the anthropological categories, which explain the individual action, endowed with meaning. And now, we are going to analyze the second dimension of the action: the relation of a person with a “you”. Schütz develops, on the idea of subjective action, in relation to the social process, which constitutes the objects signified of the cultural World from

individual subjective actions. He concentrates on explaining how the cultural objects, endowed with meaning, arise and how the person carries out his action within this symbolic which constitutes the world of human life. (*Lebenswelt*). The fields of Economics, State Law, etc., are constituted in this process.

These cultural realities, formed in institutional realities, acquire independence from private individuals. They acquire a universality which converts them into rules of social behavior and patterns of individual behavior. It should be emphasized Schütz focused on the laws of the market or catallactics in order to demonstrate his analysis. The reference to Mises' work is direct. He describes his theory in the following words:

Catallactics for Mises is part of a pure a priori theory of action considered as abstracted from its psychological and historical circumstances; Mises' concept therefore is especially useful as an example at this point. (Schütz, 1972, p. 137 note 57)

From the development of his Basic anthropological categories, Schütz erects a sociological theory, which makes it possible for him to analyze the structures of the social world.² We are not going speak here of the importance that Schütz's work has in the social sciences. In this last section, we are going to focus on the explanation of the process by which the subjective significance that a person pursues in his individual action becomes depersonalized in the social inter-relations and is converted into a universal cultural object. In this process the references to the individual actor are being minimized and the signified acquires autonomy with respect to its creator until the references to the individual disappear. In this way, the cultural object becomes depersonalized. Curiously, cultural universality is reached at the cost of the loss of personal references.

In this study of culture, Schütz's work is paramount. His study is focused on the process of the constitution of a cultural object, or in his own words, "objectivations". Within these, the tools and instruments acquire special importance. They can be characterized because: "these objectivations have in common is that they exist only as the result of the action of rational beings" (Schütz, 1972, p. 133). They are important

² In his posthumous work, compiled by Th. Luckmann he presents his last developments of the theory of social action. See Schütz-Luckmann (1973). It is important to mention Th. Luckmann (1992) who continued the work on the theory of social action developed by Schütz.

for each person to the extent that they serve for some end. They constitute an “in-order-to motive”, as we have defined it. Each instrument permits an action that the actor can repeat at will. That is to say, the instrument permits a certain type of action. As Schütz points out:

A tool is a “thing-in-order-to”; it serves a purpose, and for the sake of this purpose it was produced. Tools are, therefore, results of past human acts and means toward the future realization of aims. One can, then conceive the “meaning” of the tool in terms of the means-end relation. (Schütz, 1972, p. 201)

We are going to enter deeply into the instrumental World. The instrumental reason demonstrates the cultural character of the manufactured elements. The economic implements are “cultural objects,” objects which have a universal value. We do not make any reference to the creator of the device when we focus on the utility of an instrument. We only focus on the use of an instrument. We only focus on the action we can carry out with them. Schütz says:

Even though we implicitly refer to its author when we call it a “product”, still we leave this author and everything personal about him out of account when we are interpreting objective meaning ... insofar as the object contains within its very meaning the ideality of the “and so for” and of the “I can do it again” to that extent is that meaning independent of its maker and the circumstances of its origination. (Schütz, 1972, p. 135)

This objective sense makes the interpretative schemes of economic theory possible. The typicality and repetition of economic behavior are universal patterns of human behavior. The laws of the market or the catallactic principles have a universal validity. Schütz states:

No economic act is conceivable without some reference to an economic actor, but the latter is absolutely anonymous; it is not you, nor I, nor an entrepreneur, not even an “economic man” as such, but a pure universal “one”. This is the reason why the propositions of theoretical economics have just that “universal validity” which gives them the ideality of the “and so forth” and the “I can-do-it-again”. (Schütz, 1972, p. 137)

The relation between the theory of social construction in the life of Schütz and the praxeology of Mises is made quite clear with the arguments presented. Schütz made a sociological analysis of the laws of economics. He clearly delimits their fundamental characteristic: they are repetitive and universal. Actions such as the exchange relations present a pattern of behavior that does not depend on particular individuals and their “in-order-to” motivations. The importance of the laws of exchange lies in the fact that they are useful and that they allow individuals to increase their possibilities of Exchange. That is, if they are laid down on the universal rule of reciprocal rendering of services: merchandise-money-merchandise.

Therefore, catallactics or the theory of the market acquires a cultural value. It is the cultured way of providing for human needs. Thus, the principle of reciprocal rendering of services acquires the character of a universal rule of behavior. It becomes the general principle which regulates social exchanges. It can therefore be repeated at will, that is to say, it acquires the significant “can-do-it-again”. Through repetition of the accumulated experience of successful exchanges, the laws of the market become the “because-motive” of individual action. That is, mercantile exchange becomes the medium for the actor to obtain his ends. In conclusion, catallactics or theory of the market is a particular case of the general theory of social action.

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**From Social Democracy to Liberal Socialism: A Property
Rights Analysis of the Transition in Europe**

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JEL Classification: P14, P26, P48

Abstract: Two important lessons of all socialist experiments to date are: socialism has repeatedly failed to duplicate the accomplishments of capitalism, and socialism refuses to die. At the turn of 21st century, a new type of socialism, liberal socialism, is growing in Europe. Analysis shows that a major reason for the rise of liberal socialism lies in its success in eroding the two key institutions of capitalism, private property rights and the freedom of exchange. Unlike communism, which used brute force to replace private property rights and free exchange with state ownership and central planning, liberal socialism is spreading the wealth around, creating entitlement programs, supporting labor unions and promoting “fair” trade. The common objective of those and similar policies is to lower the costs of the emergence of liberal socialism by replacing the capitalist culture of independence based on self-responsibility and self-determination in open and competitive markets with the culture of dependence on the state.

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1 Introduction

The problem with socialism is that you eventually run out of other people's money.

Margaret Thatcher

A defining feature of the 20th century was the struggle between capitalism and socialism. Three major applications of the socialist doctrine – Fascism, National-Socialism and Communism – waged this fight against capitalism. Consistent with the socialist doctrine, as it developed in the eighteenth and nineteenth centuries, fascism, national-socialism and communism blamed the economic and social inequalities of capitalism on the behavioral consequences of private property rights and competitive markets.

All three types of socialism shared a major premise that their respective visions of a “just” society should replace the spontaneous order of capitalism. This premise provided fascists, national-socialists and communists with the political justification to replace the rule of law and individual liberties with the rule of men. Hence, all three types of socialism were equally unconstrained by law, customs, and morality. The individual was a mere instrument for the achievement of the ends as defined by the ruling elite. Communism was openly hostile to the right of ownership, whereas fascism and national-socialism settled for controlling and directing the use of resources nominally owned by individual citizens. Like the competing families of the underworld, fascism, national-socialism, and communism went to war (hot and cold) with each other as well as with the rest of the world.

While all three types of socialism were equally oppressive, fascism and national-socialism played a relatively minor ideological role in the century long competition between socialism and capitalism. Communism, on the other hand, was a major player in the last century. By promising salvation on this side of heaven, Marxism-Leninism gave socialism a pseudo-religious content. This pseudo-religious content of Marxism-Leninism justified the dictatorship of the communist party as the self-appointed avant-garde of the self-proclaimed laws of history.

Two important lessons of all socialist experiments to date are: (1) socialism has

repeatedly failed to duplicate the accomplishments of capitalism, and (2) socialism refuses to die. Every time one type of socialism failed, the critics of capitalism have been quick to come up with a new one. And there has been no shortage of the *White Knights* riding into the town to salvage socialism. Central economic planning in Stalin's Russia, self-management in Tito's Yugoslavia, the Red Guard in Mao's China, Che's crusade in South America, Ho's re-education in Vietnam and Castro's rape of Cuba had the same objective of making the economic performance of socialism superior to capitalism. And they have all failed to accomplish that objective.

At the turn of 21st century, socialism is on the march once again. Western Europe is in the process of transition from social democracy to socialism. Socialists and pro-collectivists parties in Central and Eastern Europe are recovering after the collapse of communism. What in the early 1990s was supposed to be the transition from socialism to capitalism is slowly turning into the transition from socialism to socialism. The European Union is helping the transition to socialism *via* numerous regulations supportive of "fair trade," wealth redistribution, environmentalism, global warnings, multiculturalism and all other movements that require government controls of the allocation of resources. In the United States, the Obama Administration is using the economic crisis that began in 2008 as an excuse to initiate the process of "spreading the wealth around."

Given the lesson of history, there is no compelling reason to assume that this new type of socialism that is emerging on the European continent, I call it *liberal socialism*,¹ will not, like its predecessors, fail to duplicate the economic efficiency of capitalism. The purpose of this paper is to show why and how the emerging liberal socialism in Europe is more dangerous than its predecessors, even though, like its predecessors, liberal socialism is equally incapable of duplicating the accomplishments of capitalism.

However, a few remarks about the United States seem in order. President Obama is using the current economic crisis to open the gates for the import of liberal socialism into the United States. His three major programs, socialized medicine, federal-

¹ To the best of my knowledge the term liberal socialism was used only once before and in a very different context. See Chilosi, Alberto, "Duhring's Socialitarian Model of Economic Communes and its Influence on the Development of Socialist Thought and Practice" (September 15, 1997, revised).

ized education and federal government energy policy will, if implemented, transfer decisions on winners and losers from competitive markets to Washington D.C. However, the importation of socialism and even social democracy into the United States is going to be more difficult enterprise for Obama than for his European counterparts because the United States has neither the tradition of social democracy, a close relative of socialism, nor have American intellectuals ever shared the fascination of Western intellectuals with various socialist doctrines. Obama and his advisors have also repeatedly said that the current crisis has proved that “unrestrained” free markets do not work. Their remarks are misleading because they are not telling us which system has done better than Anglo-American capitalism; what is the system they want to replace the free-markets, private-economy with, and on what evidence?

