

# Reason Papers

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DISSOLVING A MUDDLE IN ECONOMICS,  
or DR. MARX MEETS LORD RUSSELL\*

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There are techniques of mathematical logic which are well suited to analysis and clarification of the concept of economic value. This essay reviews some important prior discussions of such value, exhibiting a confusion therein. Methods adapted from Bertrand Russell's analysis of the concept of number are used in this paper to lay down a sound definition of economic value.

The result is a definition which is (1) objective, (2) quantitative, (3) not open to the criticisms that cripple previous proposals, and (4) offers a conceptual clarification for economics.

I. Value

In her preface to the second edition of *An Essay on Marxian Economics*, Joan Robinson writes

... in spite of the offence which it has given, I cannot withdraw the remark at the end of Chapter III. The concept of *value* seems to me to be a remarkable example of how a metaphysical notion can inspire original thought, though in itself it is quite devoid of operational meaning. (*Op. cit.*, p. xi, emphasis in original.)

\*The theory expounded here grew out of extensive discussion with Dr. Victor Elconin (West Coast University) and Professor Newman Fisher (San Francisco State University). Warm thanks go to Professor William Jacobs (Calif. State Univ., Los Angeles) for helping to christen Baros, Thermos and Megethos. I wish also to thank Professor J. Roger Lee (Calif. State Univ., Los Angeles) who, began nagging me to write, and subsequently improve, this paper.

The offending statement appears on p. 22 of Robinson's *Essay*; . . . no point of substance in Marx's argument depends on the labour theory of value. Voltaire remarked that it is possible to kill a flock of sheep by witchcraft if you give them plenty of arsenic at the same time. The sheep, in this figure, may well stand for the complacent apologists of capitalism; Marx's penetrating insight and bitter hatred supply the arsenic, while the labour theory of value provides the incantation.

To emphasize her claim about the metaphysical (i.e., I take it, the meaningless) character of the concept, Robinson puts the suspect term in italics in most of her book, and in particular in those places where, as she believes, the uselessness or actual disutility of the concept is most manifest (e.g., *op.cit.* pp. 26-28).

Robinson's fire is directed explicitly at Karl Marx's doctrine of value. According to Marx, on p. 37 of *Capital*, the exchange of commodities is ". . . an act characterized by a total abstraction from" the properties that make them useful, make them, as Marx puts it, use-values. He says, *loc. cit.*

A given commodity, e.g., a quarter of wheat is exchanged for x blacking, y silk, or z gold, &c. . . in the most different proportions. . . But since x blacking, y silk or z gold, &c., each represent the exchange-value of one quarter of wheat, [they] must, as exchange-values be replaceable by each other, or equal to each other. Therefore, first: the valid exchange-values of a given commodity express something equal; secondly, exchange-value. . . is only the mode of expression, the phenomenal form, of something contained in it.

Farther on, discussing an exchange of two commodities, Marx writes that in the two different things

. . . there exists in equal quantities something common to both. The two. . . must therefore be equal to a third, which in itself is neither the one nor the other. Each of them. . . must therefore be reducible to this third.

. . . the exchange-values of commodities must be capable of being expressed in terms of something common to them all.

The "something" common to all commodities, Marx finds, is the labor expended in production. He says, *ibid.*, p. 38, that after abstracting from the useful properties of goods and from the distinctions among the various kinds of labor employed,

. . . there is nothing left but what is common to them all; all are reduced to one and the same sort of labour, human labour in the abstract.

Let us now consider the residue of each of these products; it consists of the same unsubstantial reality in each, a mere conglomeration of homogene-

ous human labour . . . all that these now tell us is, that human labour-power has been expended in their production, that human labour is embodied in them. When looked at as crystals of this social substance, common to them all, they are--Values.

So, according to Marx, the value of a commodity is the same as the amount of "human labour in the abstract" expended in producing it. How then, are amounts of value to be measured? Marx says, *ibid.*,

Plainly, by the quantity of the value-creating substance, the labour, contained in this article. The quantity of labour, however, is measured by its duration, and labour-time in its turn finds it standard in weeks, days, and hours.

The last two quotations may be taken as Marx's theory of value, summarized in his aphorism, "As values, all commodities are only definite masses of congealed labour-time" (*ibid.*, p. 40).

It is no news that Marx's theory is an elaboration of, but no essential advance on, the views of the so-called classical economists such as Adam Smith (see e.g., Bk. I, Ch. V of *An Inquiry into the Nature and Causes of the Wealth of Nations*). It is also no news that Robinson is not the first to reject the theory. For example, Bertrand Russell, writing in 1896, said of Marx's theory,

Marx's proof is fallacious in *method*; we can never be sure, by mere abstraction of differences, that we have hit on the *only* common quality of a number of things, or that the quality we have hit on is the relevant one. His proof is fallacious in *substance*, for commodities have also another common quality, utility namely, or the power of satisfying some need. (*German Social Democracy*, p. 17, emphasis in original.)

Critics of the Marxist view have picked at it on many grounds. For instance, Eugen Bohm von Bawerk, in *Karl Marx and the Close of his System*, presents what he takes to be a conclusive, destructive study of the labor theory, amplifying and completing the analysis he had made earlier in his *Capital and Interest*. One of the principal charges is that the labor theory is circular: it is proposed as an explanation of how commodities come to be exchanged in the proportions that they do, e.g., in the market, yet it is the exchange value that is used to determine the labor value in commodities. Indeed, it is argued, the Marxist qualification that value is to be measured by the "socially necessary" labor expended, "congealed" and "crystallized" in commodities, reduces still farther the

possibility of giving independent content to the labor theory apart from the concept of exchange value. This even though the former is supposed to provide an explication of the latter (see, e.g., Robert Nozick, *Anarchy, State and Utopia*, pp. 253-62). Again, critics hold that the conception of "human labor in the abstract", or of "homogeneous human labor", is unhappily vague and terribly confused, incapable of unambiguous explanation or specification.

Much of Böhm-Bawerk's *Capital and Interest* is a thorough criticism of a variety of competing theories of value, and not that of Marx alone. These are all, he finds, unsatisfactory, for the same sorts of reasons brought to bear against the labor theory: logical incoherence, lack of empirical content, being misleading or positively erroneous in explicating concrete economic phenomena, &c. To repair the deficiency, Böhm-Bawerk adopts the so-called "subjective theory" of value. He gives a succinct formulation in *The Positive Theory of Capital*:

... formally defined, value is the importance which a good or complex of goods possesses with respect to the wellbeing of a subject... goods can only have an effective importance for human wellbeing in one way, viz. by being the indispensable condition, the *sine qua non*, of some one utility which subserves it... we shall define [value], unambiguously and exactly, as : That importance which goods or complexes of goods acquire, as the recognized condition of a utility which makes for the wellbeing of a subject, and would not be obtained without them. (*Op. cit.*, p. 135.)

Moreover, he writes (*ibid*, pp. 135-6):

All goods have usefulness, but all goods have not value. For the emergence of value there must be scarcity... relative to the demand for the particular class of goods... goods acquire value when the whole available stock of them is not sufficient to cover the wants depending on them for satisfaction, or when the stock would not be sufficient without these particular goods.

The subjective theory is a major doctrine of the so-called "Austrian school" of economists, of which Böhm-Bawerk was a prominent early member. The theory seems to escape most of the criticisms specifically directed at Marx's labor theory, as well as those aimed at other extant "objective" theories. No doubt this explains in part, at least, why the subjective theory commended itself to the Austrian economists.

Unhappily for economists' peace of mind, the subjective theory is in its turn not without difficulties of its own. This is evident from a consideration of Ludwig von Mises' exposition:

If in accordance with an objective theory of value the possibility of an objective concept of commodity-values is accepted, and exchange is regarded as the reciprocal surrender of equivalent goods, then the conclusion necessarily follows that exchange transactions must be preceded by measurement of the quantity of value contained in each of the objects that are to be exchanged.

But modern value theory has a different starting point. It conceives of value as the significance attributed to individual commodity units by a human being who wishes to consume or otherwise dispose of various commodities to the best advantage. (L. von Mises, *The Theory of Money and Credit*, p. 38.)

The subjective theory does not try to make *quantitative* estimates of value. According to von Mises, *ibid.*, p. 39,

But subjective valuation, which is the pivot of all economic activity, only arranges commodities in order of their significance; it does not measure this significance.

From the subjective view, says von Mises (*ibid.*, pp. 46-47),

Value can rightly be spoken of only with regard to specific acts of appraisal. It exists in such connexions only; there is no value outside the process of valuation. There is no such thing as abstract value.

The proper notion of value, for the Austrian school, is "subjective use-value", and this, all parties seem to agree, is not susceptible to objective measurement. Therefore, von Mises writes (*ibid.*, p. 45), "If it is impossible to measure subjective use-value, it follows directly that it is impracticable to ascribe 'quantity' to it."

This subjective doctrine is open to the charge of circularity just as the classical theory is. For, what more is discovered about value in exchange, on this view, other than that traders exchange commodities in various ratios? The circularity becomes more patent upon recalling that what people do is not always what, in any reasonable sense of the term, they *want* to do. After all, people often act compulsively, impulsively, under duress, etc. Thus, the Austrian school must concede that many exchanges occur in ways that do not necessarily reflect the subjective valuation of the principals, unless the term "subjective valuation" is being persuasively redefined as the notion it purportedly helps explain.

So, both the classical and the Austrian schools propose to explain the economic conception of value in self-stultifying and unfortunately speculative ways. In part, this derives from a

confusion, avoided in the theory expounded below, between what a quantity *is* and what may be causally or functionally related to some concrete situations being appropriately characterized by determinate values of that quantity. This may be seen more clearly by analogy with a similar situation that might be imagined arising about the notion of *volume*.

## II. Confusion

Imagine the savant Baros announcing the results of his cogitations. "Volume is a sublation," he announces. "It is the reciprocal negation of that which is the agent of compression, as is evident from my experiments. Thus, volume really is nothing but pressure expressed in an outward phenomenal form of inversion; it *is* pressure."

At once Baros is challenged.

"You have neglected the intensity of the Pholgistication, not to say anything of its accumulation. In fact, volume is a direct manifestation of *la motrice de feu*. For as one fires up a gas, that gas exerts itself to fill all space, and inversely as one damps the fire, the gas retreats and coils in upon itself. In a word then, volume is nothing more or less than temperature, that only, and directly." This from Thermos.

Impatient, scornful, Megethos interrupts. "Bah!" says he, "You have both been misled, deceived by the epiphenomena. You fight over the shadows and meanwhile the horse has run away--to my stable. Merely consider, my learned friends, that as you increase or decrease the amount of matter, the gas obediently increases or decreases its extension. Ergo, volume is nothing else than mass."

I venture that my three sages are disputing with only a little more silliness than the economists arguing about what value "really" is. It is not hard to resolve the perplexity in which Baros, Thermos and Megethos find themselves. It suffices to point out that since everything is what it is and not another thing, then volume in particular is--volume, and not anything else. Volume is a geometrical magnitude. This or that influence - pressure, temperature, quantity of matter, or what have you - may be causally or functionally related to the volume of a physical thing, as in the ideal gas law. But that ought not, and I am sure usually does not, lead anyone to think volume *is* any one or any combination of those other things.

Analogously, it seems to me, the economists' argument whether value is really congealed labor, or subjective marginal utility, or objective usefulness, or whatnot, is equally futile. It is tempting to say, as G.E. Moore might have, that value is value, and that is all there is to it. Indeed, I think it is true that value is value, but I also believe there is just a bit more to say about it.

### III. Abstraction

My thesis is a simple one: The economic value of a thing is just what it will fetch in the market. Since the idea is so simple it may easily be misunderstood. So I here improve the opportunity to amplify and complicate.

To prepare the way, I review Bertrand Russell's celebrated definition of natural number (see *Principles of Mathematics*, Ch. IX). What, for example, is the number of justices on the Supreme Court? Well, it is the number of players in the starting lineup of the St. Louis Browns or the Jersey City Giants. It is also the number of major planets in this solar system, the number of eggs left from a dozen after making a three-egg omelet, the number of chapters in any book of Plotinus' *Enneads*, the number of syllables needed to complete a *haiku* after eight have been set down, &c. All the sets mentioned just now *have the same number*. The metaphysical question that arises is, what is that number that all these sets "have"? What sort of thing is it? What realm of being does it inhabit?

Russell, following Frege, noted that, whatever else may be true of the several sets that "have" the same number, a necessary condition for two sets to have the same number is that the elements of the sets can be matched in a one-to-one correspondence. For instance, the set of fingers on a child's hand is put in one-to-one correspondence with the set of pigs in the nursery game that begins "One little piggy went to market. . . ." Given any set of individuals, then, there are indefinitely many other sets with which the given set is in one-to-one correspondence. It is said that such sets are *similar* to one another. On Russell's view, all the sets similar to one another in the sense just prescribed form a class of sets, a subclass of the class of all sets of individuals. Thus, there is a class among the members of which are the set of Erinyes, the set of principals in a

*menage a trois*, the set of instruments needed to play the *Ghost Trio*, and so forth. Such a class is an *equivalence class* with respect to the relation of similarity, since: (1) every set is similar to itself, (2) if one set is similar to another, then that other is similar to the one, and (3) if one set is similar to a second, and the second to a third, then the first is similar to the third. In other words, similarity is reflexive, symmetric and transitive, i.e., it is an equivalence relation. Certainly one thing the sets belonging to one of these equivalence classes have in common is that they all belong to the same club. Moreover, membership in such a club is determined by what appears to be essential and primitive in the notion of "having the same number".

Russell's proposal, then, was to construe the number a set "has" as just that equivalence class to which it belongs. The number three, for instance, is the equivalence class of which the set of Erinyes is a typical member, and the number nine is the equivalence class of which the set of Supreme Court Justices is a member, and so on. To complete the tale, Russell then construed the term "number" as referring to the class of all such equivalence classes.

From the Russellian standpoint, numbers have been shown to be definable as logical constructions from less problematic entities, and the speculations of metaphysicians and numerologists are seen to be beside the point for the purposes of mathematics and its applications.

Russell's method may be characterized in general. He forms a *partition* of the overall class (for the case of number, the class of sets of individuals) into subclasses which (1) are jointly exhaustive of the overall class, (2) are mutually disjoint, and (3) are equivalence classes with respect to an appropriate equivalence relation (in the case of number, that relation is similarity). He then defines any specific entity of the required sort (e.g., the number three) as an appropriate one of those equivalence classes, and interprets the general concept (e.g., number) as the class of all such equivalence classes. That general concept and its specific instances, then, are *abstractions* from the more concrete entities that go to form the equivalence classes.

This method of abstraction is of quite general application in mathematics. The procedure has been adapted, for example, to explicate the concept of physical quantity, e.g., length, dur-

ation, temperature, &c., as that concept is employed in the natural sciences (see Chapter Six of my dissertation, *Space, Time and Measure: A Study in the Philosophy of David Hume*). Here I propose to apply the same point of view to analysis of the concept of economic value.

#### IV. Exchange

That one quarter of wheat exchanged, at a given time, for  $x$  blacking or  $y$  silk or  $z$  gold, &c., was taken by Marx to show that those quantities of those commodities were of equal value. Had he stopped there and thought a bit Marx might well have avoided the metaphysical muddle embodied in the notions of "human labor in the abstract" and "crystallized human labor" and the rest.

Suppose that a pint of milk, a pound of bananas, 0.0001 ounce of gold, . . . , are commodities that on Marx's view have the same value. Thus, they belong to *the same equivalence class with respect to the relation of exchangeability*. Similarly, a ticket to a concert, a copy of a best-selling novel, an eye-jangling sport shirt, . . . , may be equally exchangeable, belonging to another equivalence class with respect to exchangeability. Again, an automobile of a certain make, an elaborate recording sound system, an airline ticket around the world, a set of tools, an acre of desert land, . . . , may also be exchangeable, all falling into yet another equivalence class. In general, at any time, the class of commodities is partitioned into subclasses such that all the members of any one such subclass are exchangeable, even-stephen, one with another. For the purposes of economics, the exchange relation is a equivalence relation. For, (1) any commodity is exchangeable for some commodity or other, (2) if one commodity is exchangeable with another then that other is exchangeable with the one, and (3) if one commodity is exchangeable with a second and that second with a third, then the first is exchangeable with the third. From these conditions it follows, by a simple exercise in quantificational logic, that exchangeability is reflexive, symmetric, and transitive, and hence that it is an equivalence relation. It is not unreasonable, therefore, to *define* the value of a commodity as *that exchange equivalence class to which it belongs*, and to define the class of values in general as *the class of all such equivalence classes*.

Since economists have always known that commodities that exchange evenly, like Marx's quarter of wheat,  $x$  blacking,  $y$  silk,  $z$  gold, &c., are of equal value, it is by no means a surprise to discover that that is what value amounts to. No farther elaboration, with tales of labor expended, subjective wants expressed, actual utilities, or whatnot, either need or should have been told *in order to understand what value is*.

Value so construed is a quantitative concept, for it is easy to define addition, subtraction, negation, multiplication and division by real numbers, and the rest. To illustrate, if  $A$  is one value and  $B$  another, then  $A + B$  is the value of the composite commodity composed of any one element of  $A$  together with any one element of  $B$ . An example may be useful: let  $A$  be the value of a quart of milk and  $B$  the value of a dozen eggs; then  $A + B$  is the value of the composite commodity one-quart-of-milk-with-one dozen-eggs, which is, perhaps, the same as the value of one pound of hamburger. Again, if  $A$  is the value of a gallon of gasoline, then  $1.5 A$  is the value of a gallon and a half of gasoline, which may be the same as the value of a pair of socks. It is even possible to introduce the notion of negative values. Thus in order to "exchange" a load of trash or garbage, the person who wants to dispose of it may have to *give* some other commodity, money for instance, to have it taken away.

The present proposal also helps to understand money. The pint of milk, pound of bananas and 0.0001 ounce of gold with which I began were all supposed to worth \$.25. In the days before clad coins and unbacked paper currency, gold and silver counted as money. But gold and silver are commodities, like any others, useful for some purposes, like filling teeth or making jewelry, and esteemed by some or scorned by others just as chocolate bars or racing cars may be. The precious metals, however, have certain virtues over other commodities, bananas say, for business purposes. They don't spoil, they are easily handled, and they are nearly universally acceptable in trade for other commodities. It is therefore convenient to use standard quantities of them as representative of the various equivalence classes into which those standard quantities would fall. So the \$.25 which I took to be the price of a pound of bananas would *be*, in the days of real money, a definite quantity of gold or silver or else a guaranteed certificate attesting a valid claim to such a quantity of gold or silver. Money therefore, is no more nor less than a standard commodity uni-

versally recognized as exchangeable in appropriate amounts for other commodities. In more abstract mathematical terms, a sum of money is a standard representative of the equivalence class to which it belongs.

