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Correspondence may be sent to *The Quarterly Journal of Austrian Economics*, Ludwig von Mises Institute, 518 West Magnolia Avenue, Auburn, Alabama 36832.

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ECONOMIC INDULGENCES: OLD AND NEW DEBATES ON WELFARE AND FREEDOM

DAVID COWAN

Henry Hazlitt Memorial Lecture
Austrian Economics Research Conference
Ludwig von Mises Institute
Auburn, Alabama
March 31, 2016

INTRODUCTION

In this lecture, I will look at a debate in the 1960s between Frank Knight, the subject of my new book (2016) in Palgrave Macmillan's *Great Thinkers in Economics* series, and Henry Hazlitt, memorialized by this lecture. I will look at the dispute they had on welfare, freedom and power, which was an important debate then and now. I will take Knight's observations and apply them to today's debate on inequality, and what I suggest are the economic indulgences referenced in my lecture title.

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FRANK KNIGHT

Frank Knight was a curmudgeonly character, who I dare say, in our politically correct and overly-sensitive age, would not last long, and certainly would never make tenure, because as we know tenure means never having to say you're sorry. Knight was not the kind of debater or discussant easily given to flights of fancy or expressing misgivings. I assume at least a passing acquaintance with Frank Knight on the part of this audience, but perhaps a lamentably short intellectual biographical note is in order. Within the economic world today he is chiefly noted for the notion of Knightian uncertainty featured in his first book *Risk, Uncertainty and Profit*, establishing his reputation in the pantheon of economic thinkers on a book that was essentially his Ph.D. thesis. Knight was brought up in a conservatively theological home, which was also a Republican household. His early undergraduate work was actually at evangelical colleges in the neighboring state to this one, he attended colleges in Tennessee. In spite of all this, he grew up to have distaste for much organized religion, though he attended the Unitarian church for much of his life.

Aside from being "kicked out" of Cornell's Philosophy Department and a couple of stints at the State University of Iowa, Knight spent his academic career at the University of Chicago. He inspired an almost cult-like devotion among his students at Chicago, leading his students (which included most notably Milton Friedman, James Buchanan and George Stigler) to say there is no God but Frank Knight is his prophet. Knight was a co-founder of the "Chicago School" of Economics, but he was a teacher more than a theorist or producer of books. It is because Knight was essentially a teacher and a critic that he did not pen the major volumes one might have hoped for. Buchanan, who became a long-time friend and a Nobel Prize winner, notes in the foreword to the 1982 edition of *Freedom and Reform* that Frank Knight was a critic, and apart from *Risk, Uncertainty and Profit* his work "can be interpreted as a series of long book reviews." His work is thus scattered across a host of economic journals in essay form standing on the base of his first and major work *Risk, Uncertainty and Profit*, published in 1921. What ideas he had were stated, restated and then refashioned multiple times in various essays. Hence to synthesize his work, which I have attempted to do in my own book (2016),

means working through the remainder of his writings comprised of essays, lectures and book reviews, the most notable being collected in the single volumes of *The Economic Organization* (1933), *The Ethics of Competition and Other Essays* (1935), *The Economic Order and Religion*, with T.W. Merriam (1945), *Freedom and Reform* (1947), *On the History and Method of Economics* (1956), and lastly *Intelligence and Democratic Action* published in 1960.

Knight himself described his “social function” as one of “exposing fallacies, nonsense and absurdities in what was passed off as sophisticated scientific discourse.” (Knight, 1982 [1947], p. xi) His relevance as a great economic thinker for us today, apart from Knightian uncertainty and his status as a founding father of the Chicago School, can be stated in a threefold sense. First, he is arguably one of the most interdisciplinary of economists, and thus provides a basis on which thinkers can discuss economic issues from their own disciplines. Second, he raised issues that are prevalent in the latest stages of capitalism, and the issues we currently face and will continue to face in the future. Lastly, he was an economic realist who knew the weaknesses and strengths of capitalism, so while remaining a supporter of capitalism as the best system, he also addressed the limitations and difficulties thrown up by this imperfect way of organizing our economic affairs without overthrowing what he saw as an ultimately workable system. In pursuing this agenda, Knight found himself in a number of fights, specifically with Keynes and the Austrians, with protracted arguments in the 1930s with Friedrich Hayek. In many respects I would typify these not as full scale arguments, but instead boundary disputes, somewhat akin to members of the same club or union fighting over the rules of association. Which brings me to the boundary dispute that is the subject of this lecture, the one between Knight and Henry Hazlitt.