The paper has four sections. The introductory section reviews a few elementary characteristics of private property rights, free exchange, and economic efficiency that are relevant for analysis of the economic performance of liberal socialism. The second section discusses the meaning of liberal socialism, its causes and consequences, and the role of the European Union in supporting the institutions of liberal socialism. The last section of the paper focuses on the behavior of business firms in liberal socialism. Except for occasional references, the paper is about liberal socialism in Western and Eastern Europe. The United Kingdom, the United States and the rest of the world are left out of analysis.

2 Economics 101

It is not true that administration of an economy is simply technical problem devolving from the basic “given” conditions.

G. Warren Nutter (1983, p. 102)

2.1 Free Exchange and Economic Efficiency

We live in a world of scarcity; that is, what we want exceeds what we have. The desire for more satisfaction is a predictable consequence of scarcity. Exchange is a means by

which people seek more satisfaction for themselves. Individuals enter into exchange because they *expect* that their *benefits* from acquiring a good will exceed their *costs*.²

The satisfaction a person receives from a good is purely subjective. There is no way for others to know the subjective satisfaction that one derives from acquiring that good. Thus, only voluntary exchange can move goods from lower- to higher-valued uses. To leave some exchange opportunities unexploited means that the allocation of resources is not efficient. By holding people to their promises, the law of contract increases the extent of exchange.

An important aspect of the spontaneous order that emerges from the voluntary interactions of individuals pursuing their own ends is that the value of resources in their alternative uses is identified by the only source of value: *the individual* as he acts on his subjective preferences. James Buchanan (1976, p. 2) wrote: "Economic performance can only be conceived in values; but how are values determined? By prices, and prices emerge only in markets. They have no meaning in a non-market context ...where the choice-influenced opportunity costs are ignored." This quote captures the meaning of economic efficiency which is here defined. The economic efficiency of the use of resources to produce goods and the allocation of goods among competing uses is expressed in the process through which voluntary interactions are carried out, leading into the unknown outcomes.³

At this point, two side-comments are appropriate. First, in a world of uncertainty

² The meaning of three underlined terms is as follows: The benefit from exchange is the increment in the subjective satisfaction a person derives from acquiring the right to use a good. The cost of exchange is the subjective satisfaction a person has to give up. When someone spends \$100 on a bottle of wine, the true cost of that wine is the satisfaction that would be available from another bundle of goods that \$100 could buy (i.e., opportunity cost). In a world of uncertainty and incomplete information, no one can predict the exact consequences of exchange.

³ To judge the economic efficiency by the attainment of a predetermined outcome or some quantitative measurements ignores our subjective preferences. And ignoring our subjective preferences leads to misleading conclusions about economic performance. A relevant example is the evaluation of the economic performance of the former Soviet Union by three neo-classical economists shortly before the country disintegrated. Robert Heilbroner and Lester Thurow wrote: "Can economic command significantly compress and accelerate the growth process? The remarkable performance of the Soviet Union suggests that it can. In 1920 Russia was but a minor figure in the economic councils of the world. Today it is a country whose economic achievements bear comparison with those of the United States" (1984, p. 629). Paul Samuelson said: "It is a vulgar mistake to think that most people in Eastern Europe are miserable... The gap between Western and Eastern living standard may narrow in the future" (1980, p. 624).

and incomplete information, we can never be sure that an outcome of human interactions is efficient. The best we can do is to determine whether the prevailing system of incentives and constraints encourage human interactions that are consistent with economic efficiency. For that reason, I prefer to use the term *efficiency-friendly*. Second, the paper references to the so-called Anglo-American capitalism, which is the institutionalized classical liberalism impregnated with positive transaction costs and not-so-limited government.

2.2 Property Rights

From the dawn of human history, individuals have recognized the importance of property rights for their survival. Primitive men fought each other for the right of access to better caves; tribes claimed property rights in the area where fishing or hunting was good; and a struggle between two different concepts of property rights, as represented by capitalism and socialism, consumed the entire 20th century. Roman law and the common law of England developed a number of well-defined categories of property rights that are still with us, such as private property right, communal property rights, and state (public) ownership. However, it was only in the 1960s that scholars began to translate the centuries of awareness of the importance of property rights into the economic theory of property rights.

Property rights are the legal and customary relations among individuals that arise from the existence of scarce goods and pertain to their use. That is, property rights are the norms of behavior that individuals must observe in interaction with other individuals and groups or bear the costs of violation. By implication, different property rights have different economic consequences. An economic theory of property rights must then identify the effects of alternative property rights on transaction costs and incentives, analyze the effects of transaction costs and incentives on human behavior, and offer evidence for refutable implications of alternative property rights on the economy. With respect to business firms, the property rights approach has to explain the consequences of alternative property rights on the relationship between the supply efforts of value-creating resources and the appropriation of economic rents.

The exclusivity and transferability of ownership are two components of private

property rights that set it apart from other types of property rights. The exclusivity of ownership means that the owner decides what to do with his goods, captures the benefits of his decision, and bears the costs. The marriage between bearing the costs of one's decision and capturing the benefits from that decision has two efficiency-friendly consequences. The owner has incentives to seek the highest-valued use for his goods, and the owner has strong incentives to take risk associated with the creation of new wealth (i.e., entrepreneurship).

The transferability of ownership also has two efficiency-friendly consequences. The owner can sell his property, say an apartment building, for a lump sum, or the owner can choose to take the value of his asset as a flow of rents. An important consequence of this choice, which other types of property rights do not provide, is that individuals can adjust the composition of their wealth in accordance with their attitude toward risk.

3 Liberal Socialism

My reading of history convinces me that most bad government results from too much government

Thomas Jefferson

3.1 Meaning of Liberal Socialism

Liberal socialism, like its predecessors, has two interdependent objectives that set it apart from capitalism: (1) the state should control the use of resource and (2) the collective choice should replace the rights of individuals to pursue their ends. Individual preferences need to be shifted in more "acceptable" directions. The French term, *dirigisme*, correctly describes this mind-set

Liberal socialism has also two characteristics that set it apart from its socialist predecessors. (1) Liberal socialism is emerging from within European social democracies via free and democratic elections. The transition from social democracy to liberal socialism is a process characterized by the erosion of private entrepreneurship and the middle class acceptance of mandated benefits. Analysis would gain little from

attempts to identify the exact moment of transition from social democracy to liberal socialism, and even less from attempts to provide a narrow definition of liberal socialism. If, once upon a time, we insisted on establishing the exact time capitalism was born and its exact definition we would be still arguing those points and miss all the knowledge of the history and economic consequences of the system.

(2) Liberal socialism accepts private property rights. However, the attainment of pre-determined outcomes means that the state has to attenuate private property rights. The term attenuation of private property rights refers to restrictions of either the exclusivity of ownership (e.g., the owner of an apartment cannot simply tell his tenant to vacate the place), or the transferability of ownership (e.g., price controls) or the legal protection of private property rights (e.g., the enforcement of property rights in Venezuela or Putin's Russia). The attenuation of private property rights has three interdependent consequences. It weakens the owner's freedom to use his goods in accordance with his subjective preferences; it enables the state to replace competitive markets in choosing winners and losers in total disregard of individuals' subjective preferences; and it raises the transaction costs of allocating resources to their highest-valued uses.

The fact that European leaders seriously consider the concept of "fair trade" is the best evidence that liberal socialism attenuates private property rights and rejects the spontaneous order that emerges from the voluntary interactions of individuals in open markets. Fair trade is a neutral term that has non-neutral implications. It imposes non-market terms of exchange between developed and developing countries. The term is also used by labor unions in developed countries to demand restrictions on the import of goods produced by "exploited" workers elsewhere. In essence, fair trade is a facade of words hiding attenuation of the transferability of private property rights.

The consequences of the attenuation of private property rights define the major difference between the social fabric of capitalism and liberal socialism. Liberal socialism sees the community as an organic whole that has a common good. The term common good or, to use modern jargon, social justice, is the facade of words hiding the redistribution of wealth organized and directed by people who do not own the resources that are being distributed. In contrast, the capitalist community is a volun-

tary association of individuals who enter and leave the community in the pursuit of their own ends. The function of capitalist institutions is to enhance individual interactions leading to the unknown outcome. If the rules encouraging voluntary interactions were fair and good then any outcome that emerges from voluntary interactions is a good and fair outcome.

3.2 Philosophical and Legal Origins of Liberal Socialism

In the seventeenth and eighteenth centuries, France became the birth place of socialist ideas. French socialists raised a question: What can be done to eliminate the social and economic inequalities of capitalism? The answer was syndicalism and revolution. In the 19th and early 20th century, French socialists saw syndicalism as the training school for the socialist revolution (Laidler 1927, pp. 378-9). The French Revolution of 1789 was not a socialist enterprise but it did favor weak property rights and a strong state. Moreover, the French Revolution was not carried out in the name of the individual. It was carried out in the name of centralism enforced by “enlightened” ruling elite. In that sense, the French Revolution made a contribution to the then-developing socialist doctrine.