In more detail, the various denominations of money may be regarded as providing units in which to measure values, just as the various multiples and submultiples of the meter, inch, or what you will, allow expressing the measure of other lengths relative to those selected lengths. For instance, the measure of foot in inches is a pure number, 12; the measure of the circumference of the Earth in miles is approximately 25,000; &c. Similarly, the measure of *the value of a pound of bananas* in cents is 25, according to my example; *the measure of the retail value of a gallon of gasoline* in dollars is, say, 0.609; &c. This choice of money (i.e., gold or silver or wampum or clam shells or whatever) to provide units of measure is, however, purely a matter of convenience, and sometimes other commodities provide more useful measures. Thus, quite frequently in *The Wealth of Nations* Adam Smith uses standard quantities of grain (he calls it "corn") to provide a measure for comparison of economic values at different times and places. Often another commodity, working time, is used to measure economic values. For example, in the San Fernando Valley edition of the *Los Angeles Times* for 6th September 1975 there is an advertisement urging readers to buy automobiles. The persuasion includes the following:

8. The cost of a new car now takes less from today's paycheck than it did 10 years ago. Then it took the median wage earner 5.1 months to earn the price of a base four-door car. Today, he can earn a four-door car in 4.4 months.

That is to say, according to the advertisement, in 1975 the number 4.4 is *the measure of the value of a base four-door car* with respect to the working month as unit. (For some amusing examples, see Ch. XXXIII, "Sixth Century Political Economy", in *A Connecticut Yankee at King Arthur's Court* by Mark Twain.)

This admittedly sketchy account may be summarized as recommending that the class of economic values be thought of as a semantical interpretation of the abstract theory of continuous quantity, that is, of what the physicists call "scalars". The class of economic values is a scalar class, i.e., *a continuous, ordered, additive Abelian group with natural number co-*

*efficients, for which a class of measure operators isomorphic with the real numbers is defined.* (A full account of that theory, including a development of the theory of real numbers may be found in the aforementioned Chapter Six of my dissertation.)

## V. Retort

I have already answered the objection that the present proposal ignores the essence, the very meaning, of economic value, that it evades or denies what in the last analysis value ultimately is. That answer, again, is that what others nominate for the office may for all I know be causally or functionally related to value as I have defined it, but they are *not the same* as value. Unlike the other candidates, such as subjective marginal utility or the labor theory, this account defines value objectively according to the actualities of economic exchange; it is not open to Joan Robinson's charge of being either "metaphysical" or devoid of what she calls "operational meaning"; and it separates the question of what value *is* from the question of what *causes* a given commodity to have the value that it does (compare my parable about gas volume, above Sec.II).

Another possible objection is that on this account the value of a commodity may well vary from one time to another or from one place to another, and this, it may be thought, is not compatible with the notion of an object's having value. Once more I reply with an analogy. Length, for example, is a geometrical magnitude, and the class of lengths is a scalar class, namely, the class of sets of congruent line segments. That is what length *is*, for all purposes of mathematics, natural science and engineering. That is in no way inconsistent with the fact that the length *of* some physical object may be a function of other variables, such as temperature or mechanical stress. At any time, for instance, a rubber band has some length or other, but if it is stretched its length changes, in accordance with Hooke's Law perhaps. Similarly, at any time the value of a commodity is what it is, namely, the exchange equivalence class to which it belongs. That is in no way inconsistent with the fact that at some other time, for God knows what reasons, that commodity may well be placed in a different exchange equivalence class.

The complaint of von Mises, quoted above in Sec. I, that on an objective theory such as this "...exchange transactions

must be preceded by the measurement of value contained in each of the objects . . . to be exchanged," is easily met. There is no need for such a prior measurement, for *the consummation of the exchange is the required operation of "measurement"*. That is, the exchange itself is what puts the commodities in their several equivalence classes.

Another objection is that different quantities of "the same" commodity do not always exchange in direct to proportion to those quantities. For instance, milk bought in a half-gallon container costs, say, \$.68, while two quarts cost \$.35 each, i.e. \$.70 for the same quantity of milk. The reply is simply that the commodity being bought is not merely a physical quantity of milk. In the first case the commodity is a *half-gallon of milk in a half-gallon container*, whereas in the second case the commodity (a composite one) is a *half-gallon of milk packaged in two one-quart containers*. There is no obvious reason why these two different commodities must fall into the same exchange equivalence class, i.e., have the same value. Similarly, the exchange value of a tank-truck load of gasoline is not a simple multiple of the retail value of a single gallon of the stuff, nor does any theory I know of require that it be.

Again, the value of a commodity may differ at different times. In California, the value of a gin-and-tonic dispensed in a bar may be \$1.25, before the 2 AM legal closing hour, but after 2 AM, the price may be--well, who knows? In other words, the value of a commodity at any time or place is what it is, the exchange equivalence class into which it falls, although that value may easily be a function of such variables as time, place, legal conditions, relative scarcity, labor expended, &c., &c.

## VI. Virtues

The account I have given restores the term "value" to a decent modicum of respectability for the purposes of economics. It is not open to Robinson's charge that it is a metaphysical concept, except insofar as the quibbles about the notion of class by nominalists like Quine are taken seriously. It is also not open to her charge that the concept is "devoid of operational meaning". I construe her use of the word "operational" to mean "having significant content", and on the present account the term "value" *does* have significance.

But the principal virtue of this story is that it is trivial. The present theory provides an opportunity for conceptual clarification, which, once achieved, makes the theory look like what it is: a careful statement of what should be obvious.

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## BOUNDARIES ON SOCIAL CONTRACT\*\*'

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### Introduction

The central question examined in this paper may be stated at the outset. What are the boundaries or limits on changes in the distribution or assignment of rights among persons in a society that may be "explained" on grounds of continuing social contract? I do not provide more than a few suggestions toward a set of answers. I should argue, nonetheless, that the question is of vital importance in the 1970s. We witness everywhere what must be described as an erosion in the rights of individuals, rights that were previously acknowledged. As social scientists, we are under some obligation to "explain" what is happening, and we must keep in mind that simplest of principles; diagnosis precedes prescription for cure.

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\*\*The central arguments of this paper were initially presented in a seminar on Anarchy at Blacksburg, Virginia in the Spring of 1972. This earlier presentation, under the title, "Before Public Choice", appears in the volume of essays, *Explorations in the Theory of Anarchy*, edited by Gordon Tullock (Center for Study of Public Choice, Virginia Polytechnic Institute and State University, Blacksburg, Virginia, 1973).

The general position expressed in this paper is developed more fully in my book, *The Limits of Liberty: Between Anarchy and Leviathan* (Chicago: University of Chicago Press, 1975).

## The Social Function of Social Contract

A contract theory of the State is relatively easy to derive on the basis of plausibly acceptable assumptions about individual evaluations, and careful use of this theory can yield major explanatory results. To an extent at least, a "science" exists for the purpose of providing psychologically satisfying explanations of what men can commonly observe about them. Presumably, we "feel better" when we possess some explanatory framework or model that allows us to classify and interpret disparate sense perceptions. This imposition of order on the universe is a "good" in the strict economic sense of this term; men will invest money, time, and effort in acquiring it. The contract theory of the State, in all of its manifestations, can be defended on such grounds. It is important for sociopolitical order and tranquility that ordinary men explain to themselves the working of governmental process in models that conceptually take their bases in cooperative rather than in noncooperative behavior. Admittedly and unabashedly, the contract theory serves, in this sense, a rationalization purpose or objective. We need a "logic of law", a "calculus of consent", a "logic of collective action", to use the titles of three books that embody modern-day contract theory foundations.<sup>1</sup>

Can the contract theory of the State serve other objectives, whether these be normative or positive in character? Can institutions which find no conceivable logical derivation in contract among cooperating parties be condemned on other than strictly personal grounds? Can alleged improvements in social arrangements be evaluated on anything other than contractarian precepts, or, to lapse into economists' jargon, on anything other than Paretian criteria? But, even here, are these criteria any more legitimate than any other?

In earlier works, I have tended to ignore or at least to slight these fundamental questions. I have been content to work out, at varying levels of sophistication, the contractarian bases for governmental action, either that which we can commonly observe or that which might be suggested as reforms. To me, this effort seemed relevant and significant. "Political economy" or "public choice"--these seemed to be labels assignable to work that required little or no methodological justification. It was only when I tried to outline a summary treatment of my whole approach to sociopolitical structure that I was stopped

short. I came to realize that the very basis of the contractarian position must be examined more thoroughly.

We know that, factually and historically, the "social contract" is mythological, at least in many of its particulars. Individuals did not come together in some original position and mutually agree on the rules of social intercourse. And even had they done so at some time in history, their decisions could hardly be considered to be contractually binding on all of us who have come behind. We cannot start anew. We can either accept the political universe, or we can try to change it. The question reduces to one of determining the criteria for change.

When and if we fully recognize that the contract is a myth designed in part to rationalize existing institutional structures of society, can we simultaneously use the contractual derivations to develop criteria for evaluating changes or modifications in these structures? I have previously answered this question affirmatively, but without proper argument. The intellectual quality as well as the passionate conviction of those who answer the question negatively suggest that more careful consideration is required.

How can we derive a criterion for determining whether or not a change in law, or, if you will, a change in the assignment of rights is or is not justified? To most social scientists, the only answer is solipsist. Change becomes desirable if "I like it," even though many prefer to dress this up in fanciful "social welfare function" or "public interest" semantics. To me, this seems to be pure escapism; it represents retreat into empty arguments about personal values which spells the end of rational discourse. Perhaps some of our colleagues do possess God-like qualities, or at least they think they do, but until and unless their godliness is accepted, we are left with no basis for discourse. My purpose is to see how far we can rationally discuss criteria for social change on the presumption that no man's values are better than any other man's.

### Wicksellian Contract, Constitutionalism, and Rawlsian Justice

Is *agreement* the only test? Is the Wicksellian-contractarian-Paretian answer the only legitimate one here? If so, we are willing to accept its corollaries? Its full implications? Are we willing to forestall all social change that does not

command unanimous or quasi-unanimous consent?

Provisionally, let us say that we do so. We can move a step beyond, while at the same time rationalizing much of what we see, by resorting to "constitutionalism," the science of rules. We can say that particular proposals for social change need not command universal assent provided only that such assent holds for the legal structure within which particular proposals are enacted or chosen. This seems to advance the argument; we seem to be part of the way out of the dilemma. But note that this provides us with no means at all for evaluating particular proposals as "good" or "bad". We can generate many outcomes or results under nonunanimity rules. This explains my initial response to the Arrow impossibility theorem, and to the subsequent discussion. My response was, and is, one of non-surprise at the alleged inconsistency in a social decision process that embodies in itself no criteria for consistency. This also explains my unwillingness to be trapped, save on rare and regretted occasions, into positions of commitment on particular measures of policy on the familiar efficiency grounds. We can offer no policy advice on particular legislative proposals. As political economists, we examine public choices; we can make institutional predictions. We can analyze alternative political-social-economic structures.

But what about constitutional change itself? Can we say nothing, or must we say that, at this level, the contractarian (Wicksellian, Paretian) norm must apply? Once again, observation hardly supports us here. Changes are made, changes that would be acknowledged to be genuinely "constitutional", without anything remotely approaching unanimous consent. Must we reject all such changes out of hand, or can we begin to adduce criteria on some other basis?

Resort to the choice of rules for ordinary parlor games may seem to offer assistance. Influenced greatly by the emphasis on such choices by Rutledge Vining, I once considered this to be the key to genuinely innovative application of the contractarian criteria. If we could, somehow, think of individual participants in a setting of complete uncertainty about their own positions over subsequent rounds of play, we might think of their reaching genuine agreement on a set of rules. The idea of a "fair game" does have real meaning, and this idea can be transferred to sociopolitical institutions. But how far can we go with this? We may, in this process, begin to rationalize

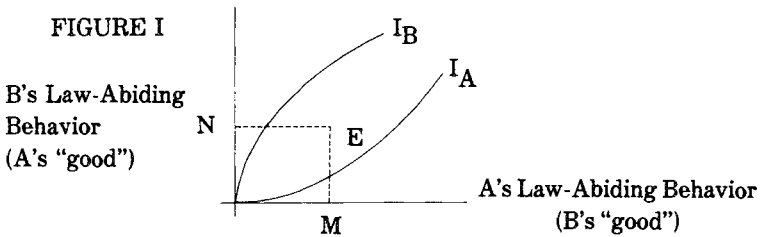
certain institutions that cannot readily be brought within the standard Wicksellian framework. But can we do more? Can we, as John Rawls seems to want to do in his *A Theory of Justice*,<sup>2</sup> “think ourselves” into a position of original contract and then idealize our thought processes into norms that “should” be imposed as criteria for institutional change? Note that this is, to me, quite different from saying that we derive a possible rationalization. To rationalize, to explain, is not to propose, and Rawls seems to miss this quite critical distinction. It is one thing to say that, conceptually, men in some genuinely constitutional stage of deliberation, operating behind the veil of ignorance, might have agreed to rules something akin to those that we actually observe, but it is quite another thing to say that men, in the here and now, should be forced to abide by specific rules that we imagine by transporting ourselves into some mental-moral equivalent of an original contract setting where men are genuine “moral equals”.

Unless we do so, however, we must always accept whatever structure of rules that exists and seek constitutional changes only through agreement, through consensus. It is this inability to say anything about rules changes, this inability to play God, this inability to raise himself above the masses, that the social philosopher cannot abide. He has an ingrained prejudice against the *status quo*, however this may be defined, understandably so, since his very role, as he interprets it, is one that finds itself only in social reform. (Perhaps this role conception reflects the moral inversion that Michael Polanyi and Craig Roberts note; the shift of moral precepts away from personal behavior aimed at personal salvation and toward moral evaluation of institutions.)

### Hobbes and the Natural Distribution

Just what are men saying when they propose nonagreed changes in the basic structure of rights? Are they saying anything more than “this is what I want and since I think the State has the power to impose it, I support the State as the agency to enforce the change”? We may be able to get some handles on this very messy subject by going back to Hobbes. We need to examine the initial leap out of the Hobbesian jungle. How can agreement emerge? And what are the problems of enforcement?

We may represent the reaction equilibrium in the Hobbesian jungle at the origin in the diagrammatics of Figure 1.



If we measure "B's law abiding behaviour" on the ordinate, and "A's law abiding behavior" on the abscissa, it is evident that neither man secures advantage from "lawful" behavior individually and independently of the other man's behavior. (Think of "law abiding" here as "not stealing".) Note that the situation here is quite different from the usual public-goods model in which at least some of the "good" will tend to be produced by one or all of the common or joint consumers even under wholly independent adjustment. With law-abiding as the "good", however, the individual cannot, through his own behaviour, produce so as to increase his own utility. He can do nothing other than provide a "pure" external economy; all benefits accrue to the other parties. Hence, the independent adjustment position involves a corner solution at the origin in our two-person diagram. But gains-from-trade clearly exist in this Hobbesian jungle, despite the absence of unilateral action.

It is easy enough to depict the Pareto region that bounds potential positions of mutual gains by drawing the appropriate indifference contours through the origin as is done in Figure 1. These contours indicate the internal or subjective rates of tradeoff as between *own* and *other* law-abiding. It seems plausible to suggest that the standard convexity properties would apply. The analysis remains largely empty, however, until we know something, or at least postulate something, about the descriptive characteristics of the initial position itself. And the important and relevant point in this respect is that individuals *are not equal*, or at least need not be equal, in such a setting, either in their relative abilities or in their final command over consumables.<sup>3</sup> To assume symmetry among persons here amounts to converting a desired normative state, that of equality among men, into a fallacious positive proposition. (This is, of course, a pervasive error, and one that is not

only made by social philosophers. It has had significant and pernicious effects on judicial thinking in the twentieth century.) If we drop the equality or symmetry assumption, however, we can say something about the relative values or trade-offs as between the relative "haves" and "have-nots" in the Hobbesian or natural adjustment equilibrium. For illustrative purposes here, think of the "natural distribution" in our two-person model as characterized by A's enjoyment of ten units of "good", and B's enjoyment of only two units. Both persons expend effort, a "bad" in generating and in maintaining this natural distribution. It is this effort that can be reduced or eliminated through trade, through agreement on laws or rules of respect for property. In this way, both parties can secure more "goods". The post-trade equilibrium must reflect improvement for both parties over the natural distribution or pretrade outcome. There are prospects for Pareto-efficient or Pareto-superior moves from the initial no-rights position to any one of many possible post-trade or positive-rights distribution.

Let us suppose that agreement is reached; each person agrees to an assignment of property rights and, furthermore, each person agrees to respect such rights as are assigned. Let us suppose, for illustration, that the net distribution of "goods" under the assignment is fifteen units for A and seven units for B. Hence, there is a symmetrical sharing of the total gains-from-trade secured from the assignment of rights. Even under such symmetrical sharing, however, note that the relative position of B has improved more than the relative position of A. In our example, A's income increases by one-half, but B's income increases more than twofold. This suggests that the person who fares relatively worse in the natural distribution may well stand to gain relatively more from an initial assignment of rights than the person who fares relatively better in the pretrade state of the world.

### The Dilemma in Maintaining Contract

Agreement is attained; both parties enjoy more utility than before. But again the prisoner's dilemma setting must be emphasized. Each of the two persons can anticipate gains by successful unilateral default on the agreement. In Figure 1, if E depicts the position of agreement, A can always gain by a

shift to N if this can be accomplished; similarly, B can gain by a shift to M. There may, however, be an asymmetry present in prospective gains from unilateral default for the person who remains relatively less favored in the natural distribution. In one sense, the "vein of ore" that he can mine by departing from the rules through criminal activity is richer than the similar vein would be for the other party. The productivity of criminal effort is likely to be higher for the man who can steal from his rich neighbor than for the man who has only poor neighbors.

This may be illustrated in the matrix of Figure 2, where the initial pretrade or natural distribution is shown in Cell IV, and the post-trade or positive rights distribution is shown in Cell I.

FIGURE 2

		B	
		Abides by "Law"	Observes no "Law"
A	Abides by "Law"	I 15,7	II 6,12
	Observes no "Law"	III 17,3	IV 10,2

Note that, as depicted, the man who is relatively "poor" in the natural equilibrium, person B in the example, stands to gain relatively more by departing unilaterally from Cell I than person A. Person B could, by such a move, increase his quantity of "goods" from seven to twelve, whereas person A could only increase his from fifteen to seventeen. This example suggests that the relatively "rich" person will necessarily be more interested in policing the activities of the "poor" man, as such, than vice versa. This is of course, widely accepted. But the construction and analysis here can be employed for a more complex and difficult issue that has not been treated adequately.