KNIGHT ON HAZLITT, APRIL 1966

The journalist Hazlitt and the academic Knight had a short but fractious relationship in print, which started from the lecture podium at Mont Pelerin and was waged via the pages of the journal *Ethics*. For his part, Hazlitt thought Knight’s attack on him was one quite unprovoked on his side. Having initially fired

a salvo or two at Hazlitt from the podium, Knight committed his more sustained attack to print in an essay published in April 1966, entitled "Abstract Economics as Absolute Ethics." In the essay, he offered a critique of Hazlitt's book *The Foundations of Morality* (1964). Knight refers to the work as a polemic, at the heart of which lie two chapters entitled "The Ethics of Capitalism" and "The Ethics of Socialism."

Knight started out by stating that Hazlitt's book demonstrated good workmanship and the makings of a good treatise on socio-political ethics. A kind of condescending "could do better" is the tenor of his remarks. This is because he surmised that Hazlitt's work contained many of the faults he believed that defenders of capitalism tend to have, namely that it was the kind of oversimplified, extremist propaganda that ignored changing theory and practice. Hence, he wrote, Hazlitt's work failed to deal with the complexity of modern society and defeated the purpose of the argument.

Knight outlines the content of the chapters as they apply to ethical rules, and turns to the question of justice, which he says is settled for Hazlitt by John Bates Clark's argument in his 1899 book *The Distribution of Wealth*, with its thesis "that 'Free competition tends to give to labor what labor creates, to capitalists what capital creates, and to the entrepreneur what the coordinating function creates.... [It tends] to give each producer the amount of wealth that he specifically brings into existence.'" This argument, Knight quickly points out, is fallacious for three reasons. First, there is only a general tendency, he says, to remunerate each productive agent. Second, society does not consist entirely of producers. Lastly, producers are not "economic men." Apart from the key factors of economic capacity, labor power, and managerial skill and property ownership, Knight points out that production also involves a large portion of "luck." Hence, individual production "is due much more to biological and social inheritance, for which the individual is not responsible, than to the individual's past efforts." Knight concludes that Hazlitt simply applies the principle of production too broadly.

Knight then turns to the ethical argument. Hazlitt summarizes capitalist ethics as a system of freedom, justice and productivity, which Knight argues cannot be precisely defined, besides which distributive justice has a number of meanings. The real point Knight wants to make is against Hazlitt's individualist ethic, which

he argues is individualistic to an extreme; to the point he never even mentions the family (Knight, 1966, p. 166). Knight goes on to say ethically one must "condemn the unfairness of an unequal start in the competition of life" and this "inequality inheritance" he argues tends to increase with each succeeding generation (Knight, 1966, p. 166).

It is this notion of "inequality inheritance" that is at the heart of the welfare question for Knight, and of course at the heart of notions of injustice tackled by many a socialist pamphleteer who wants to overthrow the capitalist system. Yet, to have socialism instead of capitalism is to replace business with politics, and Knight explains that many of the features most objected to in "capitalism" are in general similar in politics, though in his view "very obviously worse" (Knight, 1966, p. 168). They are very much alike in that functionaries in direct control inevitably have, he explained, "much arbitrary power and get their positions chiefly by competitive persuasion, or simply by accident." Rivalry, which he calls an instrumentally irrational motive, "is more natural to men than rational co-operation." Although it permeates both, Knight states this competitive persuasion takes the form of propaganda in politics and sales activity in business.

They do, however, also differ. Firstly, no-one has the power or effective freedom to form a state or jurisdiction, while there is some, albeit limited power, to start a business enterprise; obviously for Knight, limited by access to investment, skills, inheritance, and so on. Second, people are born into a state and family, but in capitalism they can choose membership among many organizations, and so for instance a laborer has a wide choice of employers to work for.

In pursuing our choices we seek better conditions, and Knight explains that when social groups seek better conditions, which they feel are rightfully theirs, their efforts can create social problems since social changes that benefit some can lead to a worsening situation for others. This can lead to a conflict between freedom and progress. For this reason, social conflict is not necessarily the oft-stated problem simply of order. It becomes a problem of power, and I will return to this later, but first let's see how Hazlitt responded to Knight.