At the time of their birth, most European social democratic parties were Marxists. For example, at the Erfurt Congress in 1891, the social democratic party of Germany accepted orthodox Marxism.⁴ In the 20th century social democratic parties began to move away from Marxism. It was as late as 1959 that the social democratic party of Germany explicitly rejected Marxism. The major reason was the realization that democratic processes could slowly bring about liberal socialism. The fact that the role of a powerful state was never seriously questioned on the European continent, as it

⁴ Yet, social democratic parties also had critics of orthodox Marxism. For example, Eduard Bernstein (1850-1932, the leader of the Bavarian Social Democrats, was a leading critic of orthodox Marxism. Bernstein and his followers argued that Marx’s criticism of capitalism was right in principle but that evidence called for adjustments in orthodox Marxism. They asserted that social conditions did not develop as the Communist Manifesto predicted; that the increase in wealth was not accompanied by a decrease in the number of wealthy capitalists; and that Marx’s economic interpretation of history underestimated the effects of morals, culture and customs on economic performance (Laidler 1927, pp. 295-302).

has been in the Anglo-American legal and cultural tradition, is helping the on-going transition from social democracy to liberal socialism.⁵

3.3 Liberal Socialism and Private Property Rights

Liberal socialism is suspicious of the freedom of choice not necessarily because of any lack of interest in individual liberties but because individual choices in the free market do not generate output and income distribution consistent with its concept of common good or social justice. As said earlier, to remedy this shortcoming, liberal socialism attenuates private property rights. The attenuation of private property rights interferes with voluntary interactions among free individuals. Interference with voluntary interactions in open markets means the interference with the subjective preferences of interacting individuals. The interference with the subjective preferences of interacting individuals, in turn, interferes with the flow of goods and services from lower- to higher-valued uses. In the end, liberal socialism fails to duplicate the economic efficiency of capitalism. How?

The value of goods depends less on the flow of services from the goods that are being traded and much more on the bundle of property rights to do things with those goods. John takes better care of the car he owns than the one he leases, even though they offer the same flow of services. Jane takes better care of the apartment she owns than the one she rents. Public housing projects deteriorate faster than privately owned buildings. Private lakes are cleaner than public lakes. Labor unions attenuate the rights of workers to get jobs at wages they find acceptable. The owner of apartment building subject to price controls has fewer incentives to maintain his property than the owner of apartment building that is not subject to such restrictions (that is so because the rate of return on resources invested in maintaining buildings subject to price controls are less than the return from investing the same funds elsewhere).

⁵ Labor and business laws throughout Europe offer good evidence of the effects of the philosophical origins of liberal socialism. In Germany, the attenuation of property rights in business firms (i.e., state interference with the subjective preferences of property owners) has a long history. As early as 1835, professors Robert Von Mohl, Wilhelm Roscher, and Bruno Hildebrand proposed the creation of “workers’ committees” in business firms because, they argued, capitalism had failed to emphasize moral issues. The trend of transferring property rights in business forms continued in Germany to date.

In all these cases, the values of goods that are traded are determined less by the flow of services from those goods and much more by the bundle of rights to do things with the goods that are being traded.

3.4 Measuring the Effects of the Attenuation of Private Property Rights

The Index of Economic Freedom published jointly by the Heritage Foundation and the Wall Street Journal, and the Economic Freedom of the World Index published by Fraser Institute have established that strong positive correlation exists between economic freedom and economic growth.⁶ To measure economic freedom, both indexes use categories that are consistent with the institutions and policies supportive of economic efficiency. To say that a country has become freer means that it has become more efficiency-friendly.

De Haan and Sturm (2000) tested the Fraser Index and found that improvements in economic freedom foster economic growth. Stocker (2005) got similar results. He found that “increases in economic freedom are associated with higher equity returns, while the absolute level of beginning and ending economic freedom do not affect equity returns” (p. 589). James Gwartney (2003, p. 3) wrote: “The maintenance over a lengthy period of time of institutions and policies consistent with economic freedom is a major determinant of cross-country differences in per capita GDP... cross-country differences in the mean rating during 1980-2000 explain 63.2 per cent of the cross-country variations in 2000 per capita GDP.” Bernhard Heitger (2004, p. 400) found that “estimating the direct relationship between property rights and end-of-period per capita incomes yields a highly significant regressor and indicates that a doubling in the index of property rights more than doubles living standards.” It is fair to say that both indexes have passed the test of time.

The paper uses the Index of Economic Freedom published by the Heritage Foundation and the Wall Street Journal (hereafter: *Index*).⁷ The Index uses ten categories

⁶ Both indexes are about economic freedom only. Political and civil freedoms are not included in either of these two indexes.

⁷ The Index classifies all countries into five groups: *free* (80-100), *mostly free* (70-79.9), *moderately free* (60-69.9), *mostly unfree* (50-59.9), and *repressed* (0-49.9). The score of 1 is the worst and 100 is the best.

to measure economic freedoms. Given the purpose of this paper, the most important categories affecting private property rights in liberal socialism are *Property Rights*, *Business Freedom* and *Labor Freedom*. Property rights category measures primarily the legal protection of private property, including the effectiveness and honesty of the judicial system. Business Freedom is primarily about the transaction costs (red tape) of opening, operating and closing business firms. Labor Freedom is about the state interference with the rights of individuals to work for wages they find acceptable, the rights of businesses to hire and fire workers, wage controls, support for labor unions, and various safety regulations.

There is a critical difference between these three categories.⁸ The first one (property rights) measures the protection of the bundle of property rights *without* specifying the contents of the bundle of rights that are being protected. The second and third category (business and labor freedoms) specify the bundle of rights that *need* to be protected.

The backbone of the Anglo-American common law tradition is that the primary function of private property rights is to serve the subjective preferences of property owners. Those preferences create incentives that maximize the extent of exchange (i.e., move resources to their highest valued uses). The political and legal tradition of Western Europe (not including the United Kingdom and Ireland, two common law countries) has constrained the function of private property rights from serving the subjective preferences of owners. In many West European countries the owner of an apartment cannot simply ask his tenant to vacate the place within a customary period. German law protects private property rights as long as they serve “human dignity” and welfare programs (Alexander 2003). The owner of a business in Spain is reluctant to hire workers because the costs of firing them are high. In France, the owner has to pay a tax (penalty) in order to close down his establishment. The Italian legal system protects private property rights only insofar as they serve a social function as defined by the state (Mingardi 2005).

The tradition of the rule of law in Western Europe predicts high scores for the protection of property rights which the emerging liberal socialism wants to preserve,

⁸ The statement is challengeable because categories overlap and the paper uses only the most important part of the description of each category.

and lower scores for business and labor freedoms, which liberal socialism wants to attenuate. Indeed, the Index for Germany shows a high score for the property rights category (90) and a low score for the labor freedom category (43) even though both categories are about property rights. The former defines the protection of private property rights, while the latter defines the bundles of private property rights that are being protected. Also, the United States and Germany have the same score of 90 for the property rights category. Yet, the bundle of rights that is being protected is not the same in those two countries.

In Central and Eastern Europe (hereafter: C&EE), the social forces affecting the attenuation of private property rights are different from those in Western Europe. Except for lingering memories of the rule of law in the parts of C&EE that belonged to the Austro-Hungarian Monarchy, the years of socialist rule has completely destroyed people's confidence in the legal system. The law is perceived as a mechanism the rulers use to do whatever the rulers want; the law is taken no more seriously than the promises of used car dealers

The prevailing culture in C&EE is not homogenous but it has a bias toward collectivism, egalitarianism, and shared values that pre-dates communism. The heterogeneity of culture in C&EE stems from the influence of three empires (Austro-Hungarian, Russian, and Ottoman) and three religions (Roman Catholic, Orthodox, and Islam). The culture of collectivism and egalitarianism gets stronger the farther east and southeast one travels. The following three quotes capture the essence of the socio-economic effects of three empires and three religions in C&EE.

Perry Anderson (1974, p. 429) explained the lingering memories of the rule of law from the days of the Austro-Hungarian Monarchy as follows: "The age in which 'absolutist' public authority was imposed was also simultaneously the age in which 'absolute' private property was progressively consolidated. It was this momentous social difference which separated the Bourbon, Habsburg, or Tudor monarchies from any Sultanate, or [the Romanovs]." Antonina Zhelyazkova (2003, pp. 140-141) described today's Albanian family. "Family community [is] composed of three or four generations, with a high level of internal solidarity. Within the [family] there is a strict, clear-cut age hierarchy, where the father's ... word is law ... this is due to the age-old internal ethno-cultural mechanism, which ... contributes to the preservation of their

tradition.” Writing about Russian culture, Silke Stahl (2001, p. 157) said: “In Russia [cultural] institutions found their expression in egalitarianism and collectivism ... The reasons for egalitarianism, and collectivism [in Russia] can be found in religious beliefs.”

To measure the effects of liberal socialism on the attenuation of private property rights, Table 1 includes information from the 2009 *Index of Economic Freedom* on property rights, business freedom, and labor freedom.

Since the effects of liberal socialism on private property rights are qualitatively different in Western Europe and C&EE, Table 1 divides the European continent into two groups: Sixteen West European countries and nineteen East European countries. The first group consists of all West European countries including Finland and Greece but not the United Kingdom and Ireland. The United Kingdom and Ireland have different (common law) legal systems from the rest of Western Europe. The informal institutions in those two countries also differ from the rest of Western Europe. The second group includes all countries that belonged to the Warsaw pact plus all countries that belonged to the former Yugoslavia. The only East European country left out from Table 1 is Bosnia and Herzegovina, which is not a functional state. C&EE countries are then divided into countries that were the subject of greater influence of Western culture and those that were the subject of lesser influence from the West. The first group includes nine countries. The Czech Republic, Croatia, Hungary, Slovakia and Slovenia used to be part of the Austro-Hungarian Monarchy, which was short on democracy but strong on the rule of law. The Catholic Church brought Western culture to Poland. The religious influence of protestant churches and the centuries of strong trade with Germany and Sweden contributed to customs and traditions in the Baltic States. The second group includes Bulgaria, Albania, Romania, Macedonia, Montenegro, Serbia, Moldova, Russia, Ukraine and Belarus.