### Dynamics and the Atrophy of Rights

Assume that agreement has been attained; both parties abide by the law; both enjoy the benefits. Time passes. The "rich" man becomes lazy and lethargic. The "poor" man increases his strength. This modifies the natural distribution. Let us say that the natural distribution changes to 6:6. The "rich" man now has an overwhelmingly more significant inter-

est in the maintenance of the legal *status quo* than the "poor" man, who is no longer "poor" in natural ability terms. The initial symmetry in the sharing of gains as between the no-trade and the trade position no longer holds. With the new natural distribution, the "rich" man secures almost all of the net gains.

The example must be made more specific. Assume that the situation is analogous to the one examined by Winston Bush. The initial problem is how is manna which drops from Heaven to be divided among the two persons. The initial natural distribution is in the ratio 10:2 as noted. Recognizing this, along with their own abilities, A and B agree that by assigning rights, they can attain a 15:7 ratio, as noted. Time passes, and B increases in relative strength, but the "goods" are still shared in the 15:7 ratio. The initial set of property rights agreed to on the foundations of the initial natural distribution no longer reflects or mirrors the existing natural distribution. Under these changed conditions, a lapse back into the natural equilibrium will harm B relatively little whereas A will be severely damaged. The "poor" man now has relatively little interest in adherence to law. If this trend continues, and the natural distribution changes further in the direction indicated, the "poor" man may find himself able to secure even net advantages from a lapse back into the Hobbesian jungle.

The model may be described in something like the terms of modern game theory. If the initial natural distribution remains unaltered, the agreed-on assignment of rights possesses qualities like the core in an  $n$ -person game. It is to the advantage of no coalition to depart from this assignment or imputation if the remaining members of the group are willing to enforce or to block the imputation. No coalition can do better on its own, or in this model, in the natural distribution, than it does in the assignment. These core-like properties of the assigned distribution under law may, however, begin to lose dominance features as the potential natural distribution shifts around "underneath" the existing structure of rights, so to speak. The foundations of the existing rights structure may be said to have shifted in the process.

This analysis opens up interesting new implications for net redistribution of wealth and for changes in property rights over time. Observed changes in claims to wealth take place without apparent consent. These may be interpreted simply

as the use of the enforcement power of the State by certain coalitions of persons to break the contract. They are overtly shifting from a Cell I into a Cell II or Cell III outcome in the diagram of Figure 2. It is not, of course, difficult to explain why these coalitions arise. It will always be in the interest of a person, or a group of persons, to depart from the agreed-on assignment of claims or rights, provided that he or they can do so unilaterally and without offsetting reactive behavior on the part of the remaining members of the social group. The quasi equilibrium in Cell I is inherently unstable. The equilibrium does qualify as a position on the core of the game, but we must keep in mind that the core analytics presumes the immediate formation of blocking coalitions. In order fully to explain observed departures from *status quo* we must also explain the behaviour of the absence of the potential blocking coalitions. Why do the remaining members of the community fail to enforce the initial assignment of rights?

### Enforcement Breakdown

The analysis here suggests that if there has been a sufficiently large shift in the underlying natural distribution, the powers of enforcing adherence on the prospective violators of contract may not exist, or, if they exist, these powers may be demonstrably weakened. In our numerical example, B fares almost as well under the new natural distribution as he does in the continuing assignment of legal rights. hence, A has lost almost all of his blocking power; he can scarcely influence B by threats to plunge the community into Hobbesian anarchy, even if A himself should be willing to do so. And it should also be recognized that "willingness" to enforce the contract (the structure of legal rules, the existing set of claims to property) is as important as the objective ability to do so. Even if A should be physically able to enforce B to return to the *status quo ante* after some attempted departure, he may be unwilling to suffer the personal loss that might be required to make his threat of enforcement credible.<sup>4</sup> The law-abiding members of the community may find themselves in a genuine dilemma. They may simply be unable to block the unilateral violation of the social contract.

In this perspective, normative arguments based on "justice" in distribution may signal acquiescence in modification in the

existing structure of claims. Just as the idea of contract, itself, has been used to rationalize existing structure, the idea of "justice" may be used to rationalize coerced departures from contract. In the process those who advance such arguments and those who are convinced may "feel better" while their claims are whittled away. This does, I think, explain much attitudinal behavior toward redistribution policy by specific social groups. Gordon Tullock has, in part, explained the prevailing attitudes of many academicians and intellectuals.<sup>5</sup> The explanation developed here applies more directly to the redistributionist attitudes of the scions of the rich, *e. g.*, the Rockefellers and Kennedys. Joseph Kennedy was less redistributive than his sons; John D. Rockefeller was less redistributive than his grandsons. We do not need to call on the psychologists since our model provides an explanation in the concept of a changing natural distribution. The scions of the wealthy are far less secure in their roles of custodians of wealth than were their forebears. They realize perhaps that their own natural talents simply do not match up, even remotely, to the share of national wealth that they now command. Their apparent passions for the poor may be nothing more than surface reflections of attempts to attain temporary security.

The analysis also suggests that there is a major behavioral difference fostered between the intergenerational transmission of nonhuman and human capital. Within limits, there is an important linkage between human capital and capacity to survive in a natural or Hobbesian environment. There seems to be no such linkage between nonhuman capital and survival in the jungle. From this it follows that the man who possesses human capital is likely to be far less concerned about the "injustice" of his own position, less concerned about temporizing measures designed to shore up apparent leaks in the social system than his counterpart who possesses nonhuman capital. If we postulate that the actual income-asset distribution departs significantly from the proportionate distribution in the underlying and existing natural equilibrium, the system of claims must be acknowledged to be notoriously unstable. The idle rich, possessed of nonhuman capital, will tend to form coalitions with the poor that are designed primarily to ward off retreat toward the Hobbesian jungle. This coalition can take the form of the rich acquiescing in and providing defense for overt criminal activity on the part of the poor, or the more

explicit form of political exploitation of the "silent majority", the constituency that possesses largely human rather than non-human capital.

This description has some empirical content in 1976. But what can the exploited groups do about it? Can the middle classes form a coalition with the rich, especially when the latter are themselves so insecure? Or can they form, instead, another coalition with the poor, accepting a promise of strict adherence to law in exchange for goodies provided by the explicit confiscation of the nonhuman capital of the rich? (Politically, this would take the form of confiscatory inheritance taxation.) The mythology of the American dream probably precludes this route from being taken. The self-made, the *nouveau riche*, seek to provide their children with fortunes that the latter will accept only with guilt.

All of this suggests that a law-abiding imputation becomes increasingly difficult to sustain as its structure departs from what participants conceive to be the natural or Bush-Hobbes imputation, defined in some proportionate sense. If the observed imputation, or set of bounded imputations that are possible under existing legal-constitutional rules, seems to bear no relationship at all to the natural imputation that men accept, breakdown in legal standards is predictable.

### We Start From an Ambiguous "Here"

Where does this leave us in trying to discuss criteria for "improvement" in rules, in assignments of rights, the initial question that was posed in this paper? I have argued that the contractarian or Paretian norm is relevant on the simple principle that "we start from here". But "here", the *status quo*, is the existing set of legal institutions and rules. Hence, how can we possibly distinguish genuine contractual changes in "law" from those which take place under the motivations discussed above? Can we really say which changes are defensible "exchanges" from an existing *status quo* position? This is what I was trying to answer, without full success, in my paper in response to Warren J. Samuels' discussion of the *Miller et al. v. Schoene* case.<sup>6</sup> There I tried to argue that, to the extent that existing rights are held to be subject to continuous redefinition by the State, no one has an incentive to organize and to initiate trades or agreements. This amounts to saying that

once the body politic begins to get overly concerned about the distribution of the pie under existing property-rights assignments and legal rules, once we begin to think either about the personal gains from law-breaking, privately or publicly, or about the disparities between existing imputations and those estimated to be forthcoming under some idealized anarchy, we are necessarily precluding and forestalling the achievement of potential structural changes that might increase the size of the pie for *all*. Too much concern for "justice" acts to insure that "growth" will not take place, and for reasons much more basic than the familiar economic incentives arguments.

In this respect, the early 1970's seemed a century, not a mere decade, away from the early 1960's when, if you recall, the rage was all for growth and the newfound concern about distribution had not yet been invented. At issue here, of course, is the whole conception of the State, or of collective action. I am far less sanguine than I once was concerning the possible acceptance of a reasonably well-defined constitutional-legal framework. If put to it, could any of us accurately describe the real or effective constitution of the United States in 1976? Can we explain much of what we see in terms of continuing change in this effective constitution while we continue to pay lip service to nominal constitutional forms?

The basic structure of property rights is now threatened more seriously than at any period in the two-century history of the United States. In the paper, "The Samaritan's Dilemma," noted above, I advanced the hypothesis that we have witnessed a general loss of strategic courage, brought on in part by economic affluence. As I think more about all this, however, I realize that there is more to it. We may be witnessing the disintegration of our effective constitutional rights, regardless of the prattle about "the constitution" as seen by our judicial tyrants from their own visions of the entrails of their sacrificial beasts. I do not know what might be done about all this, even by those who recognize what is happening. We seem to be left with the question posed at the outset. How do rights re-emerge and come to command respect? How do "laws" emerge that carry with them general respect for their "legitimacy"?

<sup>1</sup> See Gordon Tullock, *The Logic of Law* (New York: Basic Books, 1970); James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962); Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

<sup>2</sup> John Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971).

<sup>3</sup> The formal properties of the "natural distribution" that will emerge under anarchy have been described by Winston Bush in his paper, "Income Distribution in Anarchy" (Virginia Polytechnic Institute and State University, Center for Study of Public Choice Research Paper No. 808231-17, March 1972).

<sup>4</sup> For a more extensive discussion of these points, see my paper, "The Samaritan's Dilemma" in Edmund Phelps (ed.) *Altruism, Morality and Economic Theory* (New York: Russell Sage Foundation, 1975), pp. 71-86.

<sup>5</sup> See Gordon Tullock, "The Charity of the Uncharitable", *Western Economic Journal*, IX (December 1971), 379-91.

<sup>6</sup> See Warren J. Samuels, "Interrelations Between Legal and Economic Processes," *Journal of Law and Economics*, XIV, 2 (October 1971), 435-50, and my, "Politics, Property and the Law," *Journal of Law and Economics* XV (October 1972), 439-452.

<sup>7</sup> William Niskanen offers this as an explanation for public-sector growth. See, his, "The Pathology of Politics," in R. Selden (ed.) *Capitalism and Freedom: Problems and Prospects* (Charlottesville: University Press of Virginia, 1975), pp. 20-35.

FACTS AND VALUES:  
IS THERE A NATURALISTIC FALLACY?

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I. Context

In answer to those philosophers who claim that no relation can be established between ultimate ends or values and the facts of reality, let me stress that the fact that living entities exist and function necessitates the existence of values and of an ultimate value which for any given living entity is its own life. Thus the validation of value judgments is to be achieved by reference to the facts of reality. The fact that a living entity is, determines what it ought to do. So much for the issue of the relation between "is" and "ought".<sup>1</sup>

In making this statement, Ayn Rand has challenged a long established philosophical tradition, a tradition that was started with David Hume<sup>2</sup>, reinforced by Kant<sup>3</sup>, stressed by British Analytic philosophy as the prohibition of arguments from factual premises to normative conclusions<sup>4</sup> (the naturalistic fallacy), promoted by logical positivism as the thesis of emotivism, namely that "pure" normative statements have no "cognitive" but only "emotive" meaning<sup>5</sup>, and adhered to even by an apparent non-conformist like Popper<sup>6</sup> in his "critical dualism of facts and norms". Clearly, the fact that Rand is opposed to the whole tradition of the dominant academic philosophy concerning a fundamental issue of meta-ethics<sup>7</sup> does not show that she is wrong. As it will be clear shortly, I will argue in detail that she is perfectly right. But it is worth stressing that the fact just alluded to explains to a considerable degree the resistance of the bulk of academic philosophers to grant Objectivism a serious consideration. Many of them find it sufficient to claim that Objectivist ethics is "naive" since it commits the "naturalistic fallacy", and to conclude from that

that it deserves no further scrutiny.

Since the issue of the relation between facts and values, or the alternative (equivalent) issue of the existence or non-existence of logical entailment relations between factual statements and so called "normative" statements, has not been discussed in an elaborate manner by either Rand or other Objectivist philosophers, the fundamental disagreement on this matter between Objectivists and most academic philosophers creates a communication barrier. This communication barrier is different in nature from those which arise due to the highly emotional, almost hysterical response of some academic philosophers to "egoism". The latter kind of response indicates that no communication is worthwhile--since a person who does not accept that "emotions are not tools of cognition"<sup>8</sup> cannot be communicated with. But someone who holds that Rand's ethics is mistaken in principle, since it violates what that individual considers to be a logical principle, may be sincerely mistaken. Hence this paper.

## II. Purpose

The purpose of the present paper is to examine the claim that Objectivism commits the "naturalistic fallacy" by reflecting on this alleged fallacy itself, and by analyzing, from the point of view of the philosophy of language, the locutionary function of so called "normative expressions" and "normative statements." While the intellectual framework for the discussion is perfectly consistent with Objectivist epistemology (and can be directly embedded in it), it does not depend on it, academically. Rather, I will use, to a large extent, the philosophy of language of an academic philosopher, Yehoshua Bar-Hillel, I will use, though, only those aspects of his philosophy of language which are consistent with Objectivism.

## III. Inference and Context

Any linguistic act<sup>10</sup>--be that a written or spoken utterance--is always performed in a specific *context*.

This fact may seem perfectly trivial. But it is not. Its importance emerges from the consideration of the following additional points. Any human act, including linguistic acts, is pur-

poseful.<sup>11</sup> The purpose of a linguistic act is to affect a listener in a specific manner.<sup>12</sup>

Any communication process (involving speech acts by both interlocutors) is, therefore, determined by the purposes of both interlocutors, one with respect to the other. The purposes may vary--I may wish to inform you about something, obtain your agreement, make you cooperate with me, or even antagonize you. But whatever are my purposes, if I use language to reach them, I have to communicate some information to you.<sup>13</sup>

Now, whenever I communicate information to you, by means of language, I do *not* state explicitly all of it, by means of fully spelled out formulations. Rather, I rely on the fact that our communication takes place in a specific *context*, in order to make my communication as *short* as possible.<sup>14</sup>

Indeed, if I tell you "I am hungry" I do not provide you a fully explicit message. Who is hungry? When is he hungry? What business of mine is it? You are to answer these questions, usually for yourself, not on the basis of my stated sentence but on the basis of the *context*. The context tells you (by looking at me and identifying me) who is hungry, what time it is (by looking at a watch) and why you are supposed to care (say, because you have just invited me to a swim, and I indicated that a visit to a restaurant beforehand may be advisable).

Thus, the contextuality of language use implies that when a fact of reality is identified by someone via language, the linguistic formulation is not always (rather, usually not) fully explicit. Rather it relies, to a large degree, on the *context*. More specifically, certain locutions (such as "I", "now" and many others) serve to direct the attention of the listener to the relevant contextual features which have to be taken into account in order to complete the reconstruction of the fact you identify.

The fact that certain linguistic locutions are *indexical*--namely that they serve as means of referring to the context as a source of specific kinds of relevant information--is crucial for the understanding of normative formulations. For I will establish later that all so called "normative locutions" are indexical, and hence that whenever one makes a complete, fully explicit paraphrase of sentences expressed by their means, they are eliminated in terms of fully descriptive locutions. But before reaching this point let us observe that

this fact affects very seriously the issue of inference relations between sentences.

#1. I am hungry.

Hence, I am hungry.

#2. Moshe Kroy is hungry at 2 a.m. 28/8/75.

Hence, I am hungry.

At first inspection, you will accept #1 as valid, #2 as invalid. But this is due to lack of sufficient attention. Actually, if the premise of #1 is made before dinner, by John Doe, and its conclusion is uttered after dinner, the argument is no longer valid. On the other hand, if #2 is uttered by me, Moshe Kroy, at 2 a.m. 28/8/75, #2 is perfectly valid. Clearly, under these circumstances, the premise of #1 identifies a different fact from the one identified by its conclusion, while both premise and conclusion of #2 identify the *same* fact.

Thus, the use of indexical expressions (such as "I" and "am" --which refers to state of existence at the present time, the time of utterance, that is) implies that the issue of the validity or invalidity of arguments cannot be decided just by reference to the *sentences* they involve. An argument is valid only if its premises identify the same facts of reality as its conclusion. But the identification of a fact of reality by a use of sentences in utterances is always contextual. Hence, the evaluation of validity or invalidity of arguments stated in English (or any other natural language) requires taking *context* into account.

This fact, in itself, suffices to cast considerable doubt on the position of those who hold the doctrine that "normative statements" cannot be inferred from "descriptive statements". The point is that the demarcation between "normative" and "descriptive" statements is drawn by reference to a *linguistic* criteria. Normative statements are those which involve, in formulation, locutions such as "value", "should", "ought", "permitted", etc., and descriptive statements are those which do not. But since entailment, or non-entailment, depends not on sentences as such but on the *facts* which these sentences serve to identify, and these facts are always identified by sentences in specific *contexts*, it follows that it is impossible to say anything in general about entailment, or non-entailment, between sentences as such, without reference to the specific context in which they are used. Even #1, which seems to be an obvious case of an immediately valid inference, is not always

valid. It is valid only when both premise and conclusion are uttered by the same speaker, and when the speaker did not eat between the act of uttering the premise and the act of uttering the conclusion.

Thus, whoever claims that no argument with factual premises and normative conclusions is valid tries to do the impossible: to make a general claim about inference relations between *sentences*, without taking into account the *contexts* in which they are used. Hence such a position is strongly suspect to begin with, and its advocate is faced with the task of justifying it. As a matter of historical fact, there has not been a single argument in favor of the claim that normative statements do not follow from descriptive statements. This claim has always been maintained dogmatically--as if it were self-evident, which it obviously is not. So even without a detailed analysis of the use of normative expressions, the rather fragmentary discussion of philosophy of language provided thus far invalidates the position of those upholding the naturalistic fallacy to a considerable degree. But only a complete analysis of these expressions will suffice to show it completely wrong.

#### IV. Normative Locutions

Consider dialogue #3.

#3. John: I am very tired.

Mother: You should go to sleep.

This is a perfectly natural, perfectly everyday life kind of dialogue. It exhibits the use of the "normative locution" *should*. What is the context for this use?

The context, clearly, is established in part by John's prior utterance and, also, by a knowledge basis common to both John and Mother. John informs Mother he is tired. Mother assumes she and John *agree* that no one *wants* to be tired. Hence she suggests to him the relevant *means* to achieve his implied end--the end of becoming, once again, fresh and widely awake: sleep.