REPLY TO KNIGHT OCTOBER 1966

For his part, Hazlitt (1966) said, "Space does not permit me an examination of Knight's own obscure pronouncements, though they seriously need one." He does, however, offer up a defense against Knight, with the opening salvo of calling Knight's original attack at Mont Pelerin "a strange performance." Hazlitt stated he did not recognize the opinions attributed to him by Knight in the written assault. He rebuts a number of the points Knight made, and explains that his book as a whole is neither polemic, nor are the two chapters Knight singles out at the heart of the book. Contrary to Knight, Hazlitt explained the heart of the book is the much earlier chapter 6 on "Social Cooperation," although the same could be said he suggests of chapters 7 and 8, or even the conclusion, but certainly not the chapters Knight singled out. He also rebuts a number of specific points; including the ones I have drawn attention to earlier. These are not important to go through, and I suspect they are simply a case of an academic and a practitioner talking past each other.

Hazlitt set out what he considered to be the essential justice of the capitalist method of distribution. As Knight noted, Hazlitt was drawing on *The Distribution of Wealth* by John Bates Clark (1908 [1899]). The central thesis Clark put forward was the point I quoted earlier, and merits repeating here, that "free competition *tends*," a word Hazlitt italicizes, "to give to labor what labor creates, to capitalists what capital creates, and to entrepreneurs what the coordinating function creates...[It tends] to give each producer the amount of wealth that he specifically brings into existence" (Hazlitt, 1966, p. 60). This is the point Knight called fallacious. Hazlitt points out that Knight is at pains to make the qualification that this is a tendency, but as Hazlitt's italics demonstrate, this qualification is in the original quote. To which Hazlitt adds that in his own book he explained certain qualifications were necessary, and he was well aware Clark's thesis had been contested. However, he suggested much is overlooked in the dispute with Clark, and what he wanted to do was to correct this by drawing our attention to three matters.

First, Clark was rebutting the Marxian argument that capitalism systemically exploits labor and robbed the workman of his produce.

He argued that Clark in fact proves that the capitalist method of distribution is not inherently unjust, which many people believe to this day, and he states that this falsehood has given rise to "unrest, resentment, demagoguery, revolutions, and wars that now threaten to destroy not only "capitalism" but civilization itself." Second, Clark in Hazlitt's view demonstrated the tendency of the competitive market system to give to each what they create and this is in accord with the most generally accepted principle of distributive justice, at least in the first instance of economic reward for labor. He explained there is then nothing to stop people to redistribute their wealth voluntarily, and indeed capitalism does nothing to hinder or discourage charity and generosity. What is problematic is the attempt to coerce by means of a socialist or equalitarian rule a redistribution that ignores effort or efficiency, and destroys incentives and production. True justice, Hazlitt argues, is not achieved through a "leveling down." Lastly, Clark was not really describing a purely economic system in his description of capitalism and its consequences, rather he was describing a legal system that protects property rights, promotes free labor, markets and wages, enforces contracts and regulates against fraud, violence and other illegalities.

Hazlitt argued capitalism evolved over centuries and had a moral origin. The evolution of capitalism, unlike the socialist and communist revolutions, was never instantaneous or expedient. And so the real oversimplifiers (and recall this is what Knight called Hazlitt) are those who contend ethical and legal considerations are irrelevant in judging capitalism. So, after an interesting passage of defense, Hazlitt returns to Knight and concludes "I find Knight's article rambling, fuzzy, and full of inconsistencies. Even after a second or third reading I cannot decipher." (Hazlitt, 1966, p. 61). On this criticism, I certainly experienced Hazlitt's sense of a terrain that was rambling and difficult, but I hope for my reader's sake I have successfully deciphered his work.

KNIGHT'S RESPONSE OCTOBER 1967

Exactly one year later, Knight's response to Hazlitt's defense was published, with the telling title "A Word of Explanation" (1967a). Knight does not attempt a formal rejoinder, he says, rather a

clarification. While he notes the odd *touché* or two with Hazlitt, he responds by clarifying rather than admitting a defeat on the point. This is a little like when an Englishman says “with the greatest respect” and then proceeds to insult you. So having said, with the greatest respect, Knight states that the major fault with Hazlitt’s book is the “constant harping on co-operation,” which Knight argued was never defined and neglected its opposite, rivalry. For his part, Knight thought of cooperation as implying freedom and “discussion” as a means of reaching free agreement. Knight concluded his rejoinder by accusing Hazlitt of making sweeping statements of half-truths; and, I should point out here that Knight himself was accused of the same crimes by his own critics at various points during his career. He goes on to say, “I regret my critique being so negative; but some clearing away, even of rubbish, often precedes building; and social construction is a complex and hard problem. If Hazlitt-style propaganda is politically effective, I dread the consequences for the better society that might be had through wiser policies” (Knight, 1967a, p. 85). His last word in these exchanges is “And anyhow, blessed are they to whom all things are simple; and in pudd’nhead Wilson’s adage, it’s differences of opinions that makes hoss-races” (Knight, 1967a, p. 85).