The benchmark against which to compare the effects of liberal socialism in Europe on private property rights includes Hong Kong, Singapore, Australia, New Zealand, United States and Canada. All those countries are common law countries. Moreover, the Index classifies all of them as free or the most capitalist countries (scores 80-100).

Information about the effects of liberal socialism on property rights (last column in Table 1) confirms analysis in the paper. Six capitalist countries have stronger prop-

erty rights than liberal socialist countries of Western Europe. Property rights in Western Europe are stronger than in C&EE. And predictably, property rights within C&EE gets weaker as one moves farther East and Southeast.

Table 1: Private Property Rights in Liberal Socialism

	Private Prop-erty	Business Free-dom	Labor Free-dom	Average Score
Benchmark	90.83	94.97	90.95	92.25 (free)
Western Europe	81.25	84.59	59.51	75.12 (mostly free)
C&EE	44.42	66.88	56.42	55.91 (mostly unfree)
Pro-Western C&EE	58.63	71.79	59.24	63.22 (moder. free)
Non-Western C&EE	32.00	62.57	54.66	49.74 (repressed)

Source: Calculated from the 2009 *Index of Economic Freedom*, Heritage Foundation and Wall Street Journal, Washington D.C. Grading Scale: 80-100 Free; 70-79.9 Mostly Free; 60-69.9 Moderately Free; 50-59.9 Mostly Unfree; 0-49.9 Repressed

3.5 The Seditious Role of the EU in Promoting Liberal Socialism

The European Union was born in Western Europe while C&EE was home of one of the most oppressive rules in human history. It would be surprising if the expectations about the role of the EU were the same throughout the region. Western Europe is a heterogeneous region as is C&EE. Marxism-Leninism changed the rules of the game in C&EE at will and the secret police enforced the rules with no regard for human rights and privacy. Predictably, some people in member countries from C&EE (especially Czech Republic and Slovakia) see the flow of regulations coming down from Brussels as a betrayal of the post-communist hope for a society of free and responsible individuals. It is also true that many east Europeans see EU regulations as replacing the

old despotic dictatorship with a flow of benevolent rules that are helping to control corrupt domestic politicians.

The issue that affects all member countries is that EU has added one more layer of bureaucracy to those already existing in member countries. Like all bureaucracies, the EU bureaucracy has strong incentives to grow. And issuing and enforcing regulations is the most efficient way for any bureaucracy to grow. Some regulations enacted by the EU are pro-free market while others are not. However, the distribution of regulations between pro-free market and anti-free market is not as important for judging the direction of economic changes as is the power of the Brussels bureaucracy to issue and enforce regulations. And it is this growing power of the Brussels bureaucracy to regulate that cannot be trusted.

Professor Epstein (2004, p. 31) understood the problem and formulated his impressions of the direction of the EU as follows: “[The proposed EU] Constitution allows for such dominance at the center that it will take a political miracle for that competition to play a powerful role in the affairs of the EU. By giving rights with one hand and taking them away with the other, this proposed EU Constitution lacks any clear definition and structure... But when the dust settles, there will be more government and less freedom for all... My recommendation is therefore this: Opt for the economic free trade zone and consign the EU Constitution to the dust heap.”

The evidence suggests that Epstein got it right. Council Directive on the protection of pigs⁹ and proposed draft Codex standard for tomatoes¹⁰ is just the tip of the iceberg which contains a huge and growing number of similar regulations that are amusing, costly and inefficient. What makes EU regulations costly and inefficient is that they are less concerned with the protection of private property rights and a society of free and responsible individuals and much more with fair trade, environment, global warming, the right of all species (other than humans), and the scientific-political elite conviction that they know what people would demand if they knew what was good for them.

⁹ Council Directive 91/630/EEC of 19 November 1991 laying down minimum standards for the protection of pigs. See also CNN – Pig toy tale ‘anti-Europe rubbish’: <http://www.cnn.com/2003/WORLD/europe/01/29/uk.pigs.play/index.html>

¹⁰ Proposed draft Codex standard for tomatoes (CX FFV 00/16).

Vaclav Klaus has frequently spoken and written on the way Brussels has high-jacked the great idea of creating the United Europe based on free trade and individual liberties. Recently (2009a), he said: “The undergoing weakening of democracy and of free markets on the European continent, connected with the European unification process, is a threatening phenomenon ... [which] was the main building block of the European Constitution and it remains without substantial change in its new version, in the Lisbon Treaty.” Klaus is right. When the proposed constitution was voted down, Brussels invented the Lisbon Treaty. Now that the Lisbon treaty is not working out, there is talk of doing something else in order to get things rights. We observe that every time a country votes down one of the EU preferred rules or propositions, Brussels tries to engineer another election, and then another until the rule wins a majority vote. Once that happens, another election is never suggested.

Professor O’Hear (2008, p. 231) wrote that one important consequence of Brussels’ hunger for power is that “the enterprise to which EU is committed is first and foremost the creation of itself as a supra-governmental authority, a task of Hegelian pretension and of Sovietic proportion.” Professor Norman Barry (2004, p. 33) argued that EU leaders have no intention of enacting a body of laws that would take away their discretionary powers: “As long ago as 1964, the Costa vs. ENEL decision from the European Court of Justice (ECJ) struck down an Italian statute that happened to conflict with an EU regulation on the ground that European law was superior to domestic legislation. It was the beginning of the activism of the ECJ.” Vaclav Klaus has been even more specific about the effects of “harmonization.” The essence of his position is that Brussels has been attenuating private property rights, constraining free-market competition, eroding the sovereignty of member states, and transferring decision making from member states to Brussels.

Many years ago, Professor Nutter (1969, p. 39) provided a succinct and powerful description of the policies pursued by the Soviet leadership. Nutter wrote:

It was Lenin’s genius to recognize the importance of embellishing the Soviet system with all the trappings of democracy. If the people want a constitution, give them one, and even include the bill of rights. If they want a parliament, give them that, too. And a system of courts. If they want a federal system, create that myth as well. Above all, let them have elections, for the act of voting is what the common man most

clearly associates with democracy. Give them all these, but make sure that they have no effect on how things are run.

It is arguable that the same description fits EU leadership. That is so because the story of the EU is the story of the unstoppable drive to replace local laws with European-wide rules leading to the centralization of power in Brussels. And in the process of centralizing the power in Brussels, the EU supports the emergence of liberal socialism in Europe.

4 The Business Firm in Liberal Socialism

Some regard private enterprise as if it were a predatory tiger to be shot. Others look upon it as a cow that they can milk. Only a handful see it for what it really is - the strong horse that pulls the whole cart.

Winston Churchill

The economic performance of any system depends on the performance of business enterprises. And the performance of business firms depends on the prevailing property rights in resources used by business firms. The focus of this section is on the incentive effects of the attenuation of property rights in liberal socialism. For comparison, analysis begins with the incentive effects of private property rights in capitalism.

4.1 The Behavior of the Capitalist Firm

The ownership of a firm is about rights (Alchian and Demsetz 1972). To say that a firm is privately owned means that the owner has a well-defined bundle of rights in that firm. Three important rights that set the privately owned firm apart from other types of business firms are:

(1) *The owner's right to the revenue of the firm.* The owner has to pay the contractual obligations of the firm. Any residual left after all other obligations of the firm are

met from its revenue belongs to the owner. (2) *The owner's right to hire and fire members of the team.* The owner must have the right to hire and fire members of the team. Otherwise, the owner's incentives to monitor members of the team would be unenforceable. If in hiring new members of the team the owner had to satisfy criteria not related to the past performance and expected productivity of potential candidates, the team would be smaller, the costs of production would be higher, and marginal firms would not survive. An owner who had to incur high costs in order to justify firing a member of the team would have no credible threat to enforce incentives to supervise and monitor the performance of team members. (3) *The owner's right to sell the preceding two rights.* The right to transfer one's rights to others at a mutually agreed upon price is a basic component of the right of ownership. The market price of a firm is the value of the owner's bundle of rights, which is the present value of the expected residual over the firm's life discounted at a going rate of interest.

The most important consequence of the bundle of rights that define a privately owned firm is that *the owner bears changes in the value of the firm.* It means that the owner has incentives to seek ever larger profits. And the search for ever larger profits provides incentives for the owner to seek both the highest-valued uses for resources controlled by the firm as well as entrepreneurial profits. The former is about the efficient use of resources. The second is about economic development.

The incentives to seek ever larger profits mean that the owner of a business firm has to satisfy consumer preferences. To satisfy consumer preferences, the owner has to incur the transaction costs of allocating resources controlled by the firm to their highest-valued uses. In addition to seeking the best use for resources controlled by the firm, the owner has to be alert to changes in consumer preferences.