Observe that John could reply with #4.

#4. I enjoy being tired--and I enjoy it all the more so the more tired I am.

#4 is odd--since it is either a joke, or a reflection of some kind of aberration on the side of John. But it cancels the relevance of Mother's reply. Mother, if she really respects John's individuality, would then reply with something like #5.

#5. So don't go to sleep. Stay awake. Want some strong coffee? (Or, if she is a paternalistic authoritarian, would say #6.)

#6. You should go to sleep all the same since I want that you will be refreshed.

In either case, the purpose of "should" is to indicate a relevant means to some end. The end is usually not specified: it is given (or assumed to be given) by *context*. When the assumed end is explicitly withdrawn, or denied, the "should" statement loses all its force.

Thus, in the context where person A assumes person B to desire the end E, and where A takes M to be a relevant means to E (or better, the best means for achieving E, or sometimes the only means available for bringing about E), A may communicate this assumption to B by saying: "You should do M"--abbreviating thereby the much longer "You want to achieve end E, and M is the only (or best) means to realize E".

The word "should" is then an indexical word. It is used in order to *refer* to a specific feature of contextually shared knowledge: the aim (or aims) of the person to whom one addresses the "should" (who may be oneself).

Accordingly a "should" statement is true provided both the following conditions are satisfied:

- i. The person to whom the "should" statement is addressed *wants* to achieve the end which the speaker assumes that person wants to achieve.
- ii. The action which is recommended by the use of "should" is the only means, or best means, to achieve this end.

Thus one can object to a "should" statement on either of two grounds:

- a. One does not have the aim the other assumes one has.
- b. One knows of better means of achieving it--or has reason to suspect the recommended means to be irrelevant, or even damaging from the point of view of one's own aims.

Observe, moreover, that in view of i. and ii. the following argument is valid, provided that its premises and conclusion are stated by the same speaker, consecutively.

#7. You want to become President of the U.S. The only way to become President of the U.S. is to promise to the voters reduction of taxation and government spending. Hence, you should promise to your voters reduction of taxation and government expenses.

#7, however, violates strictures subscribed to by those who uphold the "naturalistic fallacy" claim. It infers a "should" conclusion from factual premises. Therefore it is invalid according to their doctrine. But obviously it is valid. And the fact of its validity refutes the doctrine.

Now, on what *grounds* can someone ascribe a given goal to another? This issue, of the greatest importance to moral philosophy, is totally irrelevant in the present context. Rand holds that one person can address "shoulds" to another on the basis of the principle of *non-contradiction*, as applied to that person's system of goals. None can consistently hold a goal-system which includes one's own death--since one's death will make the realization of that person's other goals impossible. This, however, has no relevance here, even admitting its truth fully, since what I wish to show is that "should" statements are indexical, that they refer to an assumed goal; I do not aim here to get involved in the moral issue of the grounds on which one is entitled to attribute to another goals (or even to recommend goals to another).

The analysis of "should" statements, however, is not restricted to these particular brand of "normative statements". Consider #8.

#8. John: I have promised Aunt Bertha to visit her today.

Mother: So you ought to go and visit her.

This discussion, when its context is brought fully to light, illuminates the nature of "ought" statements. An "ought" statement is true if it follows a *promise* (or more strongly a contractual commitment). By promising, you make your intention to act in a specific manner (usually desirable from the point of view of your interlocutor) known to your interlocutor. The concept of "ought"--which expresses an *obligation*--is usable in a context of such a promise. Each and every "ought" derives from a promise. To say to A that he ought to

do something is to refer to a past promise he made.

This, in itself, has nothing to do with the Objectivist analysis of the reasons why one *should* keep promises. These reasons, which pertain to one's own life as an ultimate *goal* (one which is required by the principle of non-contradiction) and relate to one's specific nature as a rational animal with a volitional consciousness<sup>15</sup>, point out that keeping promises is a *means* required by this goal. But even if, per impossible, these reasons would not exist, it would still be true that what one ought to do is what one promised to do--simply due to the contextual nature and meaning of the word "ought"--which refers to an act of promising. But such "thought experiments" cannot really be made--they assume something requiring demonstration, namely the analytic-synthetic dichotomy.<sup>16</sup>

Consider now #9.

#9. John: Mr. X tried to kill me, pretending that he was my defender.

George: It is totally permissible for you to take severe retaliatory actions against Mr. X.

Clearly, the "permissible" here is, as the "should" and "ought" before, contextual. It means, when explicitly elaborated, that the action considered is consistent with the totality of John's goals (values). Thus you can oppose a "permissibility" claim by indicating a goal of yours which will be violated by carrying out the "permissible" action. But in any case, the issue is factual. Both "permissible" and "ought", just as "should", refute the doctrine of the naturalistic fallacy. It is not fallacious to argue as in either 10 or in 11:

#10. I promised John to visit him today.

Hence, I ought to visit him today.

#11. I do not mind whether the cat will live or not.

Hence, it is permissible for me to kill the cat, provided I have nothing better to do.

Both #10 and #11 commit the "naturalistic fallacy". Their validity shows, therefore, that it is not a fallacy.

Consider, finally, the most important word--that of *value*.

#12. A good car is a great value.

Under what conditions can #12 be asserted to true? Clearly, when the person to whom you talk is assumed to wish to be

capable of easy, convenient, and swift locomotion, and that it is very important for his further aims to possess one. Thus, the concept of *value* serves as an indexical concept to refer to what a person *wants*. The preference of one value over another is the preference of one wish or desire over another. The objectivity of the Objectivist ethics follows from the fact that it managed to formulate consistency criteria to demarcate consistent from inconsistent value systems. But this success depends on the previous realization that a *value* is what somebody wants to achieve and/or maintain.<sup>17</sup>

So, sentences formulated by means of locutions such as "should", "ought", "permitted", "value" identify facts. They differ from more straightforward "factual" formulations only in the fact that they involve *indexical expressions*--expressions which refer directly to the context of communication: to the purposes of one's interlocuter, to that person's prior actions, etc. But this difference is not fundamental: any sentence which involves personal pronouns, tenses, etc., presupposes context in the same fashion, and to the same degree. Consequently, the truth or falsity of "normative" formulations, as that of any other formulation, depends on nothing else but the facts. Specifically on the fact that human beings act for a purpose, and that their actions are directed by their knowledge of the means required by the achievement of given purposes--and on the additional fact that one cannot act in order to achieve inconsistent goals and be successful, since contradictions do not exist.<sup>18</sup>

## V. Summary

Academic philosophers, by and large, hold the principle that "ought" statements do not follow from "is" statements. They label inferences from "descriptive premises" to "normative conclusions" cases of the "naturalistic fallacy".

This conception follows from ignoring the fact that entailment relations never hold between sentences as such but between sentences as used in specific contexts--in virtue of the fact that all use of language is contextual.

Therefore, it is impossible to state either principles of inference or principles of non-inference by reference to the linguistic structure of sentences alone.

Moreover, all "normative locutions"--specifically "should", "ought", "permissible" and "value"--here examined (the rest being left as an exercise readers might want to carry out) were found to be *indexical expressions*. They all serve to direct the attention of the hearer to some contextual information--which completes the information explicitly contained in the sentence--in order to identify the fact to which the utterance of the sentence refers.

So, the only way in which one can use rationally normative locutions (namely, either assert statements by means of them or deny statements thus asserted) is by pointing out relevant *facts*. It is not only permissible to derive "ought" from "is". There is no other way.

<sup>1</sup> Ayn Rand, *The Virtue of Selfishness* (New York: Signet, 1964), p. 17.

<sup>2</sup> The usual source given by historians of philosophy is David Hume, *A Treatise of Human Nature* (Garden City, N. Y.: Dolphin Books, 1961), p. 423. For one specific reference to Hume as the source of this tradition see J. Hintikka, *Models for Modalities* (Dordrecht, Holland: D. Reidel, 1969), p. 212

<sup>3</sup> This in Kant is reflected in his stress that "theoretical reason" and "practical reason" are totally separate, and in his stress that apart from "hypothetical imperatives" which are means-end imperatives, there is a "categorical imperative" which states a "should" which has no ulterior purpose, as well as in his metaphysical separation of reality into two worlds: seen but unreal (phenomena) and unseen but real (noumena), where facts concern phenomena but imperatives concern man as a "noumena" since they assume that man is free while as a phenomena he is "obviously" deterministic. Cf., I. Kant, *Critique of Practical Reason* (Indianapolis, Ind.: Liberal Arts Press, 1956), *Groundwork of the Metaphysics of Morals* (New York: Harper Torchbooks, 1964).

<sup>4</sup> Cf., A. C. Graham, *The Problem of Value* (London: Hutchison University Press, 1961), especially pp. 15-19.

<sup>5</sup> Cf., Charles L. Stevenson, "The Emotive Meaning of Ethical Terms" in A. J. Ayer (ed.) *Logical Positivism* (New York: The Free Press, 1959), pp. 264-281.

<sup>6</sup> Karl Popper, *The Open Society and its Enemies* (London: Routledge & Kegan Paul, 1945), Vol. I, pp. 60-61, 234-5, Chapter 5, Sec. III, *passim*.

<sup>7</sup> The term "meta-ethics" usually refers to the study of the meaning, function, and logical relations of ethical statements--as against the study of actual principles of ethics. Objectivism does not accept this dichotomy (which reflects the analytic-synthetic dichotomy, actually, although I will not here demonstrate this). I make use of the term since academic philosophers by and large assume that meta-ethics precedes ethics and the Objectivism is to be ruled out on preliminary, "meta-ethical" grounds.

<sup>8</sup> Ayn Rand, *For the New Intellectual* (New York: Signet, 1961), p. 55.

<sup>9</sup> Y. Bar-Hillel, *Aspects of Language* (Jerusalem: Magnes press, 1970), esp., Chapters 5, 7, 10, 16, 17, 21, 24, and 32, and my "Bar-Hillel, Generative Semantics and Generative Pragmatics" *Logique et Analyse*, 65-66 (1974), p.

3-60. I no longer fully adhere to the views expressed in this paper, having written it prior to my understanding of Objectivism.

<sup>10</sup>The term "linguistic act" or "speech act" is from the J. L. Austin tradition and has been stressed particularly by J. Searle in "What is a Speech Act?" in J. Searle (ed.) *The Philosophy of Language* (New York: Oxford University Press, 1971), Chapter III.

<sup>11</sup>This obviously excludes pure reflex action which is irrelevant here.

<sup>12</sup>Cf., H. P. Grice, "Meaning" in D. D. Steinberg & L. A. Jakobovits (eds.) *Semantics* (Cambridge: Cambridge University Press, 1971), pp. 53-60.

<sup>13</sup>Cf., my "Logic, Language and Formalization" *Logique et Analyze* 67-68 (1974). Again, I no longer adhere to most of the points made in this paper.

<sup>14</sup>Cf., note 13.

<sup>15</sup>Cf., Ayn Rand, *Atlas Shrugged* (New York: Signet, 1957), p. 939.

<sup>16</sup>For a discussion of the invalidity of this philosophical idea see Leonard Peikoff, "The Analytic-Synthetic Dichotomy" *The Objectivist* Vol. 6 (1967), Nos. 5-9.

<sup>17</sup>Op. cit., Rand, *The Virtue of Selfishness*, Chapter 1.

<sup>18</sup>Op. cit., Rand, *Atlas Shrugged*, p. 315.



## GOVERNMENT AND THE GOVERNED

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*Law reveals itself as something self-contradictory. On the one hand, it claims to be something essentially good or noble: it is the law that saves the cities and everything else. On the other hand, the law presents itself as the common opinion or decision of the city, i.e., of the multitude of citizens. As such it is by no means essentially good or noble. It may very well be the work of folly and baseness. There is certainly no reason to assume that the makers of laws are as a rule wiser than "you and I"; why, then, should "you and I" submit to their decisions? The mere fact that the same laws which were solemnly enacted by the city are repealed by the same city with equal solemnity would seem to show the doubtful character of the wisdom that went into their making. The question, then, is whether the claim of the law to be something good or noble can be simply dismissed as altogether unfounded or whether it contains an element of truth. (Leo Strauss, *Natural Right and History*, p. 101.)*

There is a group of men and women on the political scene today who are generally characterized as a group which believes in a more or less absolute adherence to human rights and (perhaps therefore) to liberty. Our purpose here will not be to spell out the meaning of "rights" or "liberty" but merely to begin by assuming that whatever such terms mean these two concepts constitute the basic *political* ends for this group of political thinkers.<sup>1</sup> Those who adhere to this position and who believe in the necessity of government (some do not) found their political science in the concept of a "limited government". It is with this political science that we shall presently be concerned.

In the following consideration we shall seek to indicate reasons for the following two positions:

I. That a position which dictates absolute adherence to human rights, liberty, and limited government is not inherently committed to any particular form of limited government. A commitment to a "limited government" means a commitment to a government whose powers are enumerated and in which such enumeration is consistent with or seeks to secure human rights and which does not violate these rights. This meaning of government, however, does not dictate any particular form of government.

II. That it is not inconsistent with a position seeking to secure complete social liberty by the maintenance of human rights to argue that men need, in some sense, to be governed where being governed means something distinct from having an institution which merely establishes rights, judges violations of rights, and in which the citizens enjoy rights.

To my knowledge, this new group of political thinkers (some of whom call themselves "libertarians") have never taken up a principled discussion of questions dictated by the nature of the discipline of political science.<sup>2</sup> This is a serious defect in their position, but it is probably a defect which stems from a general confusion about the nature of government and of political science.<sup>3</sup> Thus, part of our purpose here is to offer some indication as to what some of the issues are which might have been ignored with respect to the purpose, nature and functioning of government.

In indicating reasons for the validity of the two positions above, we shall be utilizing a somewhat unorthodox methodology. Instead of directly arguing for the two positions we shall provide a summary of a debate by a certain group of men who argued about government. We shall conclude by indicating what in the summarized debate of these men points to the validity of our two positions. The debate we shall be summarizing (on some issues only) was the debate carried on by our Founding Fathers in the constitutional convention and with the Anti-federalists.<sup>4</sup> Even though the debate took place in the past, the interpretation of that debate to be offered here is abstracted to such a level that one might view the issues discussed in the debate in an a-historical way. In other words, the purpose of summarizing the debate at all is to at least implicitly claim that the kinds of questions the Founding Fathers raised are the kinds of questions we must also raise when thinking about government. I believe the constitutional debate indicates the kind of dialectic which ought to be

engaged in when considering questions of the form of government. In our discussion below we shall assume (as is largely conceded) that, like the libertarians of today, the prime purpose or end of those libertarians of the past (the Founding Fathers) was to secure rights and promote liberty.<sup>5</sup>

## I

During the constitutional debates the dialogue among the Founding Fathers centered around the three branches of the government they were designing. We shall thus begin by discussing some relevant issues which were raised in connection with each branch.

The first branch with which we shall be concerned is the legislative branch. There were basically two key questions which concerned the founders in this area: 1.) how democratic should the legislature be, and 2.) as a corollary, what should the mode of representation be like.

Numerous views were expressed on both of these points. James Wilson, for example, takes a general position which is indicative of the kind of view a large state representative might have and which is also indicative of a more democratic bias as opposed to a more aristocratic position. Wilson makes these three points: 1.) at least part of the legislature should be immediately grounded in the people, 2.) government ought to rise to a fairly high peak, and 3.) popular election is the best way to reduce the influence of the states.<sup>6</sup> The small states, of course, were for having the states determine who the representatives were and in such a manner that the large states would not have an advantage over them. Thus the Virginia Plan, which opted for proportional representation, was being combatted by small states who recognized that this form of representation would give the large states a majority in Congress.

Yet the issue which concerns us here is not the large state/small state controversy as such but rather the meaning behind the various forms of representation. The Virginia Plan, for example, proposed two houses the first of which was to be elected by the people and the second to be elected by the first. Those who wanted the first house elected by the people felt it was necessary in order to give the government durability.

Without concurrence in and respect for government by the people, durability could not be maintained.<sup>7</sup> On the other hand, there were those like Gerry who feared the excesses of democracy and thought the people easily duped by "pretended patriots".<sup>8</sup> More aristocratic measures were thus needed. There were still others who felt that at least the lower house should be very close and representative of the whole people. Despite these differences, most eventually did agree that the first house should be popularly elected. The house of representatives, the, became a largely democratic body, 1.) for reasons of durability, and 2.) because it was felt that the government's purpose was to serve the people. The Founding Fathers felt that the people must certainly have some assurance that their rights and liberty will not be abused by those in power which could only be secured by a democratic branch of the legislature.

Yet, the debate over how democratic the house should be continued when the question of tenure of the office holder was taken up. Some felt that the term should be only one year and reasoned that if this were not the case then the representatives would be too far removed from the people. Others wanted longer terms because they feared that if the representatives were too close to the people they would be subject to the passions of the people and lose their ability for detached and objective judgement.<sup>9</sup> Without detachment of some sort the mere will of the people could be exerted to the detriment of the country and ultimately to liberty itself. A two year term was finally settled upon as a mean between these two views and in order to incorporate the validity of both views.

The debate over the extent to which democratic principle should be employed became particularly acute with respect to the senate. Randolph felt that the senate must be exempt from the "passionate proceedings to which numerous assemblies are liable". He sums up his position by saying:

... The general object was to provide a cure for the evils under which the U.S. labored; that in tracing these evils to their origins every man had found it in the turbulence and follies of democracy: that some check therefore was to be sought against this tendency of our Governments; and that a good Senate seemed most likely to answer the purpose.<sup>10</sup>

But Randolph's plan (the Virginia Plan) called for having the senate elected by the house. As such it was recognized by

Mason and Sherman that this second branch would be dependent on the first and thus no real check at all.<sup>11</sup> It is clear from reading the debates that while there were disagreements as to how to secure the senate's independence, most did agree that the senate should be a body which would check the excesses of democracy.

Checking the excesses of democracy was not merely a matter of making the senate an independent body but also the Founding Fathers were concerned with the kind of men that were to compose the senate. There were roughly two views on this matter which might be termed the Madisonian view and the Aristocratic view. The latter view held that in order to check the excesses of democracy (specifically with regard to a violation of property rights by the poor) what was needed in the senate were men of merit and property because such men would have an inherent interest in checking the popular passion of envy. The way to secure this would be by long terms and election of senators by other than popular means, i.e., means likely to assure that such men would get in office. The Madisonian view is somewhat different.<sup>12</sup> Madison argues that as the country grows there will be competition for limited resources and thereby factions. The problem of republican government is that the poor can rather easily gain political power and with a majority use it to thwart rights (again primarily property rights). Madison's solution was basically to utilize large districts rather than small, all of which would be interrelated by a universally applicable system of law. This was Madison's notion of an "extended republic" which generally was in contrast to the more or less localistic attitudes of the time. In the case of the House, large districts would insure that representatives would be elected who are not the pawns of special interests or causes. This would be so because a large district is unlikely to contain a special interest or view and that such a district will contain a cross-section of status and belief. In the case of the senate, an extended republic would insure that whether the senators were elected by the national or state legislatures the outcome is likely to be that men of merit, property, and reputation would be chosen. Only such men have the means and ability to distinguish themselves to a point where they are likely to be considered for senatorial positions.<sup>13</sup> It should be noted, however, that Madison also recognizes the validity of some aspects of the Aristocratic

position but asserts that we cannot *depend* upon a search for virtuous men per se.