The bundle of property rights that define a privately owned firm also provide the owner with strong incentives to seek entrepreneurial profits; that is, profits over and above the normal rate of returns. Innovation, a major activity for seeking entrepreneurial profits, means doing something that was not done before. Doing something that was not done before increases the community's set of choices. By implication, voluntary acceptance of an innovation means that the community is better off. Thus, innovation is the engine of economic development. Being a novelty, it is impossible to know the risk of innovation. A powerful incentive to accept the uncertainty

about the outcome is the innovator's property right in the *entire* entrepreneurial (temporary monopoly) profit of a successful innovation. Any attenuation of the innovators property rights in the entire profit reduces the incentives to innovate and slows down economic development.

Finally, academic research and empirical evidence have shown that better understanding of the efficiency implications of antitrust laws by judges (Kovacic and Shapiro 2000), the protection of owners-investors by parliaments (La Porta et al. 1999), the efficient market for management control (Manne 1965) and decline in the power of labor unions increases the bundle of rights in privately owned firms and, in doing so, improves the performance of capitalist firms.

4.2 The Behavior of the Liberal Socialist Firm

Unlike socialist movements of the past, liberal socialism accepts private property rights. The acceptance of private property rights takes the form of various ways of attenuating them. The purpose of the attenuation of private property rights is to use privately owned resources to serve the objectives of socialist leaders.

The concept of industrial democracy is an umbrella for all the different methods of attenuating private property rights in business firms. The focus of this section is on the efficiency consequences of labor participation in the management of business firms.

The concept of labor participation in the management of business firms has been thriving in Western Europe and the EU long before the fall of socialism in Central and Eastern Europe. The former president of France Giscard d'Estaing said, "Participation of workers' representatives in the life of their company reflects the workers' aspirations not be left out of decisions that concern them." Former chancellor of Germany, Willy Brandt, a devout socialist, said, "We consider the development of [labor participation in the management of business firms] to be one of our main tasks ... in this, we start from the principle of equal rights and even balance of weight of employees and employers." Most importantly, the European Commission proclaimed labor participation in the management of business firms as one of its fundamental objec-

tives. It said: "No less than one third of the members of the supervisory organ (i.e., board of directors) shall be appointed by the workers or their representatives."

In post-communist C&EE countries the tendency is to give managers and employees a large number of shares in their respective enterprises either free of charge or at a significant discount (Mitra, Selowsky, et al. 2000, p. 75). This method of "privatization" changes the balance of power between shareholders, managers and employees at the expense of shareholders. Freed from the pressure to maximize the residual, the alliance between labor and management tends to employ unneeded workers, make business decisions that maximize near-term cash flows, and offer pecuniary and non-pecuniary benefits to local bureaucrats in exchange for favorable treatment (Milovanovich 2007).

Two consequences of labor participation are inefficiencies in the allocation of resources within labor participatory firms and inefficiencies in the allocation of resources in the economy. Let us start with inefficiencies within the firm. Labor participation in the management of business firms means that employees have incentives to seek investment alternatives that shift incomes forward and postpone costs. The former benefits current employees, while the latter shifts current production costs to future generations of workers. For example, consider two investment alternatives of equal cost. The expected present value of one alternative is \$1,000 while the other yields only \$750 at a going rate of interest. However, if the returns from the first alternative are expected over a period of 20 years and those of the second over only 5 years, workers have incentives to push management in the direction of choosing the less efficient one. And they are likely to win because the attenuation of private property rights in liberal socialism shifts the balance of power away from shareholders to the coalition of managers and workers.

Let us now assume an open economy that has a mix of labor participatory forms and non-participatory enterprises. Attenuations in the owner's right to capture the residual (via sharing with workers) and the owner's right to hire and employees raise the costs of capital for labor participatory firms. Given differences in the costs of capital, the rates of return in the labor participatory sector would fall relative to the rates of return in the labor non-participatory sector. The flow of capital from the labor participatory sector into the non-participatory sector would increase the returns on

investment in the labor participatory sector relative to the returns on investment in the labor non-participatory sector. The flight of capital into the non-participatory sector would continue until the equality in the rates of return is re-established. In the end, the labor participatory sector with attenuated private property rights would be smaller, produce smaller output, and charge higher prices relative to the non-participatory sector with private property rights.

The labor participation in the management of business forms is not efficiency-friendly method of organizing production. Not surprisingly, labor participatory firms do not appear voluntarily in any significant numbers.¹¹ To avoid the embarrassment, social democrats and socialists have incentives to mandate labor participation in the management of business firms and then to protect labor participatory firms from competition by other types of enterprises.

We can say that the attenuated private property rights in liberal socialism transfer the guidance of production from the competitive process in which the knowledge of all is used to generate efficiency-friendly outcomes to specific individuals with limited knowledge, such as regulators, politicians and bureaucrats.

4.3 The Rate of Investment in Capitalism and Liberal Socialism

Liberal socialism preserves private business firms. It, however, attenuates the bundle of rights that defines privately owned firms. And the attenuation of that bundle of rights has consequences discussed in the preceding section. One such consequence is the increase in the cost of capital. A growing body of literature shows that business firms in countries with Anglo-American capitalism earn returns on investment that is at least as large as their costs of capital, while enterprises on the continent of Europe earn on average returns on investment below their costs of capital.¹² Of course, those returns have no relationship to the returns shareholders earn on their investments.

¹¹ There is no law in the United States that says that there shall be no labor participation in the management of business firms. Yet, we observe an insignificant number of labor participatory firms.

¹² Gugler, K, Mueller, D., Yurtoglu, B. (2004), "Corporate Governance and Globalization," *Oxford Review of Economic Policy*, 20, No 1, pp. 129-156. The evidence is about the rates of return in common law and civil law countries. However, those differences in legal systems coincide with the difference in Anglo-American and Continental capitalism. Moreover, they are also consistent with the ranking of countries in the Index of Economic Freedom.

Adjustments in share prices eventually bring the expected returns to shareholders on their investments into equality.

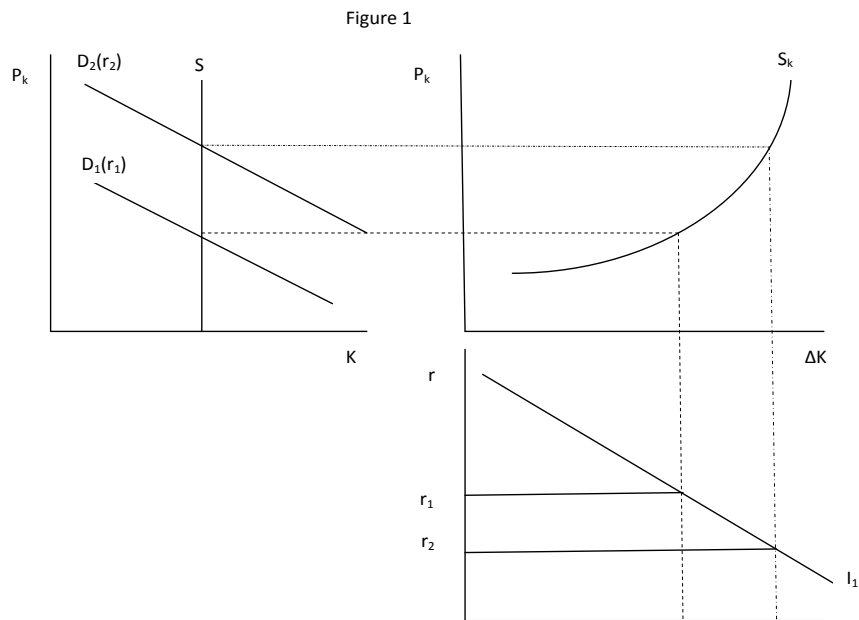
The issue is the efficiency effects of the higher costs of capital in liberal socialism on the rate of investment of business firms and the redistribution of wealth. In the 1960s, Professor Witte (1963) developed a model on the determinants of the rate of investment of business firms. Key proposition of Witte's model was that "the firm's demand is for stock rather than for flow of capital goods because the services it wishes to have available are at least functionally related to the stock and not to the rate of change of the stock" (Witte 1963, p. 441); and "I find that a sufficient condition for the existence of a market-equilibrium relationship between the aggregative rate of investment and the rate of interest is a capacity and cost constraint on the rate of output of capital goods." (Witte 1963, p. 456)

Witte's model was limited to analysis of the determinants of investment by business firms in the private-property, free-market economy. In the early 1970s, I expanded Witte's model to show the effects of three additional types of property rights on the rate of investment by business firms (1971). The rest of this section relies on my 1971 research to highlight the efficiency effects of the attenuation of private property rights in liberal socialism on the redistribution of wealth and rate of investment by business firms.

As a footnote, it is true that macroeconomics has made large advances since Witte wrote his article. Yet, Witte's model is, I believe, still conceptually relevant because of his emphasis on the microeconomic foundations of the aggregate demand for investment. Moreover, most advances in macroeconomics have been technical improvements at the expense of the incentive effects of alternative institutions. And in 1990s, Central and Eastern European countries were in the initial stages of institutional restructuring; that is, they were moving away from their prevailing institutional arrangements. Yet, a piece of major advice they kept getting was to maintain macrostability. Macrostability presumes policies based on and directed at the prevailing institutions. It means that whatever macroeconomists wanted to stabilize had to raise the transaction costs of the spontaneous development of new institutions. Stabilization programs were then based on technically impeccable models based on assumptions that new equilibriums are created instantaneously or that government

fine-tuning of economic process is possible or both. For those assumptions to be borne out, Central and Eastern Europe needed the Second Coming.

The basic line of Witte's analysis of the aggregate rate of investment in capitalism is as follows: The SS curve in Figure 1 is the assumed supply of the existing stock of capital in the community. The demand curve (D_1D_1) is the demand for the capital stock to hold at the rate of interest (r_1). This price of capital is determined in the capital market where the rate of interest is equated to the percentage return from the capital stock.

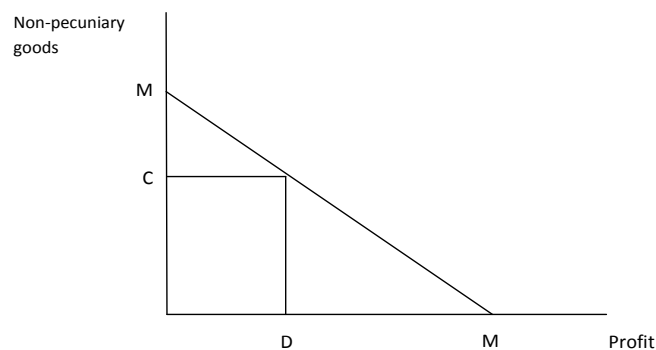


Suppose now that individual preferences change in favor of future income. The price of nonhuman assets would increase, and the rates of return from those assets fall. The switching activity among different markets would reduce the market rate of interest to (r_2) and shift the demand for the capital stock to hold to (D_2D_2). The (S_kS_k) is the supply schedule of capital goods. Like all supply schedules in competitive markets, the (S_kS_k) schedule equates the marginal supply price to the market prices of capital. The investment function (I_1I_1) is then a market equilibrium curve

and not a demand curve for investment. The market rates of interest (r_1 and r_2) bring into equality the rates of return from capital goods and bonds, the community's time preference, and the interest rate implicit in the price of the capital stock to hold.

Let us now adjust Witte's analysis to the effects of attenuated private property rights on the aggregate investment in liberal socialism. As discussed earlier, the attenuation of private property rights has many forms. One form of attenuation of private property rights is restrictions on profits earned by business forms. Public utilities in the United States have operated for decades under such restrictions; profit restrictions (formal and/or informal) exist in European countries practicing industrial democracy, and windfall profit tax is still remembered in the United States.

Figure 2

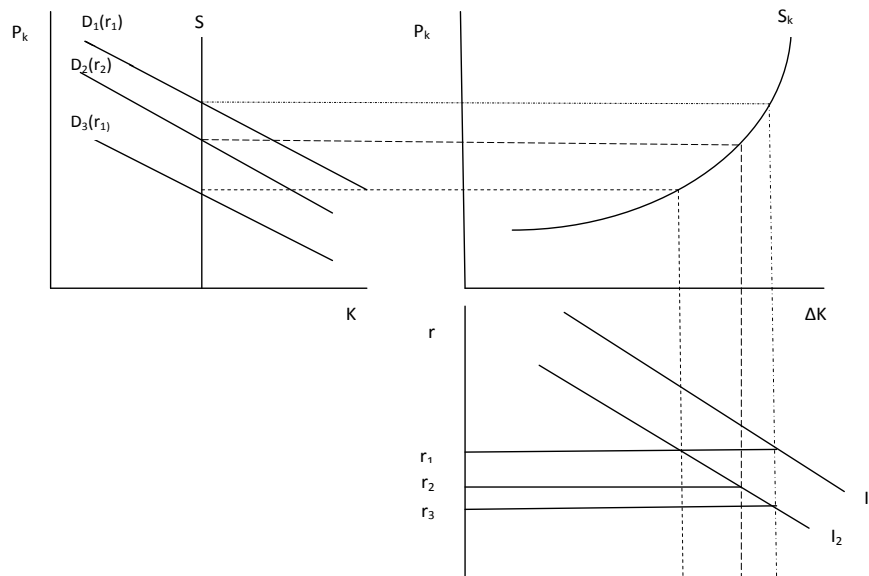


The control of profit earned by business firms has, like most other forms of the attenuation of private property rights, two consequences: the redistribution of wealth and re-allocation of resources. Figure 2 illustrates the effects of profit controls on the distribution of wealth. (OM) is the maximum profit the firm could earn, while (OD) is what the firm is allowed to earn. (MM) is the rate at which the managers can increase his total earnings by exchanging non-allowed profits for the consumption of nonpecuniary goods. The managers' nonpecuniary income consists of variety of goods such as monthly staff meetings in Las Vegas, membership in private clubs, generous expense accounts, opulent offices, lots of beautiful secretaries, including one that can type, and a company plane.

It is clear that the managers have incentives to ignore profit controls and maximize profits as long as they could spend (OC) amount on the supply of nonpecuniary goods. Those incentives are constrained by the reaction of shareholders and state regulators. Shareholders have no reason to object to the managers' behavior which in a non-regulated firm would reduce their wealth. The managers hide their consumption of nonpecuniary goods from the state by reporting those expenditures as the costs of doing business.

It is obvious that the control of profit means the redistribution of income from shareholders to managers. What is much less obvious is that this redistribution of income reduces the community's wealth. Reporting the expenditures on the nonpecuniary goods as the costs of doing business limits the kind of goods the managers' can purchase for themselves and get away with. It means non-reported profits (OC) in Figure 2 are not allocated to their highest-valued uses.

Figure 3



For example, if the managers spent \$1,000,000 on nonpecuniary consumption (i.e., liberal use of the company plane, membership in golf clubs, expense accounts,

etc.) that consumption would make them better off but not as well off as the most preferred bundle of goods worth \$1,000,000 would. At the same time, shareholders loss is \$1,000,000 in cash, which in the absence of profit controls, they would be free to put to the highest-valued use. The result is a loss of wealth. And lower wealth has implications on the rate of investment by business firms.

The control of profit results in a decrease in net earnings of the firm (DM in Figure 2). Given the rate of interest (r_1) the demand curve for capital stock shifts downward to (D_3D_3) in Figure 3, and the market price of capital goods falls. A corresponding increase in the demand for monetary and human assets would, via switching activities in different markets, reduce the market rate of interest to (r_2) and shift the demand curve for capital stock upward to say (D_2D_2), where (r_1) > (r_2). The investment function shift from (I_1I_1) to (I_2I_2) is due to a loss of wealth. Given the consumers' time preference, savings are less at each rate of interest. An increase in demand for monetary and human assets would then not be strong enough to the shift (D_2D_2) schedule back to (D_1D_1) and reduce the rate of interest (r_1) to (r_3). Thus, the market rate of interest will be found somewhere between (r_1) and (r_3), say at (r_2). The effect of the attenuation of private property rights via profit controls is loss of wealth, less investment, and lower rate on interest.

5 Conclusions

The sacrifice of cognition is particularly easy to detect in objections to the market system introduced by discrepancies between one's desires, glorified as social values, and the results of market processes. However, our ability to visualize "better" states more closely reflecting our preferences yields no evidence that this state can be realized.

Karl Brunner (1970, p. 563)

All three major socialist movements from the last century, Communism, National-Socialism, and Fascism were either imposed by force (e.g., USSR, Spain) or were the

outcome of a one-man, one-vote, one-time type of election (e.g., Germany). Once in power, all three types of socialism relied on secret police to stay in power. Unlike its predecessors, liberal socialism has neither been imposed from without nor maintained by force. Liberal socialism has been emerging from within capitalism.

Analysis in this paper shows that a major reason for the rise of liberal socialism lies in its success in eroding the two key institutions of capitalism, private property rights and the freedom of exchange. Unlike communism, which used brute force to replace private property rights and free exchange with state ownership and economic planning, liberal socialism is bribing” people to voluntarily accept the erosion in those two key capitalist institutions and relies on free elections to validate the resulting institutional changes. The term bribing refers to government policies that are spreading the wealth around, creating entitlement programs, supporting labor unions, promoting fair trade, and enacting various legal restrictions on hiring and firing employees in privately owned firms. The common objective of those and similar policies is to lower the costs of the emergence of liberal socialism by replacing the capitalist culture of independence based on self-responsibility and self-determination in open and competitive markets with the culture of dependence on the state. I conjecture that the emergence and survival of liberal socialism depends, as Professor James Buchanan (2005) argued, on whether those policies succeed in making individuals “afraid to be free”.

Liberal socialism is the clear and present danger to free trade, competitive markets, and individual liberties. It is unfortunate but also undeniable that Brussels bureaucracy is promoting policies that support cultural changes that liberal socialism needs for its survival. Speaking before the European parliament on February 19, 2009, Vaclav Klaus talked about the role of the EU in enhancing the threat to the private-property, free-market economy and individual liberties. A few excerpts of Klaus’ (2009b) speech are the most effective summary of the message of this paper.

“We must say openly that the present economic system of the EU is a system of a suppressed market, a system of a permanently strengthening centrally controlled economy. Although history has more than clearly proven that this is a dead end, we find ourselves walking the same path once again. This results in a constant rise in both the extent of government masterminding and constraining of spontaneity of

the market processes. In recent months, this trend has been further reinforced by incorrect interpretation of the causes of the present economic and financial crisis, as if it was caused by free market, while in reality it is just the contrary – caused by political manipulation of the market.”

“Many of you certainly know the name of the French economist Frederic Bastiat and his famous ‘Petition of the Candlemakers’, which has become a well-known and canonical reading, illustrating the absurdity of political interventions in the economy. On 14 November 2008 the European Commission approved a real, not a fictitious Bastiat’s Petition of the Candlemakers, and imposed a 66% tariff on candles imported from China. I would have never believed that a 160-year-old essay could become a reality, but it has happened. An inevitable effect of the extensive implementation of such measures in Europe is economic slowdown, if not a complete halt of economic growth. The only solution is liberalization and deregulation of the European economy.”