In this very brief discussion we have seen that the debates over the legislative branch concerned finding a way in which the best elements of democracy could be instituted while at the same time checking the defects of democracy. As Wilson's second point indicates, it was felt that by raising government to "peaks" the best checks against the excesses of democracy could be established.

Generally the Founding Fathers saw the need for an executive to be threefold: 1.) to have some focal point of responsibility in executing the laws, 2.) to have a leader of the people, and 3.) to have a symbol of the nation particularly with respect to foreign powers.<sup>14</sup> It was also felt by many of the founders that the executive must be a strong one for two reasons, 1.) in a large republic execution of the laws means that the executive's influence and ability to command respect requires a good deal of power, and 2.) no foreign nation will respect the word or office of a nation which does not have a clearly recognizable and authoritative leader (Hamilton emphasized this position the most).

The first concern of the Founding Fathers was to consider whether an executive was consistent with the "genius of the people", but this question did not detain them long. The basic issue of the debate consisted in answering the question of how close or far away should the executive be from monarchy. Some, such as Sherman, felt that the executive should do no more than carry out the will of the people as expressed by the legislature. Others, like Hamilton, wanted a very strong and independent executive. Most of the Founding Fathers fell somewhere in between the Hamilton and Sherman position though leaned more to the Hamilton side. Yet all feared to some extent the possibility that the office of the executive might be a vehicle to tyranny. Thus Randolph, for example, proposed having a three man executive. However, it was also felt that unity in the executive was necessary for efficiency and responsibility. A three man executive would be subject to disputes and disharmony<sup>15</sup> and was therefore rejected. Most of the discussion on the executive, though, did not center around these questions. Instead, the debates centered around the mode of election of the executive.

In order to secure the right kind of executive, i.e., a man of

merit capable of gaining the confidence of the people, it was felt that the mode of election was important. Some argued that state legislatures should choose the executive while other felt that the national legislature (either house or senate) should do so. Eventually these views were rejected on the grounds that the executive must be a separate branch and not dependent on any other or the states. Another alternative, proposed by Wilson, was to have the executive elected by the people. Yet some argued with Gerry that, "the people are uninformed, and would be misled by a few designing men".<sup>16</sup> The kind of man needed as a leader of the country was a man of the best quality. The people are likely to elect a man who appeals to their passions or are likely to pick the wrong man because of their inability to secure adequate or complete information. Moreover, it was felt that the executive must be free from all political obligations in order that his integrity be assured. None of the methods thus far could really assure this last point.

The above account points to two essential problems the founders were faced with: 1.) since the executive was to be a leader of the people and needed their confidence, his election must in some way be tied to the people, and 2.) but in order to assure integrity in the office of the executive that office must be free from the promotion of demagoguery and the dispensing of political favors stemming from political obligations. The final solution to these problems was the electoral college.<sup>17</sup> We cannot go into all the complexities of the electoral college here. We can, however, point out the following: since each state was independently in charge of selecting the electors to the college, the Founding Fathers brought the executive close to the people without sacrificing the integrity of the office. Moreover, by having the electoral college convene *only* for the purpose of electing the president and by not allowing the electors to be political office holders, the presidency was virtually free of political obligations. And furthermore, by relying on electors rather than the people themselves, it was more likely that men of character would be put in office. In short, the Founding Fathers wanted the institutional symbol of America to be as unsoiled as possible.

There was one other major matter the founders considered in their debate over the executive -- the matter of in some sense combining the executive and judiciary.<sup>18</sup> Balance of pow-

er was a key concern here as was competent law making. Madison felt that the executive was naturally weak in a republic. Indeed, it is almost impossible to make another branch or combination of non-legislative branches as powerful (and therefore a full check to) the legislature. Moreover, Madison thought that by using the judiciary as a kind of council the wisdom of the judges would insure good laws and add weight and respectability to the executive. Separation would be maintained, according to Madison, by enumerating exactly how the executive and judiciary would come together. The opponents of this proposal, such as Gerry and Martin, argued that, 1.) to expand the executive with the judiciary would only weaken judicial strength and reputation, 2.) it seemed to Gerry and Martin that what Madison wanted (i.e., competent law making) could be best accomplished by separation, and 3.) there is no necessary reason to believe that the judge's wisdom is any greater than the legislature's. Martin sums this up well when he states:

A knowledge of mankind . . . cannot be presumed to belong in a higher degree to the Judges than to the Legislature. As to the Constitutionality of laws, that point will come before Judges in their proper official character. In this character they have a negative on the laws. Join them with the Executive in the Revision and they will have a double negative. It is necessary that the Supreme Judiciary should have the confidence of the people. This will soon be lost, if they are employed in the task of remonstrating against popular measures of the Legislature.<sup>19</sup>

As it turned out, the basic Martin/Gerry view was upheld, and it seems to me fortunate that it was. The impartiality and objectivity of the judges would have been much harder to secure if Madison's position had been established. Gerry was right, it seems to me, to fear the making of 'Judges into statesmen'. Furthermore, as Strong puts it, "the power of making ought to be kept distinct from that of expounding, the laws. No maxim was better established. The Judges in exercising the function of expositors might be influenced by the part they had taken, in framing the laws."<sup>20</sup>

Other than the preceding questions concerning the judges, the Founding Fathers spent little time on the Supreme Court relative to the time spent on the other branches.<sup>21</sup> Yet the Supreme Court remains one of the most fascinating and important branches of the United States government. As such, some account of it must be given. In this connection I espec-

ially like Eidelberg's interpretation<sup>22</sup> and that which follows will be an exposition of some of Eidelberg's suggestions.<sup>23</sup>

As we learned in part from the above, the Founding Fathers finally established that there must be a distinction between those who make the laws and those who judge them, i.e., those who make laws ought not to be the final judge of their constitutionality. Another distinction also arises in this context and that is the distinction between rejection of laws because of their constitutionality and rejection because the laws are unwise. Since the first distinction above was maintained, the former part of this last distinction was generally sought. Despite this, it is unlikely, according to Eidelberg, that a plainly unjust law would be instituted because the Court would interpret the constitution in a way which would reject the unjust law.

If the judiciary is not combined with the executive, it will be more difficult for judges to stop the operation of improper laws. Moreover, separation from the executive meant that the court would be relatively the weakest branch of government. This meant that the court would not exercise judicial review without self-restraint, for a constant exercise of judicial review would initiate the wrath of the other branches and/or make each decision the court rendered that much less forceful and significant. Thus, by making the court a fully separate branch of government, the orientation of the court shifted from an emphasis on the exercise of its *will* to the exercise of its *judgement*. In other words, the court was meant to be a body concerned with proper judgement more than anything else.

The Constitution was to be considered the supreme law of the land, i.e., the fundamental law or the law of last resort. Each time the Court expounds the Constitution it confirms the permanent nature of this law and invites us to consider the founder's intentions.<sup>24</sup> Yet how can any group of men be entrusted with the job of reviewing the laws? The basic answer is that the Court has no material power and thus no immediate interests. A decision one way or another on a case is not likely to increase their personal fortune nor give the judges any more actual power than has been enumerated to them. To preserve the Constitution as a permanent body of law is the only theoretical justification for investing the judges with permanent tenure. Moreover, the permanency of the

law, 1.) is not likely to promote judges who want radical changes, and 2.) is likely to promote an attitude in the judges which is concerned for the public interest, i.e., that which fully reflects the truth about the nature of the good for society (as fundamentally dictated by the Constitution) and a discerned judgement as to whether a law maintains that good.

If it seems to some (as myself) that the present Court (or recent history of it) has not lived up to these ideals then this may be attributed to the fact that the Court is often involved in what Eidelberg calls "creative interpretation". This interpretive power is that which most fully influences our lives for better or worse. Yet if one's position toward the Court is that the Court has presently used its interpretive power to the detriment of society, then I would suggest that one look to more cultural influences (e.g., philosophy, or the tenor of dominant ideologies, etc.) than to the removal of the Court's interpretive ability as the corrective measure. Even if it were possible to completely stamp out "creative interpretation", which it is not, it would not be desirable to do so. The Court must be permitted to have enough flexibility to deal effectively with changing implications of rights and social circumstances.<sup>25</sup> Without this interpretive ability the Court would soon degenerate into an archaic body.

In short, my vision of the judicial branch is one which views this branch as the main protectorate of objectivity. It is true that this objectivity is more of a legal than a philosophic nature, but in a world without the philosopher king legal objectivity is normally that which is most desirable and necessary to maintain.

Our summary of the debates of the convention is now complete. In the next section we shall turn to a brief exposition of the debate over the general nature of society and government as expressed in the debate over the ratification of the Constitution between the Anti-federalists and the Federalists.

## II

We now turn to one of the most fascinating and important debates in American history -- the debate between the Federalists and the Anti-federalists. Despite the importance of this debate few people seem to be aware of the general features of

the debate. Yet as Herbert Storing suggests, the Anti-federalists should also be considered as founders for two reasons: 1.) the Federalists won the debate but did not simply win, and 2.) the Constitution is the basis for a continuing debate in American politics and the Anti-federalists were the first participants in the debate. Indeed, as Storing also suggests, much of the later debates in American politics were anticipated by the Anti-federalists. Moreover, one will recognize in what follows that some of the present day attitudes on the nature of government and society were in large part enumerated by the Anti-federalists as were some of our present problems.

Before presenting our summary of the debate a word of caution is in order. The Anti-federalists agreed on absolutely nothing, i.e., there was no one position on which all the Anti-federalists agreed.<sup>26</sup> In fact, some Anti-federalists even voted for the Constitution! However this may be, the Anti-federalists are generally those men of this period who had strong reservations about the Constitution. Furthermore, there are certain points on which many or most agreed. In our discussion below we shall try to focus on these main features.

It is generally conceded that James Madison is the father of the American Constitution. As such, it is often Madison whom the Anti-federalists are attacking. Because of this we shall spend a brief moment on Madison's general philosophy of government (recognizing, of course, that many Federalists were less modern, more aristocratic, or more democratic than Madison).

A basic maxim can be applied to Madison's philosophy of government: 'republican solutions for republican problems'. Generally Madison sought to construct a government which was cognizant of the problems of republicanism but which solved such problems by largely republican measures.

Like most of the Founding Fathers, Madison stressed a balanced government. Yet, unlike most, Madison's vision was more modern. He argued that balanced government, as it was employed in Britain, could not be employed here because there were no well established and traditional classes in America, as in Britain, to balance off. Some men, such as Dickenson, agreed but felt that the major elements of the balance should be the states. Others, like Hamilton and Adams, thought that the balance should center around dichotomies which are inherent in the nature of any society, such as

the rich vs. the poor or merchants vs. landed interests. Madison's position was neither of these; he argued that the balance should be a constitutional one, i.e., that the branches of government set up by the constitution will be balanced off against one another with less emphasis being paid to the balancing of cultural differences or interests.<sup>27</sup>

Governments which have relied on merit or on a balancing of "natural" cultural differences have not worked well in the past. They have a tendency to either "freeze" the classes balanced (i.e., almost institutionalize the views of the particular classes involved such that the government becomes hopelessly divided between the classes) or to degenerate into oligarchy or the rule of the few or into democracy (the rule of the many). In both cases, human rights and liberty tend to fall by the side.

Madison's great and ingenious solution to the problem of fixed and warring classes or the problem of relying simply on men of merit is his notion of the "extended republic". Madison believed that a number of basic republican problems could be solved by an extended republic. In the first place, the danger to rights and liberty comes not so much from the rich as from the poor. As such, the passions of the poor or many must not be allowed to surface to the extent of having rights (especially property rights) abrogated. There are two basic solutions to this problem. The first is to have a fluid, expanding, and commercial society (possible only in an extended republic) whereby the poorer members do not actually suffer from need. On a more general level the question was whether democracy could maintain or secure property at all. This was a question because it was felt that as society grew and resources became scarce those without much property would come to demand that the minority (the rich) not be permitted the absolute right to keep what they have. There were three basic ways to insure a maintenance of property rights: 1.) leave suffrage only to freeholders<sup>28</sup> (which Madison rejected basically on the grounds that freeholders would considerably dwindle as society expanded), 2.) have one branch with property and the other without, and 3.) have one branch represent property and the other everyone. These last two seem most appealing (especially to such men as Hamilton) but Madison remained highly sceptical of the ability of working out such solutions in practice. His proposal was to deal in large districts. In respect

to this problem, large districts would promote men of means because it is most likely that in large districts only men of means will be enough in the public eye to be in a position for office. Since men of means have an interest in remaining men of means it is likely that they will not consent to an erosion of property rights.<sup>29</sup>

More generally, the extended republic was designed to stem the problems which develop from minority vs. majority faction. In an extended republic the will of the minority is not likely to emerge. If it does and the minority does gain control of the government then the minority will have to either proceed in secrecy or by deceiving the people, for if the minority ruled in the open against the majority the majority would eventually rush in and rectify the situation. Yet to rule in secrecy or by deception in a large republic is not likely to be successful in the long run basically because it would be quite difficult to close off all channels of exposure.

The problem of the will of the majority is much more severe. If the will of the majority does take hold of the government it is almost impossible to remove. The extended republic notion is an attempt to combat the problem at its root. In an extended republic, composed of an almost infinite variety of interests and attitudes, it will be quite difficult to get a majority to agree on much of anything that might threaten minority rights. In other words, an extended republic is not likely to give rise to a majority which conceives of itself as a majority. Thus an extended republic is not likely to foster a majority of men and women who are self-conscious about a "majority interest" per se.

Basically, an extended republic is designed to de-class the classes. No class, whether rich or poor, will come into government with a class consciousness, i.e., no governmental office holder will conceive of his duty as being the promotion of his class interests. An extended republic is an attempt to defuse rigidly dichotomous interests which seem to develop in most societies. The idea is still to promote men of merit and property (or whatever characteristic is needed) but, in an extended republic, the promotion is designed to assure that (for example) the only meaning men of property will attach to the notion of property rights is the meaning spelled out in the Constitution.

The Anti-federalists were generally for the notion that the

major part of government ought to be carried on by the states. The reason which they offered is simple: only in small territories can republican government be successful. An extended republic will not promote freedom or respect for the laws but will destroy it. Samuel Bryan in "The Letters of 'Centinel'" sums up the view this way:

If one general government could be instituted and maintained on the principles of freedom, it would not be so competent to attend to the various local concerns and wants, of every participant district, as well as the peculiar governments, who are nearer the scene, and possessed of superior means of information; besides, if the business of the *whole* union is to be managed by one government, there would be no time. Do we not already see, that the inhabitants in a number of larger States. . . are loudly complaining of the inconveniences and disadvantages they are subjected to on this account, and that, to enjoy the comforts of local government they are separating into smaller divisions?<sup>30</sup>

Since a large or extended republic is not close to the people, the Anti-federalists argued that confidence in and voluntary obedience to the laws could not be maintained. And since a large republic cannot secure voluntary obedience to the law because people are not close to it, freedom will be destroyed because a great deal of compulsion will be needed to enforce the laws. The Anti-federalists saw that the Constitution would develop a huge bureaucratic machine in order to enforce these laws. Moreover, the Anti-federalists felt that the only way to secure law enforcement was by utilizing a large military force (which is one reason they feared a standing army). As Richard Henry Lee put it:

There is more reason to believe, that the general government, far removed from the people. . . will be forgot and neglected, and its laws in many cases disregarded, unless a multitude of officers and military force be continuously kept in view, and employed to enforce the execution of the laws, and to make government feared and respected.<sup>31</sup>

The Anti-federalists thought that almost any form of representation was aristocratic and should be avoided. Their position was that the legislative body should merely reflect the people. On the other hand, the Anti-federalists never had a satisfactory response to the question of why there should be representatives at all since no representative body looks exactly like the people. The reply to this was that the representative body instituted by the Constitution was much too aristocratic even granting that some representation was needed.

Their solution was to make sure that the representative body contained enough middling type or mediocracies in order to mitigate aristocracy. They also felt that a frequent and continual rotation of office holders was necessary in order to insure that the representatives returned frequently to their localities so that they did not become too far removed from the people.

Basically the Anti-federalists thought that the law and the will of the people should be pretty close to the same thing. If the people and the law do not get along then there will be an end to free government. The Anti-federalists saw the people as public spirited, homogeneous, and self-restraining. Any attempt to enlarge the republic would undermine these basic political virtues. But the Federalists had two rejoinders to this, 1.) we cannot rely on the virtues and good morals of the people or the officials (supposing there are these virtues) to make government work, and 2.) the kind of continuous popular consent the Anti-federalists wanted was dangerous. Popular consent is a great exertion and should be relied upon only infrequently -- an inflamed public was not a tranquil one. Moreover, the passage of time would insure the veneration of the laws, though the Anti-federalists doubted this would happen. The Federalists also argued that what the people really wanted was an effective protection of their rights and not necessarily a government which is close to the people. The Anti-federalists might respond to this view by saying (as implied before) that even if it were granted that the Constitution "more effectively" protects rights, what is required for this protection is far from the best mode of securing a free society. A free society is one where men obey the law more or less voluntarily. Thus even if the Federalists could protect all rights effectively, the police force needed to do this would be so large that, 1.) the danger to freedom would be great, and 2.) people would actually be unfree, even though their rights were protected, because they would only be obeying the law out of fear and not consent.

The Federalist position was that there must be enough power in government to insure that the ends government was set up to secure were actually secured. Thus it is somewhat mistaken to say that the Federalists were for a limited government in the sense of limited powers. Actually the Federalists (at least Madison) were not for limiting the powers of government at all; they were only for limiting the ends of govern-

ment. According to the Federalists, to limit powers in a constitution is, in effect, to put a limit on the ability to secure proper ends which in practice means that such ends will not be secured at all. The Anti-federalists claim, however, that one should always grant power (or the possibility of power) cautiously, that the Constitution grants too much power, and that it is better to grant more power if needed than to set up initially a system whereby power can be easily increased. If the Anti-federalists had a maxim it would be something like, "keep government as poor as possible". In their eyes, the big problem with the Constitution was that it falls between simple and complex government (like Britain) and thus is neither. Since the Constitution has no genuine or natural balancing (only constitutional balancing) and since it is not a simple government, the Constitution utilizes the worst of both the simple and complex worlds--there was no genuine responsibility and no genuine mixture. It is always easier to grant government more powers if need be than to take powers away.