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Rejoinder to Machaj on Indifference

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JEL Classification: B25, B40

Abstract: Nozick (1977) was a methodological critique of the Austrian School of economics. He took the view that the praxeological school was guilty of a logical contradiction. On the one hand, it eschews the concept of indifference. On the other, it utilizes that of supply. But, Nozick argued, for there to be any supply of a good, people must be *indifferent* to constituent elements of it. Block (1980) attempted to answer Nozick’s criticism, making the point that “supply” is a coherent concept, and people are indeed indifferent to units of which it is comprised, but *before* human action. *During* human action, there cannot be any such thing as indifference, in the technical sense. Machaj (2007) criticizes both Nozick (1997) and Block (1980). The present paper is a response to Machaj (2007).

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Both Nozick (1977) and Block (1980) were published a long time ago. I cannot, of course, speak for the former, but as author of the latter, I consider it an honor that Machaj (2007) would, particularly at this late date, see fit to subject my early publication to scrutiny and criticism. Better late than never: surely, the worst fate for a publication is to be ignored, not criticized. It is a privilege, now, to be able to respond to it.

Before introducing the specifics, and my criticism of him, let it be said that Machaj and I, paradoxically, at least to some not small degree, are on the same side of this issue. We are both Austrian economists, who see praxeology as the essence of this discipline. We both are attempting to defend this school of thought against the criticisms leveled at it by Nozick (1977). Our goals are the same; we diverge, only, in the different means we employ to this end.

In order to obviate confusion, let us consider Machaj's (2007) attempt at refutation of Block (1980) in his own words (cites, footnotes, deleted):

... 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".

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.

Machaj is, of course, correct in claiming that the girl is not at all likely to view the two wedding rings as part of the same supply, the one offered her by her beloved fiancé, the other by a stranger in the street. But this is a problematic way of putting the matter. Garrison (1985) correctly indicates that we cannot play fast and loose with the *ceteris paribus* assumption, but, surely, we must be allowed to retain *some* semblance of it; that is, we are entitled to rule *some* counterexamples of supply out of court, and, if so, this is certainly one of them. In order to make the case for a thymological or physical definition of supply, consider not those two wedding rings, the one imbued with sentimental value, the other not. Instead, look at the couple at the jeweler's store, *before* any of the wedding rings is chosen by the fiancé. *Here*, we have a true supply of wedding rings, dozens of them we may suppose, all of them physically indistinguishable from one another. There is no doubt that the law of diminishing returns holds in the case. The first of these rings is of greater value than the second, etc. Even if we assume polygamy, we reach the same conclusion. If the man contemplates marrying four different women, he will give the first of these rings to his favorite wife, the second to the second, etc.

Our problem with Machaj (2007) is that he is engaged in over-praxeologicalization. Just because praxeology is the core, the very essence of Austrian economics, does not mean that it is applicable in *all* contexts. Thymology, too, has a place, albeit a secondary one, in the Austrian edifice. And, when it comes to supply and demand, I contend that the latter takes on its proper role. This author, in contrast, insists that each element in the supply of a good must be of equal serviceability, namely, must be seen so by the acting man (or girl, in this case.) That is, of course, praxeologically correct, but it assumes that praxeology is always and ever appropriate, the very point in question. My claim is that this opens the drawbridge for the Nozickian (1977) attack: if supply is defined in such a manner, the economic actor *must* be indifferent to the various elements of the stock, and that will never do from an Austrian perspective.

We move, now, to a consideration of Machaj's third definition of homogeneity (his second is indifference, and we concur with his splendid rejection of that misbegotten concept):

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.

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.

As can be seen from supra, we regard this as precisely the wrong tack to take. It opens us up to the charge that we must accept indifference, for, whatever else does indifference mean but Machaj's "*homogeneous* and *interchangeable* or *equally serviceable*."¹

How, then, does this author attempt to obviate this possible rejoinder? He does do on the following grounds (Machaj, 2007):

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.

The difficulty² here is that Machaj stands condemned out of his own mouth, well,

¹ Mises (1949, 354) does not disparage "equally serviceable" specifically, but he comes very close: "... valuing that results in action always means preferring and setting aside; it never means equivalence or indifference."

² Hoppe (2005) also tries to square the circle: reconcile a supply curve being composed of equally serviceable units in the eye of the economic actor, with a rejection of indifference. For a rejoinder, see Block and Barnett (forthcoming).

word processor. He *admits* that, on his account, there will be “indifference,” and, not, in the unobjectionable thymological or ordinary language sense; rather, horrors, as a matter of *praxeology*. But this completely tears it. What more does Nozick (1977) need to make his case that Austrianism is internally self contradictory? No, there is no having of cake and eating of it too; the circle simply cannot be squared. Once we concede that two units of anything are equally serviceable in the view of the economic actor, we might as well fold our tents and go home as far as warding off the charge of consorting with indifference is concerned.

Machaj continues (footnotes deleted):

They are homogenous before action and after action. 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.

But how would this read were we to substitute the word “indifferent” or the phrase “the same” for Machaj’s “homogeneous”?

They are ~~homogenous~~ [indifferent] before action and after action. 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 ~~homogenous~~ [the same] and man is indifferent which one will satisfy *this* particular need.

If that is not unwarranted appeasement to the Nozickians (1977), it is difficult to discern what would be. “... man is indifferent which one will satisfy *this* particular need,” indeed. Moreover, Machaj’s attempts to save his position by employing the keen insights of Long (2004) regarding non-precise abstraction, ignoring irrelevancies, avail him nothing. Machaj has surrendered the Austrian position to Nozick (1977), and no attempts to evade this will suffice.

Machaj has zigged when he should have zagged. Homogeneity is, properly, at least in the context of diminishing marginal utility, a thymological, *not* a praxeological category. If homogeneity is praxeological, if it is really equally serviceable, then

Nozick and the critics are correct; Austrians must jettison either the law of diminishing marginal utility, or, embrace indifference. No; homogeneity is thymological. It is satisfied when goods are indistinguishable chemically, or physically, not praxeologically.

Machaj (2007) is dissatisfied with my (Block, 1980) attempted refutation of Nozick (1977). Machaj states:

... the problem with Block's analysis (Block 1980, pp. 424-25) ... [is] 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.

However, if the concept of supply (and demand) is thymological, not praxeological, as I aver, *supra*, then this objection loses its force. Of course cars and peanuts can be homogenous (non differentiable) when there is no human action taking place with regard to them. Their differences only come to the fore when addressed by human action. As to the second objection of Machaj, it is my view that decreasing marginal utility is praxeological, and, for this law to not logically imply illicit indifference, supply cannot consist of equally serviceable units; rather, it must be (thymologically) composed of physically or chemically identical units. Thus, cars and peanuts cannot be part of the same supply.

Everything doesn't have to be praxeology, even for the Austrian. There is also thymology; it, too, is a valuable aspect of overall Austrian economics. Machaj is guilty of praxeologicalization: over use of praxeology. To take an example from an unrelated issue, it is praxeologically true that all voluntary human action benefits both parties

in the *ex ante* sense. But, it is also thymologically true that all voluntary human action benefits both parties in the *ex post* sense, or, rather, at least, that this is a correct empirical or historical generalization. We would scarcely ignore this latter empirical point, merely because it is not grounded in praxeology. In like manner with indifference and the supply of a good.

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Book Review

Jörg Guido Hülsmann and Stephan Kinsella (eds.). *Property, Freedom, and Society: Essays in Honor of Hans-Hermann Hoppe*. Auburn: Ludwig von Mises Institute, 2009.

Many academics toil a thankless life, striving for truth amid a sea of fallacies and inaccuracies. Some who do this with mediocrity are ignored. Those who do it well are often subject to intense criticism and ridicule. A select few rise to the challenge, and with conviction, carry forward – ever aiming to convince the masses that their truthful pursuit is right. Of this miniscule number of individuals, only a handful may ever reach the point where their peers recognize them for their insights, and reward their toils accordingly. Hans-Hermann Hoppe is one such individual.

Jörg Guido Hülsmann and Stephan Kinsella have edited a magnificent *Festschrift* to honor Professor Hoppe for his life-long achievements in championing individualism, private property, rights, and above all else, liberty. The collection of scholars who have come together to pay their respects reads like a veritable “who’s who” list of the world’s leading political philosophers. Hülsmann and Kinsella note in their brief introduction that after Murray Rothbard’s untimely death in 1995, Hoppe assumed a role of “uncontested leadership” among the Austro-libertarian scholars. The scope of this leadership is evident as one reads the contributions offered by his admirers in the following pages.

The book is divided into five sections delineating five specific areas where Hoppe’s influence has been greatest. The sheer number of contributions provides a limitation on giving a full assessment, but in this brief review we may see some of the startling affects Hoppe has bestowed on some of the individuals’ lives and thinking.

Personal Recollections

The venerable Lew Rockwell opens the book’s contributions by writing a short expose of his first encounter with Hoppe. Listening to a German give a lecture on the pitfalls of the American constitution provided a learning experience in what would be typical Hoppean political economy. Challenging the prevailing doctrine would become the norm for our esteemed honoree, and Rockwell’s recounting of his early experiences with Hoppe show that not much has changed since the early years of his transatlantic move.