The Anti-federalists had two other basic worries. The first was that they felt the Constitution was founded solely on the pursuit of self-interest. Such a principle could not serve as the foundation for a government, for it would lead or degenerate into luxury, licentiousness, and thereby a lack of concern for virtue by the citizens. This ties into their second worry, i.e., the worry that the Constitution provides no means for civic education or character formation. At least in a small republic the community could oversee what its members were doing and thereby keep them in line with what is right and good. An extended republic cannot do this.

Our examination of this debate has been all too brief, but we must move on. It is hoped that the reader will catch at least a glimpse as to the importance of the above debate and how it in many ways still applies to today. While we have not covered all the issues here (e.g., taxation),<sup>32</sup> suffice it to say that in many important ways the debate still rages. Only by attempting to come to grips with the debate will we be able to come to grips with many of our own present problems.

### III

We have spent a good deal of time in the last two sections on

summarizing some important features of the two related debates. Now we come to the questions of, "why was all that important?" As stated in the beginning of this paper, we shall try to briefly answer this question by indicating how the foregoing discussion applies to the two points with which we began.

The first of the two points stated "that a position which dictates absolute adherence to human rights, liberty, and limited government is not inherently committed to any particular form of limited government". If this view is correct, then one could properly opt for limited monarchy as the best means by which to form a government. However, the position stated above (i.e., the rights and liberty position) normally associates itself with a democratic or republican regime. The argument against limited monarchy by such people is basically of the type that a monarchy, 1.) is very likely to secure for itself too much power, and 2.) that the very nature of a monarchy is counter to the notion stated in the Declaration of Independence that 'all men are created equal'. I am not certain that monarchy is *necessarily* opposed to the principle stated in the Declaration of Independence. However this may be, our concern here is not with the second more theoretical point but rather with the first.

To argue that limited monarchy is most likely to abuse power is to emerge from questions on what the ends of government are to how these ends should be secured. In other words, to argue against monarchy on more less practical grounds is to engage in the type of debate that the Founding Fathers engaged in. Yet to engage in this debate is to be somewhat non-committed as to the particular form of government. If our ends are the same as those of the Founding Fathers (rights and liberty) then there is nothing in particular in the nature of those ends which precludes our entering into the same sorts of considerations as they did. In short, in rejecting monarchy we have said that this means monarchy will not or is not likely to secure the ends desired.

The importance of our foregoing summary of the constitutional debates centers around the truth of the point above. The Founding Fathers were debating about what institutional structure would best secure rights and liberty and why. There are two areas of importance which must be recognized: 1.) much of the debate concerned negative matters, i.e., matters

devoted to a recognition of forms of degeneracy and the solutions for degeneration. For example, the Founding Fathers felt that democracy could degenerate to a level whereby the rights of more well off members of society would be threatened. On the other hand, many were concerned with the degeneracy of the rich whereby government would be used to further the position and status of the rich. These kinds of concerns can, and I believe always will, pose problems for those who seek the maintenance of rights and liberty. To put it more explicitly, to accept a rights and liberty doctrine does not commit one to any position with regard to, for example, the question of whether the executive and judiciary ought to be combined (or whether an executive is needed at all). The beauty of the constitutional debates is that they offer us a first-class example of high level political discourse and thus a means to judge whether those of us who hold similar ends as they, have taken into account all the complexities associated with such ends.

Our second (2) point is that it is not simply enough to suppose that all that is needed for the good society is to have proper laws on the books. The debates over the Constitution show that not only were the Founding Fathers concerned with the establishment of good laws but that they were also concerned with the question as to what institutional structure was likely to secure these good laws over time. Since these men had various attitudes and opinions as to what the best institutional form should be there is *at least* a prima facie case to be made that there are a variety of plausible claims to consider when thinking of the best institutional form. This, then, is what I mean when I say that a position which accepts the ends of rights and liberty is not committed to any particular form of government. The Founding Fathers have indicated not only what kinds of questions might be discussed but also how the debates on such questions might proceed.

This leads us to the second, and less obvious, position with which we began, namely that it is not inconsistent with the rights and liberty position to argue that men need to be governed (where being governed means something distinct from having an institution which merely establishes rights, judges violations of them, and has citizens who enjoy those rights). The Founding Fathers have indicated, and we have stated above, one reason for the plausibility of this claim, i.e., that it

is not enough merely to concern ourselves with putting good laws on the books--we must also be concerned with securing such laws over time. In this context, being governed means having an institutional apparatus which attempts to ward off the passions, or in more modern terms, the attitudes of men which might destroy or severely threaten human rights and liberty. Thus "being governed" does not always have to carry with it the meaning that someone is "telling someone else what to do". What it means is that, like the individual man who resists temptation or stops to think before he acts, some means for filtering the valid from the invalid objections to the present state of things has to be established. The term "government" or "being governed" is a proper term in this context because not all men's expressions or beliefs are permitted to have a political manifestation.

Those contemporary men and women who argue for the rights and liberty position seem to have made two mistakes -- one naive and the other from ignorance. The naive mistake we have already mentioned, i.e., the mistake of supposing that the mere recording of good laws and the maintenance of a police force is enough (simply) to insure that rights and liberty will be secured over time. This mistake stems largely from the second one. There seems to be a general ignorance about or lack of concern for the abrogation of rights and liberty. What *is* recognized is how government threatens our rights or how intellectual doctrines do. Yet throughout man's political history such basic human vices as envy, greed, honor (a mere concern for praise), and the desire for power have had important political manifestations against rights and liberty. Some of these vices seem to be continuously associated with certain political forms. For example, envy and greed seem to be the vices of democracy while honor and power are the vices of the upper classes. A political philosophy which does not at some point concern itself with such issues will not be a convincing and complete doctrine.

On the positive side I am saying that the vices of any political regime must be checked. If we are convinced, as the Founding Fathers were, that republicanism is the best form of government we must construct some means whereby the defects of this form are checked. As we have seen in our summary of the debates, the Founding Fathers differed as to how to go about solving this problem, but at least they recognized

the problem as a problem. Contemporary market anarchists who want law seem to have little recognition of this problem. Since these people believe in no government whatsoever they have no real means by which to filter the various political pressures which will be placed on the law. Since the pressures to change the law for the worse will always be present either the anarchists must adopt some means whereby these pressures are modified and channeled (which means establish a government, i.e., an overriding institution which is more than a mere police force) or they must see their law collapse under continual revolutions. This latter point is likely to be the case because the people and the law will confront one another directly. Without a mediating body (e.g., a government) the changes in the laws are likely to be radical and therefore revolutionary since there would be no way of separating legitimate revisions from illegitimate ones. If, however, some reasonable option for change could be provided in an anarchistic society, those changes would be founded on a merely democratic principle. We have not only seen from our summary of the debates that this principle was questioned and checked by the Founding Fathers but also that such a principle is still open to debate. In other words, it is quite an open question as to whether a society founded solely on the democratic principle can maintain rights and liberty over a long period of time.

The criticisms of the preceding paragraph implicitly house at least two basic questions. The first question is that did the decline of the free-market come as a result of the increased application of the democratic principle to government (e.g., popular election of senators and the president) or by calculating individuals in positions of power acting as individuals? In other words, were changes in the law antithetical to the free-market the result of efforts by populist leaders and sympathizers or mainly the result of power seeking businessmen and/or government officials? Kolko notwithstanding, the assertion that the present day violation of rights and liberty stems largely from the democratization of law is not an implausible claim. If the decline did come this way then the following kind of general problem is raised. Since the market place is a completely democratic phenomenon, the anarchist must show that since the content of law would be determined by the market the market would respond *first* to the maintenance of the law rather than to demands to change it. If this is not the

case and the law was initially good and the changes demanded were bad then how would the market sustain the good law? Would not any completely market institution which could be pointed to as a possible filtering mechanism for the preceding difficulty itself fundamentally depend on the democracy of the market? If so, then at least as a matter of principle, the question as to the relationship between democracy and the law remains. It may just be that the peoples' relationship to the law and to a commodity require rather different sorts of institutions. It would seem that this kind of possibility is not open to the anarchists.

There are two ways out of the preceding problem. One is to argue that the market place is not as democratic as we have supposed. However, this is an unlikely alternative since free-market advocates have long argued that the market as a social mechanism is as completely responsive to demand (whatever those demands are) as is humanly possible. The second alternative might be the general result of the second side of our previous question (i.e., the side which claimed that the decline of the market was mainly the result of power seeking individuals acting *qua* individuals). Here the claim would have to be that democracy does nothing to threaten rights and liberty in terms of altering the law in this rights and liberty threatening way. This must be the claim since any admission that democracy might be detrimental to rights would in principle involve the problem of the preceding paragraph. In other words, a non-democratic means would have to be employed to check the democratic, which means that not every demand or combination of demands would be allowed to directly influence the law. I shall not argue that this second alternative is mistaken but shall only say that our summary of the debates of the Founding Fathers gives reason to question it.

The second basic question is simpler but more fundamental. This question is the following: is the market a generic or derivative feature of social interaction. In other words, does the operation of the market depend on the establishment of certain kinds of legal precepts or is the market more or less intrinsically endowed with its own self-enforcing laws such that once government is removed a free-market mode of social interaction *necessarily* develops (the generic claim)? I believe that the market anarchists consider (and probably must consider) the market to be generic. However, this question is

much too complex in all its implications to go into here. While the Founding Fathers had no fully conceptual understanding of the free-market, I think it is safe to say that they would have held that the market structure is derivative, i.e., that the law and the market are rather different kinds of things and that the market would necessarily depend upon the law as a foundation in order for it (the market) to operate. To say that the founders might have felt that the market was in some sense derivative is not to say that they would be right. Nonetheless, whoever is right the question remains as one to be answered by both sides.

The present day limited governmentalsists are similar to the anarchists. They have accepted the anarchists' claim that the only proper function of "government" is to be a defense agency. Thus they have ignored one important aspect of government that the Founding Fathers were trying to teach us, namely, that it is not enough merely to enforce rights and arrest violators. Included in a government must be some means for filtering or halting various claims. Our summary of the debates has shown the various means by which such filtering might be done. Fortunately, I do not believe that those who have argued for the limited government equals defense agency view have necessarily precluded this piece of wisdom of the other aspect of government which the Founding Fathers gave us. In other words, at least the limited governmentalsists have an apparatus whereby the other aspect of government can be incorporated. This is not the case with the anarchists. In more explicit terms, since there must always be some means for amending the present body of law there must also be a means for trying to assure that the amendments are in accord with the nature of the most fundamental law (rights). The elaborate governmental structure of the Founding Fathers was designed to insure just this point.

To say that men must be governed in the sense of having an institution which weeds out various political claims is not to take a position which is inconsistent with the rights and liberty view. The reason why such a position is not inconsistent is quite simple: to establish a government whereby the house has elections every two years, or where the senate is elected by the house, or where the judiciary has no material power is not to violate anyone's rights. No one's rights are violated whether the tenure of the house be one month or fif-

teen years. Moreover, there is nothing inherent in an argument for a more democratic or aristocratic government which constitutes a rights violation. As such, the claim of the second position of this paper seems plausible.

In this paper we have tried to indicate some reasons for considering the two positions with which we began. We did so by first summarizing the debates of the constitutional convention and the Anti-federalist/Federalist debate. We also tried, in this last section, to indicate the significance of these debates. Some questions have not been touched upon, such as what legitimizes authority. Yet it is hoped that the foregoing discussion has provided a means whereby serious men may sit down, much as the Founding Fathers did, and debate the basic questions. It must be emphasized again that we have not set out in this paper to prove a particular point about what the right form of government should be or even whether we should have a government. Instead we have tried to set down some considerations regarding where the foundations of the important political questions may lie. It is not enough to begin debating about what is right and wrong in political matters; we must first have some idea of *where* to begin.

<sup>1</sup>There may be higher ends than liberty and rights outside the strictly political sphere.

<sup>2</sup>The archy/anarchy debate of recent times comes closest to this kind of discussion but is rather unhelpful. The anarchists, of course, argue for no government, but when the archists argue for government they never specify what that government should look like nor how government is supposed to go about fulfilling its functions.

<sup>3</sup>I am speaking of political science in the old sense, i.e., a science concerned with principled arguments about what the relationship between the government and the people should look like.

<sup>4</sup>We shall be ignoring completely the complex question of how to interpret the debate of the Founding Fathers. For a good discussion of the various positions, c.f., Jack P. Green, *The Reinterpretation of the American Revolution 1763-1789*, Harper and Row paper, pp. 2-45.

<sup>5</sup>I owe my interpretation and generally most of my knowledge about the debates to Professor Herbert Storing of the Department of Political Science at the University of Chicago. The following should not, however, be necessarily regarded as Storing's view of the proceedings.

<sup>6</sup>Max Farrand, *The Records of the Federal Convention of 1787*, Yale University Press, paper, 1966, Vol. I., May 31. All notes unless otherwise stated will refer to Farrand's edition and will state the volume and the date and shall refer to Madison's notes.

<sup>7</sup>C.f., Paul Eidelberg, *The Philosophy of the American Constitution*, Free

Press 1968, p. 60.

<sup>8</sup>Vol. I, May 31.

<sup>9</sup>C. f., Eidelberg, *op. cit.*, p. 6.

<sup>10</sup>Vol. I, May 31.

<sup>11</sup>Eidelberg, *op. cit.*, p. 79.

<sup>12</sup>This does not mean that Madison would reject the means just mentioned but only that they are not the only means.

<sup>13</sup>E.g., c.f., Vol. i, June 6, Madison's position. Also note the implications of Dickenson's view of the same day.

<sup>14</sup>For a discussion of many of the aspects of the debate over the executive see Vol. II, July 17-21.

<sup>15</sup>C.f., *Federalist Papers* #70 for a discussion of unity in the executive.

<sup>16</sup>Vol. II, July 19.

<sup>17</sup>C.f., Eidelberg, *op. cit.*, Ch. 9 for a superb discussion of the quite remarkable character of the electoral college.

<sup>18</sup>Cf., the debates of June 6 (Vol. I) and July 21 (Vol. II).

<sup>19</sup>Vol. II, July 21.

<sup>20</sup>Vol. II, July 21. I take the essential position of Strong, Martin and Gerry on this matter to be a telling objection against the market anarchists who want the maintenance of law and the protection of rights, but also place the legislative, executive, and judicial functions all in the courts.

<sup>21</sup>C.f., June 5, June 15, Vol. I; and July 26, Vol. II.

<sup>22</sup>Eidelberg, *op. cit.*, Ch. 10, pp. 202-246.

<sup>23</sup>One main purpose of Eidelberg's discussion was to argue that the founders really did intend some form of judicial review. We shall not, however, be concerned with that issue here.

<sup>24</sup>Eidelberg argues in this connection, I think rightly, against the Jeffersonian view that every so often the law should be more or less completely revised. Eidelberg points out that such a policy encourages disrespect for the law (a changing law can hardly be regarded as fundamental) and invites the rule of passion or whim (since each changes invokes the desire to mold the new law to one's own vision of how society should be).

<sup>25</sup>For example, the Court may want to apply some notion of property rights to goods normally considered free, e.g., air and water.

<sup>26</sup>There is also not as much coherence on the Federalist side as the *Federalist Papers* might lead one to believe.

<sup>27</sup>This does not mean, however, that certain kinds of men will not be attracted or promoted by certain branches of the government. This will indeed be the case, but Madison did not want to be limited to the particular interests or social outlook of any group of men at any specific time.

<sup>28</sup>E.g., c.f., Vol. II, Aug. 7.

<sup>29</sup>It was generally believed at this time that the best protection of property rights was the maintenance of freehold suffrage. However, Hamilton seems to suggest that freeholders can adequately be replaced by merchants who will be concerned with the maintenance of a healthy commercial society which will benefit all.

<sup>30</sup>Cecelia M. Kenyon, *The Antifederalists*, Bobbs-Merrill Co. 1966, Second printing, "The Letters of 'Centinal'", p. 11.

<sup>31</sup>Kenyon, *ibid.*, Richard Henry Lee, "Letters from the Federal Farmer", p. 214.

<sup>32</sup>E.g., c.f., Kenyon, *ibid.*, "Debates in the Virginia Convention.

THE AUSTRIAN BUSINESS CYCLE THEORY  
AND ITS IMPLICATIONS FOR  
ECONOMIC STABILITY UNDER LAISSEZ FAIRE

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I

It is today almost universally believed that laissez faire capitalism is not the most desirable of social systems. There does exist however a significant minority which takes exception to this view both on economic and moral grounds.

It is not surprising that many members of this minority look to the writings of such prominent advocates of capitalism as Milton Friedman and other economists of the "Chicago" school for a partial economic justification of their views. But perhaps even more than to these economists, they look to the economists of the "Austrian" school for support. Associated with this school are such well known economists as Ludwig von Mises, Friedrich A. Hayek, Lionel Robbins, and Murray N. Rothbard.

The adjective "Austrian" is generally associated with three major contributions to economic theory. First, following the lead of Carl Menger, was the development of the marginal utility analysis and the identification of individual (subjective) valuations as the ultimate source of all economic values. Second was the famous capital theory introduced by Boehm-Bawerk. While these have to some extent been incorporated into the accepted body of economic theory, the third major contribution remains outside of mainstream economic thought;

and the acceptance of its importance most clearly distinguishes present day Austrians from other economists. This contribution is the so-called "monetary overinvestment" theory of the business cycle.

Perhaps of all aspects of economic theory, theory of the nature and causes of business cycles has the most direct import for an evaluation of laissez faire, for it was to the alleged instability of capitalism that the great depression was attributed, providing a justification for the massive and ever expanding government intervention into economic affairs, beginning even before the New Deal and presumably not ending with the wage and price controls of today (1972). Before dismissing the efficacy of laissez faire on economic grounds, one should evaluate the business cycle theory which is offered to counter the arguments of interventionists which today rule supreme. It is towards such an evaluation that this paper aims.

## II

The Austrian theory of the business cycle was first presented by Ludwig von Mises in his book *Theorie des Geldes und der Umlaufsmittel* published in 1912. The second edition (1924) of this book was later (1934) translated into English under the title *The Theory of Money and Credit*. Though only a small portion of this book was devoted to discussion of business cycles, it was not until the publication of *Human Action* in 1949 that a fuller English language exposition was to be had from von Mises.