The rest of the first section contains personal recollections of the scholar. Former

students have come forward with their experiences learning from the master's knee, and the effects this has had on their lives. Prominent libertarian scholars recollect how Hoppe has shaped and changed their own thinking. Ed Stringham provides a story of his early days as a student with an honors bachelor's thesis on the privatization of law. After encouragement from his own professor, Walter Block, he submitted it to Professor Hoppe for advice on how to proceed. To his astonishment, Hoppe not only read the whole 120 pages, but offered more than constructive advice on the contributions, resulting in Stringham's first publication: "Market Chosen Laws," in the *Journal of Libertarian Studies*. The other contributions recount similar stories with their prominent effects.

Crossroads of Thought

Section two provides an interesting look at some of the controversies that Hoppe has managed to generate (with good reason). Philipp Bagus provides a brief look at why radicalism is a promising strategy for current Austro-libertarian thinkers. Taking an unwavering attitude towards these beliefs, much as Hoppe has espoused his whole life, provides libertarians with the credibility to continue pushing their theories forward as a consistent and unified whole.

Martin Froněk and Josef Šíma provide a detailed analysis of some issues that arise in the current law and economics literature. Specifically, they take issue with the Posnerian analysis that has become prevalent stemming from the University of Chicago since the 1960s. In pure Hoppean fashion, they deconstruct the myth that wealth maximization is an attainable standard for legal rulings. By relying on market prices to achieve such an equitably remedy, legal scholars neglect that these prices must necessarily reflect only past preferences, and hence, are unable to provide any sort of standard by which to make decisions concerning future events. The standard law and economics approach is shown to be faulty, something which Austrian economists and legal scholars have been demonstrating for years, yet are often ignored in the relevant literature. This is a puzzling development as both economic and legal scholars understand that the field of law and economics must be challenged due to its shortcomings. Perhaps this specific paper may do much to change that.

Joseph Salerno provides what may well prove to be the most controversial piece of the volume. “The Sociology of the Development of Austrian Economics” provides a print version of a thinly circulated paper written in 1996 which received heated exposure at the time. Salerno takes issue with many of the issues that arose during what may be best referred to as the *Methodenstreit II* of the Austrian school which followed the famed South Royalton conference of 1974. In it, Salerno takes issue with the question: “What is Austrian economics?” While specifying a vague methodological stance based on subjectivism or individualism may seem like an attractive option, the result is a bifurcation between many strictly *un*Austrian thinkers and our more Austrian counterparts – George L.S. Shackle and Milton Freidman, as examples of non-Austrians who support subjectivism and individualism. In its place, Salerno strongly reckons that if Austrian economics must be defined by a single tenet, it must be methodological – praxeology. This approach has been the strictly Austrian approach since Carl Menger and may be found in several older eighteenth and nineteenth-century philosophers and economists – notably Cantillon, Say, Senior, and Cairnes. This methodological foundation is highly influenced by Hoppe’s work on the Austrian method, including his 1988 book *Praxeology and Economic Science* and his 1995 book *Economic Science and the Austrian Method*.

Political Philosophy

This third section provides the reader with grouping of articles continuing Professor Hoppe’s arguments concerning the political sphere.

Frank van Dun gives an interesting essay on the potential conflict that arises between property rights and individual freedom. One well-known case illustrating this conflict is where one person is blocked from exiting (or gaining entrance) to their property due to being physically surrounded by another’s property. This paradox has been solved previously via the “Blockean Proviso.” Under such a condition, any individual who homesteads land encircling unowned land must allow an easement to permit potential homesteaders access to this unowned property. Van Dun goes further by questioning whether freedom and property rights can both be considered compatible goals *at all times*. The conclusion is that where cases of this conflict arise,

freedom must be given primary consideration. A compromise in property rights in such cases is not an arbitrary decision, but rather one grounded in natural law and the attainment of a greater freedom (which must be the overreaching goal of such actions). The ramifications for property rights theorists is manifest as it requires a response or reformulation of the sanctity of the uninhibited right to one's property.

Much as Salerno's piece focused on what it is that specifically defines an Austrian economist, Stephan Kinsella delineates "What Libertarianism Is." Using a belief in capitalism or the free market as a litmus test seems too narrow. At the same time, using other metrics, such as property rights seems to include too many other doctrines. Instead, it is a particular set of property assignment rules which sets apart libertarians from other political canons. Kinsella's piece gives added emphasis to van Dun's earlier look at the conflicts between the end of freedom and the ubiquity of property rights.

Democracy

Professor Hoppe's 2001 book *Democracy: The God that Failed*, marks a high-point in his intellectual battle with prevailing political principles. In it, he outlines not only the pitfalls of democracy, but also the advantages that traditional monarchies have enjoyed due to the principle of continual succession and the resultant benefits of lowered time preference for the political leaders. This fourth section offers some novel viewpoints on this ongoing battle against the doctrine of mob rule.

Robert Higgs points out the hereto now largely unaddressed problem of *faits accomplis*. Elected rulers seldom face any effective constraints once in office, except the looming deadline of the end of their ruling period. Woodrow Wilson was not elected in 1916 to wage the Great War; Franklin Roosevelt was not elected in 1932 to impose the New Deal, nor reelected in 1940 to campaign another Great War. In the interim periods after their elections their electorates were left with little to no recourse to enforce what the elected officials had originally been elected for. As Higgs points out, Goethe's dictum that "none are more hopelessly enslaved than those who falsely believe they are free" has never wrung more true.

Doug French defeats the mantra that “we just need to elect the right people,” in response to the belief that politicians who are incompetent must just be replaced by the competent. Indeed, the competent are typically those who are busying themselves servicing consumers’ wants, and not running for political offices to redistribute the wealth with little regard to real constraints. David Gordon manages in a few short pages to use the Hoppean arguments contra democracy to destroy David Estlund’s epistemological justification for democracy found in his new book *Democratic Authority: A Philosophical Framework*.

Economics

In this final section, several key contributions to the current corpus of Austrian economics literature are expanded upon.

Thomas DiLorenzo provides a comparison of Hoppean political economy and prevailing Public Choice opinion. Opening by showing that Public Choice commences with the basic Hobbesian argument *viz.* the need of government to avoid a life rampant with theft and violence, he proceeds to demonstrate that Professor Hoppe’s political economy searches for much more theoretically secure underpinnings. By assigning the government an explicit right to tax its citizenry (if ever so slightly), a violation of property rights is undertaken before the state ever reaches a position where it may protect them. Addressing the fallacy of the majority rule doctrine, DiLorenzo shows that the idea of “tacit” agreement in political decisions based on the possibility of unanimous political consent is “patently absurd.” Indeed, DiLorenzo’s piece has much in common with Jesús Huerta de Soto’s fine contribution “Classical Liberalism versus Anarcho-Capitalism.” By showing that classical liberals sowed the seeds for their own demise by accepting as a starting assumption a minimal state, Huerta de Soto proceeds to reach the same conclusions as DiLorenzo – that even a minimal amount of state is impossible to sustain over the long-term, and will result in a reduced quality of life for all citizens under its command.

Nikolay Gertchev delves into the inner workings of securitization to explore its effects on the business cycle. Its use coupled with fractional reserve banking has delinked growth in the money supply from the growth in the credit supply. Thus,

securitization has allowed a new avenue for credit creation, making central banks' goals for money supply growth targets more or less ineffective in light of the credit growth figures that can result. As a result, as Dr. Gertchev coherently demonstrates, securitization has become a tool to spread the illusion of savings-driven growth, for its real manifestation – a business cycle.

Jörg Guido Hülsmann's own contribution to his edited work shows that while the demand for *commodity* money is not time-neutral, demand for *fiat* money most definitely is. Austrian business cycle theory generally rests on the claim that shifts in the supply of money affect the rate of interest, while shifts in the demand to hold money do not (i.e., they are time-neutral). Hence, fiat money represents a very basic way that the structure of production is misaligned with the underlying macroeconomic conditions. The typical result of an Austrian business cycle prevails – the greater tendency for capital to be wasted.

Mateusz Machaj takes issue with the standard argument against the feasibility of socialism. The lack of a numerical calculation system is less important, so it seems, than the underlying characteristics that *define* socialism. It exists in a dictatorial form and necessarily survives as such. The introduction of centrally controlled and produced accounting ratios cannot change the fact that competition is ruled out of socialism by definition.

Some Concluding Remarks

Professor Hoppe, with this honor on his 60th birthday, shows no sign of slowing down. Currently working on another opus, he is tying together his life's work to weave together a new reconstruction of human history. By combining elements of epistemology, ethics, and rationality, Hoppe aims to provide “a systematic and interdisciplinary reconstruction of human history (pre-history, hunter-gatherer societies, agricultural societies, industrial societies).”

His latest endeavor has been the promotion of debate through the *Property and Freedom Society* which he founded in August 2005. Challenging the important political questions of our time, the society seeks to promote Austro-libertarianism with ties

to the French laissez-faire liberal economists Frédéric Bastiat and Gustave de Molinari.

The thirty-five contributions to his Festschrift – *Property, Freedom, & Society: Essays in Honor of Hans-Hermann Hoppe* – show the far-reaching effects that his writings have had. In many diverse fields we can see the torch of Hoppean economics and political philosophy carried on. The quality of the contributions is outstanding and should result in this work being highly read and influential in furthering the Austro-libertarian research paradigm.

In many ways, it is unfortunate that honors such as a Festschrift come along only once a lifetime for an individual. With so many contributions currently progressing and many significant works yet to come, it will be interesting to see our *Herr Professor Doktor's* sphere of influence grow as the years continue. Until such a time, the present work is a succinct place to read the scope and influence of Hans-Hermann Hoppe's works over his lifetime; let's hope that more is to follow in the future.

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