It is not surprising therefore that despite von Mises' originality, it was through the more accessible writings of Friedrich A. Hayek during the 1930's that most English and American economists became aware of this theory. Hayek's first work on business cycle theory was his *Geldtheorie und Konjunkturtheorie* published in 1929 and later (1933) published in English under the title *Monetary Theory and the Trade Cycle*. But before this translation was published, Hayek had already introduced the theory to the English speaking world with the publication in 1931 of what was to become one of the most controversial books on economic theory of the decade, *Prices and Production*. Despite the controversy surrounding this book, the theory never gained wide acceptance before interest

in the theory was lost in the enthusiasm for Keynes' *General Theory* and the "new" economics. A third book by Hayek, *Profits, Interest, and Investment*, comprised of essays and articles revising and clarifying his version of the theory, was published in 1939, but it failed to arouse the interest accorded to his previous book.

When von Mises' *Human Action* was published in 1949, it received relatively little attention, and as it was a general treatise on economics, the portion devoted to discussion of business cycles received correspondingly less. The same can be said for Murray N. Rothbard's presentation of essentially the same theory in his *Man, Economy, and State*, published in 1962.

Applying the theory to explain the depression of the 1930's are Lionel Robbins' *The Great Depression* (1934) and Rothbard's *America's Great Depression* (1963).

### III

The wide and broad-based fluctuations which the Austrian theory of the business cycle seeks to explain are a relatively recent phenomenon. Before the industrial revolution and the development of sophisticated capital markets, business cycles as we know them today did not occur. Of course severe fluctuations could and did occur, but they generally took the form of crises and dislocations, caused by obvious and identifiable external shocks, and the recoveries therefrom. Typical causes were wars, plagues, famines, and royal expropriations. The boom phase characteristic of modern cycles was notably absent from these earlier fluctuations, or at least if one terms periods of good harvest as booms, then such booms were not necessarily followed by depressed conditions except in a relative sense.

With the advent of the industrial revolution came fluctuations which had no obvious external causes. Fluctuations seemed to arise from within the workings of the economy itself, and their existence cast doubts about the viability of the capitalist system. Booms characterized by widespread optimism, increasing productive activity, and rising employment were followed by periods when the error of the previous optimism was revealed, giving rise to general pessimism, with

output and employment falling. There were however two regular and recurring features of these fluctuations which indicated that, whatever the verdict on the inherent stability of the capitalist system, the fluctuations had a common origin. One was that during booms prices were generally rising or at least not falling to accommodate rising output, and conversely that during depressions prices were generally falling. The other feature was that the effects of the business cycle were much more pronounced in the capital-goods industries than in those industries producing consumer goods.

Implicit in most business cycle theories is that there exists some fundamental source of business error which accounts for these greater fluctuations in the capital-goods industries and is the immediate cause of the business cycle. During the boom, businessmen miscalculate in such a way as to lead to overinvestment and overexpansion in the capital-goods industries, those industries providing new plant and equipment and the raw materials needed for their construction. When the overexpansion of these industries becomes apparent, a crisis and financial panic may ensue accompanied in due time with widespread unemployment, unused resources, and excess capacity particularly concentrated of course in those industries which had previously overexpanded. A painful period of adjustment or nonadjustment follows. What business cycle theories differ on is the nature and source of such widespread business error.

According to the Austrians, the nature of the error is an overestimation of the resources becoming available for investment in new plant and equipment. More precisely, businessmen believe that more resources will be released from the provision for current consumption (i.e., saved), and will thereby become available for the provision for consumption in the future, than actually are released. If this happens, businessmen will find that fewer resources are available for investment in plant and equipment than were expected, and perhaps some investment projects begun in the past will have to be abandoned. In any case those capital-goods industries which had overestimated the investment in plant and equipment will face less demand for their products than they had anticipated.

This situation has been compared to that of a centralized communistic economy where a five year plan calling for mas-

sive industrialization was ordered by the production czars, but is later abandoned because the necessary sacrifices can not be made or are deemed too great a burden. The original plan may have called for the production of power plants, steel mills, and tractor factories while keeping the production of food, clothing, and other consumer goods with existing primitive methods to an absolute minimum. But since the fruits of industrialization would only become available in the distant future, perhaps only after many five year plans, this would involve enormous sacrifices by the populace in the meantime. If the plan was too ambitious, then the industrialization will have to be interrupted, and the energies devoted to the abandoned projects will be lost.<sup>1</sup>

The effects of this sort of miscalculation on the part of production czars would have no parallel in capitalist economies if there were no fundamental source of business miscalculation which affected a large part of the business community.

One possible source of such miscalculation would be a sudden, substantial, and unanticipated decrease in the rate of saving. This would, *ceteris paribus*, decrease the funds available for investment, forcing up interest rates and revealing the error of all calculations assuming a more or less constant rate of saving. Investment activity would have to be curtailed, causing depressed conditions in the capital-goods industries which had anticipated the maintenance of investment. Conceivably this could precipitate a crisis and financial panic leading to a full-fledged depression. The possibility of such a phenomenon under normal circumstances is rather unlikely and historically unimportant, although it may be what one should expect if the end of the world were suddenly to seem imminent, and as a result all saving and provision for the future appeared useless. Of course even if such a shift in the rate of saving were to occur, it could only precipitate half a business cycle without the usual antecedent boom.

A much more important source of miscalculation is a monetary change affecting the loan market, such as a credit expansion accompanied by low interest rates. Such a source as this can not only explain business miscalculation, but can also explain the general movements of prices during the cycle. Easy money and low interest rates stimulate investment in plant and equipment and the expansion of those industries providing these capital goods. However the fact that the in-

creased credit available is created by the banking system and is not supplied by the voluntary savings of income earners sows the seeds of destruction for the boom thus created. The increased investment financed by this "forced" saving first causes the utilization of any previously idle resources. The increased incomes received by the owners of these mobilized resources are then spent largely on consumer goods. Thus when unemployment and excess capacity exist and are general, increased investment and expansion of the capital-goods industries will cause the demand for consumer goods and the output of the consumer-goods industries to increase also. However as the economy approaches full employment of resources, expansion of the capital-goods industries can only take place at the expense of the consumer-goods industries. If credit expansion encourages continued expansion of the capital-goods industries, then the incomes of the owners of the resources bid away from the consumer-goods industries will increase in money terms at the same time the output of consumer goods is being reduced. At this point trouble is unavoidable. The owners of resources will try to use their increased incomes to maintain their consumption at a higher level than the transfer of resources from the consumer-goods industries will permit. This will raise the prices of consumer goods, and the consumer-goods industries will attempt to bid back the resources they had lost. The increased investment and output of the capital-goods industries is now threatened unless enough additional credit is created to keep the capital-goods industries one step ahead of the consumer-goods industries in the bidding for resources. When the credit expansion stops, investment drops and the output of the capital-goods industries can no longer be sold at remunerative prices, forcing production to be cut back and releasing resources faster than they can be absorbed by the consumer-goods industries. The values of those assets which cannot be easily transferred to the production of consumer goods suddenly drop. In the face of falling asset values, an increased desire for liquidity develops and a financial panic may ensue, strengthened of course by any questions raised about the overextension of the banking system. Lack of smooth price adjustment to the now deflationary conditions makes adjustment more difficult, and unemployment of resources may spread even to the consumer-goods industries. This essentially is the business cycle as it is seen

by the Austrian theorists.

#### IV

There are several tools of analysis used by the Austrians which must be introduced before a more detailed presentation of their business cycle theory can be attempted.

One tool of analysis is the analysis of interest rates similar to that originally developed by the Swedish economist, Knut Wicksell. Essential to this analysis is the distinction made between the "natural" or "pure" rate of interest and the net "money" or "market" rate of interest. Natural interest is simply the discount of future goods. This discount results from the fact that people prefer consumption in the present to consumption in the future. The various discounting valuations or time preferences of individuals will be represented in a single discount rate for the economy as a whole, which will equate the present demand for and provision for consumption in the nearer and remoter futures. This single discount rate will determine whether the present structure of production will be geared to the provision for more or less consumption at various dates in the future. The net market rate of interest differs from the structure of gross market rates by the rate premiums charged for the various anticipated risks and for the expected changes in the value of the monetary unit. Individuals seeking out the highest rates of return will tend to push all net interest and also net profit rates to a single rate which in equilibrium will be the natural one.

If the net market rate is below the natural rate, borrowing for investment will be stimulated so as to make investment in real terms greater than voluntary saving, and forced saving is said to occur. This can happen if new money enters the economy through the loan market either by a credit expansion or by the introduction of new money proper. Conversely if the net money rate is above the natural rate, more will be saved than can be profitably invested at that rate, and some real investment opportunities will be thwarted. This can occur if money leaves the economy through the loan market either by the contraction of credit or by the destruction or hoarding of money which previously would have been offered on the loan market.

Some confusion exists about when forced saving or thwarted investment opportunities arising from natural - net market interest rate differentials actually occur. Can, for example, saving be forced or investment thwarted if the economy has adjusted to a given net rate of money entering or leaving through the loan market? This confusion stems from the fact that, in some presentations, natural - net market interest rate equality was defined so as to require equality in money terms of investment and voluntary saving.<sup>2</sup> For our purposes we shall state that no saving is forced, no investment is thwarted, and no natural - net market interest rate differentials exist if the money entering or leaving the economy through the loan market is already anticipated and adjusted for in the actions of the populace.

Another tool used in analyzing the business cycle is the analysis of the structure of production. Production is visualized as divided into many stages with different time dimensions. The earliest stages are those the products of which are to contribute to the production of those consumer goods which will become available in the most distant future of any consumer goods for which any provision is currently being made. The latest stages are those which put the finishing touches on the goods becoming available for current consumption, and the intermediate stages are those intending to contribute to the production of those consumer goods which will become available after those in the latest stages but before those being provided for in the earliest stages. The products of the earlier stages then are temporally further removed from consumption than those of the later stages. Goods produced in the earliest or first stage of any production process are produced only with what the Austrians term "original" means of production or rather only with land and labor. (Land as an original means of production does not mean "pure" land exclusive of all past improvements such as the clearing of land, the digging of mines, and even the construction of roads, buildings, and machines to the extent that such improvements are permanent. To the extent that such improvements have to be maintained or replaced, they retain their capital character. The important thing in the present structure of production is not past history but the present plans and provisions for consumption in the nearer and remoter futures.) Goods produced in the second stage are produced with original means and the

product of the first stage; goods produced in the third stage are produced with original means and the product of the second stage, and so forth. In other words, except for the first stage, the product of every stage is produced with original means of production and the product of the previous stage; and if one traces the origin of any good back to its first stage, the product of every stage is produced ultimately only with original means. The product of a stage might only be a service which renders the product of the previous stage more valuable, or it may be a physical good which by passing through later stages is rendered more valuable. A physical good may eventually be transformed into a consumer good, or it may become a capital good which is consumed in the production process. The consumer good itself of course might only be a service.

Corresponding to different stages of production, in the terminology of the Austrians, are goods of different orders. First order goods are goods ready for current consumption. Second order goods are those used directly in the production of first order goods, third order in the production of second order goods, and so on. First order goods, then, are produced in the last stage of production, and the highest order goods are produced in the first stage of any production process.

At any point in time, the number and forms of the various stages form the structure of production. A hypothetical structure of production representing an economy in equilibrium is illustrated by Diagram #1.<sup>3</sup>

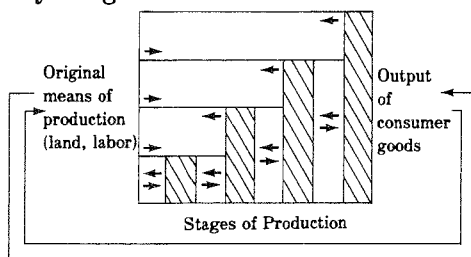


DIAGRAM #1

The diagram shows an economy with four stages of production, the value of each indicated by the shaded areas with the earlier stages on the left. Each stage represents a different industry, and only one consumer good is produced. No loan market exists, and all saving and investment are done by entrepreneurs. Original means of production are applied in the

first stage to the production of goods later to be used by the industry representing the second stage. This industry uses the product previously produced in the first stage in conjunction with original means to produce goods to be used by the industry representing the third stage, and so on until in the fourth stage consumer goods are produced to be used by the owners of original means of production. Money exchanged against goods and services flows in the opposite direction through the stages of production. Revenue from the sale of the consumer good is used to compensate the original means used in the final stage and to purchase the product of the previous stage. The industry representing the previous stage does likewise with its revenue and so on until all revenues accrue as income to the owners of original means of production. The flow of goods and services is indicated by the arrows pointing right and the flow of money exchanged against them is indicated by the arrows pointing left. In this equilibrium situation there exists no net savings or investment, and the output of consumer goods equals the net incomes accruing to the owners of original means.

An example might make the structure of production easier to visualize. Suppose the consumer good is bread, and to simplify matters, suppose also that no maintenance is required for tools and equipment. Then the first stage of production might be the mining of potash to be used as a fertilizer in the growing of wheat. The mine owners will sell their potash to the wheat farmers in the second stage. The wheat farmers will in turn sell their wheat to the millers in the third stage, who will sell their flour to the bakers in the fourth stage, who will sell their bread to the miners, farmers, and millers.

In our structure of production, the value of each successive stage of production is greater than that of the preceding stage not only because of the value added in that stage, but also because its product is discounted less by virtue of its being temporally closer to consumption. According to the Austrians, an economy's rate of discount determines its structure of production. Suppose the entrepreneurs of our economy change their time preferences so as to discount future goods less than they did before. Suppose also that mere stockpiling of consumer goods will not satisfy their increased desires for future consumption. Then the new lower entrepreneurial rate

of discount will mean that the entrepreneurs will now save and invest a larger portion of their incomes so as to be able to increase their consumption in the future. But since resources are presently fully employed, output and consumption cannot be increased in the future with the existing structure and methods of production. Output and consumption can only be increased if a new, more productive structure of production can be adopted. If a more productive structure is available, it will tend to be a longer one involving more and temporally more distant stages of production, both because lower rates of discount permit longer processes of production and because more productive and more capitalistic processes are generally more roundabout and involve more stages. In the absence of technological change, a more productive but shorter structure of production cannot be adopted, for if such a structure were available, it would have been adopted even before the change in time preferences. Let us assume that a longer, more productive structure of production is available, and that it is consistent with the new time preferences. A hypothetical equilibrium structure corresponding to this new lower rate of discount is illustrated by Diagram #2.

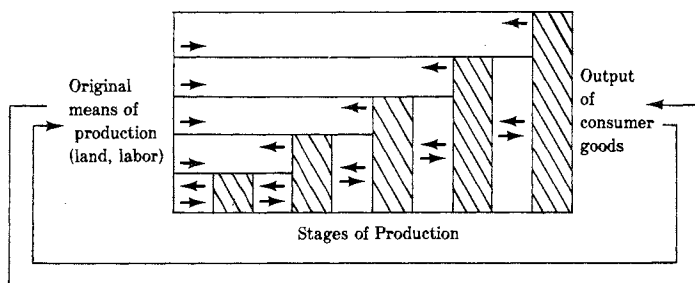


DIAGRAM #2

With the time spans between and within stages assumed to be unchanged, the new longer structure of production is represented by five stages compared to the previous four. The lower rate of discount also means that the interstage price differentials are relatively smaller than previously. The effect of the lower rate of discount then is to make the structure of production longer and, in terms of interstage price differentials, narrower. (In the sense that goods of a higher order are produced, the structure is also higher.) If the total money value of all stages has not changed, then the money value of the earlier and later stages will be more and less res-

pectively. In this case it should be recognized that, although the money value of the output of consumer goods is less than previously, the real output of consumer goods is greater, for otherwise the new structure of production would not have been adopted.

To continue our example of the production of bread. Suppose that the entrepreneurs who change their time preferences see opportunities to invest their increased savings and divert resources into the production of new labor saving farm machinery, and that this involves the creation of two new industries: one constructing the machines and the other mining the metal to make them out of. The resulting greater productivity of the wheat farmers will release the resources needed by the other industries to contribute to the increased output of bread. Of course when the new equilibrium is reached, no net saving or investment again exists, and the production of new farm machines only serves to replace those old ones wearing out. It should be noted that, in the new structure of production, the industry constructing the farm machines occupies the same stage as the industry mining potash because they both sell to the same stage. The only entirely new stage is occupied by the industry mining the metal to be used by the industry constructing the farm machines.

This analysis of the structure of production is meant only as a conceptual aid, and no attempt is made or could be made to classify products, in any sort of cardinal order, according to their stages in the structure of production. The structure of production of any actual economy has many stages with complex interrelationships. For example, the same physical good or service may be used in several stages of a production process or used in different stages of production processes leading ultimately to the creation of different consumer goods, which may themselves require different numbers of stages of various lengths. Salt is used in many different industrial processes as well as on the dinner table. The mining of salt therefore cannot be assigned to any one stage of production. Also any production process could theoretically be divided into a virtually infinite number of minute stages. A modern assembly line is an easily visualized example of goods moving through many stages within a single firm.

Nevertheless, production in many industries or groups of industries may be identified as belonging more or less to earl-

ier or later stages of production. Broadly speaking, the industries representing the earlier stages are industries providing raw materials for other early stages, industries constructing heavy capital equipment and machinery for use in later stages, and industries constructing and maintaining structures to house the manufacturing and management of the various stages. The consumer-goods manufacturing and retailing industries represent the later stages of production, and somewhat earlier are the industries providing the raw materials and lighter equipment which they use.

As may already be apparent, the important distinction between earlier and later stages of production is that their products are not equally distant from consumption and thus their relative values are influenced by time preferences. Another factor determining a good's temporal distance from consumption, besides its order, is its durability. The more durable a good is, the more distant it is from consumption, for the services which any durable good provides are distributed over a relatively long period of time. A durable good is not consumed until its contribution to consumption ceases or rather until it wears out and/or is depreciated to its scrap value. A capital good then might be distant from consumption not only by virtue of its being of a high order, but also by virtue of its being relatively durable.

One last tool of analysis sometimes used is that of the "Ricardo effect" introduced by Hayek. According to this analysis, the change in a firm's profit rates due to changes in selling prices or in prices paid to factors of production will not be unaffected by the firm's capital intensity, or rather by the length of time it takes for the capital invested to turn over. Perhaps this can best be illustrated by a table similar to one used by Hayek.<sup>4</sup>

	Money capital invested for				
	2 years	1 year	6 months	3 months	1 month
Initial amount of profit on each turnover in per cent.	12	6	3	1½	½
	(all corresponding to 6 per cent per annum)				
Add 2 per cent additional profit on each turnover due to rise of price of product.	14	8	5	3½	2½
Resulting profit rate per annum (compound interest neglected).	7	8	10	14	30

A rise in product prices of 2 per cent will, *ceteris paribus*, increase the amount of profit on each sale by 2 per cent irrespective of the length of time it takes for the revenues thus obtained to yield a return on the capital invested. But since the amount of profit on each sale must, *ceteris paribus*, be smaller for enterprises with higher rates of turnover if all enterprises are to receive equivalent per annum rates of profit, an increase in the amount of profit on all sales by an equal amount will increase the per annum rates of profit for enterprises with higher rates, or shorter periods, of turnover more than for enterprises with lower rates, or longer periods, of turnover for the capital invested. This is shown in the table for investments in which capital turns over in different lengths of time. Thus an increase in product prices or conversely a general fall in the prices of factors of production will provide an incentive to shift to processes in which capital invested turns over more rapidly. For a firm this will mean more labor intensive use of existing machinery, and a shift in purchases to cheaper, less durable machinery and to machinery which takes less time and fewer stages to produce. For an economy as a whole, this will mean a shift to a shorter, less capital intensive structure of production. Of course a fall in product prices or a general rise in the prices of factors of production will have the opposite effect of lowering the per annum rates of profit more for enterprises with high rates of turnover, and will, for the economy as a whole, encourage a shift to a longer, more capital intensive structure of production.

#### V

Having presented these tools of analysis, we can now take a closer look at the business cycle of Austrian Theory.

Let us assume an economy in the depths of a depression. Unemployment and unused resources are widespread but are particularly concentrated in those industries encompassing the earlier stages and producing higher order goods, i.e., the capital-goods industries. Furthermore the depression so far has been marked by massive deflation and unprecedented demands for liquidity. But as the depression advanced to its present stage, individuals, firms, and banks became increasingly successful in their attempt to hold money balances, and as their money balances grew and as prices fell, the incentive for continued hoarding tapered off. Thus the contraction of total monetary demand, or of  $MV$  in the notation of the quan-

tity theorists, has finally come to an end. Conditions are now ripe for a revival of trade. As time progresses and nothing triggers a new round of bank runs or some other deflationary phenomenon, confidence that the deflationary panic has finally ended begins to mount. Hoarding will now no longer seem rational, and the dismantling of these hoards, or rather dishoarding, will begin. The previous contraction of total monetary demand will be reversed into an expansion.

If the banking system does not participate in the dishoarding, then the fate of the revival will be somewhat uncertain. If enough adjustment of prices (including wages) had been made during the depression, then the increase in monetary demand resulting from the dishoarding may be such as to permit the employment of all existing unused resources (including labor) with no further general fall in their prices. More likely is that further downward price adjustments will still be necessary, although in extreme cases prices may be so low and accumulated hoards so great that upward price adjustments will be called for. If further downward price adjustments are required and are effectively resisted, the revival will not be completed. But in any case, unless time preferences have changed so as to favor the investment-consumption ratio and the lengthened structure of production of the previous boom, relative price changes and/or movements of resources vis-a-vis the earlier and later stages of production will still be necessary if maximum reemployment of unused resources is to take place. In other words the prices of higher order goods may still have to fall relative to the prices of lower order goods, and resources will have to be transferred away from the industries representing the earlier stages and toward the industries representing the later stages. It may be however that any such movements of prices and resources can be postponed to some extent for the duration of the dishoarding process if those dishoarding spend their accumulated hoards relatively more on investment than the economy as a whole is willing to spend. This is likely to be the case if, as is generally believed, hoarding takes place more at the expense of investment than of consumption.

It is however extremely unlikely that the banking system will remain neutral in the dishoarding process. As the revival gets under way, the reserves of banks will be high relative to the now lower demands for redemption, and the banks will be

encouraged to dishoard, or rather to expand credit. Also the return of confidence in the banks will lead to increased reserves as people and firms redeposit their money and thus further encourage credit expansion. More importantly the government through the central banking authority will probably be encouraging credit expansion by such measures as the lowering of required reserve ratios, lowering rediscount rates, and the purchasing of various obligations, such as government bonds, from the banks. The government may also directly introduce money into the economy so as to lower interest rates and to favor investment by purchasing various obligations from non-bank institutions and from individuals.

Since the credit expansion will almost surely not be adjusted for in the actions and plans of the populace, it will force the net market rate of interest below the natural rate and probably also cause an underestimation of the rate premiums which should be charged to compensate for future changes in the value of money. If there is no realization that a general expansion of credit is really underway or if the effect of a credit expansion on the value of money is not generally understood, the latter possibility may be of no small import. In any case the real rate of return on loans will be reduced below the natural rate and forced saving will occur. Of course underestimation of the risk premiums which would be charged or too liberal rationing of credit may similarly indicate forced saving.

The low interest rates of the credit expansion will attempt to act on the structure of production like a lowering of the natural rate of interest. In other words the low interest rates will stimulate lengthening and narrowing the structure of production as provision for more and more distant future consumption is encouraged.

Some tendency to lengthen the structure of production may have already existed due to the working of the Ricardo effect. Inadequate wage adjustment relative to falling product prices during the panic induced deflation may have produced some encouragement to shift to a longer structure of production, but this would probably have been more than offset by the relatively high interest rates of the depression. (Interest rates may be low absolutely during the depression, but are probably high relative to those needed to maintain the investment and the lengthened structure of production of the previous boom. This may be due to the inadequacy of negative interest rate

premiums adjusting for the rising value of the monetary unit and a panic induced reluctance to incur debt for the purpose of investing in a seemingly highly uncertain future.) As long as widespread unemployment of resources still exists during the recovery, the Ricardo effect will probably still encourage a lengthening of the production structure as there will be little upward pressure on product prices and an easing of downward pressures on wage rates. The rising profit rates characteristic of the recovery will more likely be due to increasing volume than to the rising of prices received from the sale of goods and services relative to the prices paid for those factors used in their production. The Ricardo effect then may work for some time in conjunction with the ensuing credit expansion and low interest rates to lengthen the structure of production.

As the credit expansion gets under way, the increased credit available will be used to finance the holding of larger inventories such as the all-round increase in trade will make desirable and to finance capital improvements of all sorts. Industries in all stages of the structure of production will be encouraged to expand their operations with the use of borrowed funds until their marginal rates of profits approach the now low rates of interest. To accomplish this, industry will begin reemploying idle labor and capital equipment to increase current output and will begin investing in new plant and equipment so as to increase future capacity. Those industries in the earlier stages providing the material, plant, and equipment used in the later stages will be doubly stimulated by the expansion of credit, directly by the low interest rates and indirectly by the increased demand of later stages. The stimulation provided by the low interest rates therefore will have a magnified effect on the earlier stages of the production structure. This magnified stimulation of the earlier stages will produce a tendency to narrow interstage price differentials as the products of earlier stages, or rather the higher order goods, have their prices bid up or at least supported by the increased demand of later stages. The credit expansion will also tend to act on the structure of production in another way, the result of the fact that some new kinds of investment projects previously unprofitable will be made profitable by the low interest rates. The adoption of new processes of production, perhaps leading to the production of new types of producer and consu-

mer goods, will be stimulated, and probably the majority of such processes will tend to be of longer duration or lead to the production of goods temporally more distant from consumption. In this latter respect the Ricardo effect will probably be of some help. This provision for more distant future consumption, through the adoption of longer techniques of production and through the production of more durable goods, will give rise to a more lengthy structure of production involving the use of more and earlier stages of production. In sum then the credit expansion and the resulting low interest rates will stimulate greater investment and will do so in such a way as to encourage a more lengthy and more top heavy (in the sense that relatively more higher order goods are produced) structure of production.

With credit expanding, the pace of the recovery will be substantially quickened. This will not only be because total monetary demand will be increasing at a faster clip, but also because low interest rates will be stimulating relatively more those industries of the earlier stages, where unemployed resources can be mobilized easily and without the discouragement of having to be bid away from alternative uses. But the effect of newly created credit on the economy will not end simply with the mobilizing of idle resources. The owners of the mobilized resources (including laborers) will now have increased incomes at their disposal, and how they dispose of them will of course affect the economy and the course of the revival. Presumably a portion of these incomes will be saved and invested; and to the extent that they are, the credit expansion will create the real savings needed to finance continuation of the investment originally financed by the creation of credit. But no doubt the greater portion of the incomes created by credit expansion will be spent on consumption. The resulting increase in consumption expenditures will stimulate the later stages of production, and as long as continued creation of credit maintains low interest rates and as long as consumption expenditure is expected to be maintained permanently at higher levels, this stimulation will be magnified in its effects as it is relayed back to earlier stages in the form of increased demand for their products. In other words the later stages will again be stimulated to invest in material, plant, and equipment as well as labor for the purpose of increasing both present and future output and will in so doing further

stimulate the earlier stages. This added stimulation of investment and of the earlier stages will create additional demands for borrowable funds and thus will permit additional credit to be created without the disincentive of further lowering interest rates and of perhaps thus increasing awareness of the credit expansion's existence. While the recovery is still relatively young, then, the secondary effects of the credit expansion might only serve to further the expansion of credit and the pace of the recovery.

But as the economic expansion progresses and as the structure of production assumes a shape reminiscent of the previous boom, the supply of still unemployed resources will begin to dwindle, and continued expansion of credit will no longer be able to induce continued expansion of output. Expansion of credit will lead more and more to increases in prices and less and less to increases in output and employment.

If the expansion of credit were to stop and thus halt the development of inflationary pressures, other unpleasant consequences would follow instead. Unless, as is unlikely, time preferences change so as to favor the investment-consumption ratio and the lengthened structure of production which the credit expansion has fostered, the voluntary savings of income earners will be insufficient to maintain them. Still increasing consumption expenditure and higher interest rates resulting from the reduced supply of loanable funds will force a lowering of the investment-consumption ratio and a shortening of the structure of production. But such a change in the structure of production may require substantial frictional unemployment during the transition process as resources would have to be transferred from the earlier to the later stages and as the prices of higher order goods would have to fall relative to those of lower order goods. To avoid this result, the government may go to great lengths to insure that the expansion of credit does not end, let alone force such a development in the interests of avoiding inflation.

Let us assume then that the credit expansion continues unabated. If credit can be created on such a scale as to raise investment to still greater levels and to further lengthen the structure of production, a situation impossible to maintain will soon develop. As resources are now relatively scarce, the increased credit available will have to be used largely to bid

away resources from the consumer-goods industries if investment and the earlier stages are to be expanded. But if this happens, the owners of the transferred resources (especially laborers) will attempt to use their increased incomes to increase consumption while the transfer itself will reduce the available supply of consumer goods. As a result the prices of consumer goods will be bid up even higher than they otherwise would have been, and the consumer-goods industries will be stimulated by higher profit margins to bid back the lost resources. The lengthened structure of production will now become progressively more difficult to maintain, requiring ever increasing amounts of additional credit to keep the earlier stages one step ahead of the later stages in the competition for resources.

But there is another consideration which would indicate that no amount of additional expansion of credit could long even maintain the lengthened structure of production, let alone lengthen it still further. As the owners of resources mobilized by the credit expansion spend their incomes on consumption, the profit margins of the consumer-goods industries will be increasing. However unlike previously when unemployed resources were still widespread, this stimulation of the consumer-goods industries and the later stages will be more diminished than magnified as it is relayed back to the earlier stages. This will be due to the increasing importance of the Ricardo effect. As the prices of consumer goods are bid up relative to factor prices, the Ricardo effect will work more and more to shorten rather than to lengthen the structure of production. This shortening will come as the consumer-goods industries change the mix of products they purchase from the preceding stages. They will now spend more on purchasing materials to increase output in the near future and less on plant and equipment to increase output in the more distant future. Those expenditures for plant and equipment which do take place will tend to be for shorter term capital improvements involving less durable and less complex plant and equipment which can be produced in fewer stages. In sum, increasing consumption expenditure will through the Ricardo effect stimulate more and more just those stages immediately preceding the consumer-goods industries and less and less the economy's earlier stages, and will in so doing shorten the structure of production. If, as we have assumed, the credit expansion is continuing unabated, the consumer-goods industries and the later

stages will be in the best position to obtain the increased funds. But they will no longer use the funds to invest in long term capital improvements and to thus stimulate the earlier stages, but will now use the funds to bid away material and labor from the earlier stages so as to be able to increase the output of consumer goods in the nearest possible future. The continued creation of credit will now actually serve to lower the real investment-consumption ratio as the increased funds will be used to prevent provision for relatively distant future consumption so as to increase provision for current and relatively nearer future consumption. The existence of continued credit expansion, then, cannot circumvent the pressures to shorten the structure of production and to lower the investment-consumption ratio.

One more factor may add to these pressures to shorten the structure of production. As income earners face higher prices for consumption goods, they may spend larger portions of their incomes on maintaining their desired levels of consumption. If they do so, interest rates may be adversely affected as higher net market interest rates and higher rate premiums adjusting for the falling value of money are demanded. Higher interest rates will further hurt long term investment and the earlier stages as the lower supply of credit will be rationed increasingly towards the consumer-goods industries which are being influenced by the Ricardo effect, for only they will be able to afford the higher interest rates.

If the banks try to offset this development by further increasing credit, the likelihood of financial panic will be greatly increased. As the expansion of credit reaches ever greater heights, fears about the ever more precarious reserve positions of the banks will mount, and almost anything may be able to trigger a series of bank runs and thus force the contraction of credit. As the economy approaches full employment, there will be no lack of possible triggers. A rash of corporate bankruptcies in the higher order capital-goods industries, such as the Ricardo effect may cause, might be such a trigger. Or perhaps the dramatic failure of enterprises begun with or heavily dependent upon borrowed funds, enterprises which as factor prices and interest rates are being bid up are unable to raise at profitable rates the additional funds necessary to continue. This latter possibility may be especially important if the credit expansion is already being slowed or halted.

In any case, let us assume that runs on banks do begin. What otherwise would only have been a relatively mild setback due to a structural readjustment of production will now develop into a full-fledged depression. Once begun, the running on banks may mushroom as the early failure of some banks will cause questions to be raised about the ability of the remaining banks to honor their debts. In the face of ensuing and/or threatened runs, banks will be forced to contract credit. This will be done by calling those loans which are on call and by not reloaning as outstanding loans are repayed. As individuals and nonbanking institutions hoard the money they withdraw and as banks are forced to hoard by contracting credit, the net market rate of interest will be forced above the natural rate, further discouraging investment and working to the detriment of the earlier stages. Any further bankruptcies that this and the resulting deflation may cause will encourage a new round of bank runs, and a spiraling deflation may develop. If the lowering of important product or factor prices (e.g., wage rates) is successfully resisted, unemployment will no longer be frictional and may even be extended to the consumer-goods industries. If the deflationary pressures are strong and if they are fiercely resisted, the unemployment of resources it will create may be massive and quite prolonged.

This, in somewhat more detail, is the Austrian theory of the business cycle.

## VI

In 1943 Ludwig von Mises wrote the following:

In the thirty-one years which have passed since the first edition of my *Theory of Money and Credit* was published no tenable argument has been raised against the validity of what is commonly called the "Austrian" theory of the [business] cycle. It was easy to prove that all objections brought forward were either futile or founded on a mistaken interpretation of the doctrine attacked.<sup>5</sup>

It is my belief that the passage of twenty-nine more years has not altered the truth of von Mises' pronouncement. In fact, to my knowledge, no new objections have been brought against the theory during the interim. This is, no doubt, partly due to the decline of interest in business cycle theory after World War II. Since most countries have abandoned the gold standard and taken to insuring bank deposits,

deflationary panics have had little chance of developing and of thus precipitating massive depressions. As a result, the need to explain and find cures for the business cycle no longer seemed as pressing as it once did. Nevertheless, business cycles have continued, even though on a smaller scale, as recent years have amply demonstrated. The need therefore for a proper business cycle theory still exists, especially if present "countercyclical" policies are to be evaluated.

But it is not my intention here to debate the subtleties of this or any other theory of the business cycle. I wish only to stress what I consider the most important contribution of the Austrian theorists in this area. This is the correct identification of monetary disturbances, such as the expansion or contraction of credit, as the *sine qua non* of the business cycle. Various nonmonetary theories have been brought forth to explain the phenomenon of the business cycle. For example, discontinuities in the number and importance of inventions or innovations have been accused of stimulating cyclical swings in investment activity. Likewise, relatively small changes in consumption expenditure have been held to be responsible, through the working of the acceleration principle, for large cyclical changes in investment expenditure. But these and all other nonmonetary theories must, as Austrian theorists have pointed out, logically assume the coexistence of monetary changes with their more explicitly identified "causes".<sup>6</sup> But given this, the superiority of the Austrian theory becomes apparent, for it alone can claim to have identified a cause which is both sufficient and necessary.

## VII

It is evident then that the question of economic stability under *laissez faire* reduces to a question of monetary stability. It is also evident that the question of monetary stability reduces to a question of the existence of credit expansions and contractions, for presumably the cyclical changes in hoarding are largely induced by the fluctuations in confidence which the changes in credit bring about. But since the accepted definitions of *laissez faire* do not specify the nature of the monetary framework, the relevant question becomes this: can a *laissez faire* or free market society be organized so as to prevent the monetary disturbances such as can result from changes in

credit? I will consider two proposals for such an organization offered by Austrian economists as well as third similar to one offered by Milton Friedman.

According to Ludwig von Mises, the government should simply refrain from instigating credit expansions for the purpose of fostering easy money and low interest rates. To tie the hands of government in this vital area, he proposes that central banks be abolished and that a full gold standard be allowed to rule. Without a central bank and the resulting pyramiding of reserves, he argues, a credit expansion would never be able to proceed fast enough to cause any maladjustments in the structure of production. Those banks which attempted to expand credit would soon find that their reserves were being drawn down, and they would move to reverse the situation for fear that otherwise public confidence would be lost and bankruptcy would result.<sup>7</sup>

Another Austrian economist, Murray Rothbard, also recommends the adoption of a full gold standard but with the requirement that all bank deposits be backed 100% by gold. Anything less, he claims, would be fraudulent. This would of course make credit expansion or contraction impossible, and all investment would have to be provided for out of voluntary saving.<sup>8</sup>

Whatever the merits of these two proposals, they share a common defect. There is no provision for increases in the money supply. This would be no problem except that in an expanding economy prices would have to be falling. But with smooth price adjustment even this would be no problem except that gross market rates of interest would have to embody negative interest rate premiums adjusting for the rising value of money. This is the crux of the problem. A strongly negative interest rate premium may attempt to push the gross market rates of interest to zero or below. But it is clearly impossible for it to succeed, as people will not be motivated to lend out money at a rate approaching zero or below. There may develop then a situation where the Pigou effect takes command and forces a lowering of the economy's investment-consumption ratio below that which is desired by the populace. Whether this situation would ever develop is of course an empirical matter, but nevertheless the potential would exist under the conditions proposed by Rothbard and von Mises.

The solution, I think, is something akin to the proposal out-













































