Having looked at the demarcation dispute between Knight and Hazlitt, we can delve a little deeper into Knight’s notion of cooperation, which has the three aspects of welfare, freedom and power. There is not sufficient time to go in depth into each of these, but I would like to highlight some of the key points of each.

WELFARE

At the core of Knight’s conception of welfare “is the premise that economic welfare must not be identified with aggregate (i.e. allocative) economic efficiency. Rather, welfare must be seen as the sum of economic freedom, the balance of economic power, and economic efficiency” (Nash, 1998, p. 161). He also offered an argument that the outcomes of imperfect competition reflect the relative power imbalances in an industry, and these outcomes are fundamentally unfair. We can extrapolate from this the general conclusion for all markets that unconstrained self-interest will not always lead to fair outcomes, or outcomes beneficial for society

as a whole. This is a challenge to the “invisible hand” of Smithian economic thinking, and provides an alternative notion of perfect competition to orthodox economics, critical to which is Knight’s conception of economic welfare.

Thus, in looking at welfare, Knight draws our attention to the relationship between the ‘economic’ and ‘moral’ domains of our society, arguing that self-interest cannot maximize the value of the aggregate ‘social welfare function.’ (Nash, 1998, p. 165). He refused to separate the intellectual from the moral pursuit of understanding society, nor could he accept there was a way of having widespread agreement on the goals of social policy. The idea that social and economic thinking can achieve the best ends for society is not an idea agreeable to him. The problem we face in social policy-making is one of values, not of facts, he argued, and social problems arise through conflict caused by the mere assertion of opposite claims. In a market society, a price theory amounts to a value theory because price is the means by which we arrive at agreement between individuals in exchange. Yet, we have higher wants and goals of conduct with which to test our values, rather than simply having a system that accepts and satisfies wants.

We see in his analysis how Knight used his “economics” and “social philosophy” combined to help us understand the human predicament. If we simply look at the competitive system as a wants-satisfying system, then we will see into a mirror that reflects back who we are rather than what are our highest ideals. Knight argued that the social order we have may gratify us, but it also shapes our wants, and hence our system must be judged ethically by the type of character it encourages and forges in the people within this social order, since giving the public what it wants “usually means corrupting popular tastes” (Knight, 1935, p. 49). The problem emerges, however, that price is the measure of efficiency and reflects what the people really want, through their free choice in the market, while also leading to the corruption of public taste. Yet, who is to say what is in good taste? Is this not simply liberal elitism? In the conclusion to my book *Economic Parables: The Monetary Teachings of Jesus Christ* (2007), I make the point that the economy is like a mirror. If we look into the mirror and think we look a little ugly then smashing the mirror is not going to make us look any prettier. The problem is not the system, it is us.

FREEDOM

Put plainly, for Knight economics is about freedom. Knight's essays in *Freedom and Reform* were collected and published in 1947, essentially as a sequel to the 1935 *The Ethics of Competition*, and again on the initiative of some of his former students. The major theme of the work, as the title implies, is freedom, but the reference to reform makes this very much a Knightian expedition, as he sought to mount an attack on any superficial grasp of freedom, and root it in some deep economic and philosophical soil. If we think of freedom in terms of *laissez-faire* then Knight, in his major essay *Laissez-Faire: Pro and Con* (1967b), explained that the relationship between *laissez-faire* and government control cannot arise outside of an economic and political order operating under market conditions. He argued it is absurd to draw strict battle lines between *laissez-faire* and "planning." He explained that humans are social animals, and social life sets many limits to freedom, which includes social and welfare issues. He also explains that *laissez-faire* has been rapidly modified down the ages by political regulation, but how far this change will go he suggests is a question for prophets. The point remains: we need to recognize the necessity of a democratic political order and its inherent limitations on freedom.

Certainly, Knight is in the business of supporting the market, but this means addressing the significant challenges faced by capitalism in respect to freedom and equality, and there are many aspects of inequality to consider in the Knightian view. He accepted inequality as an inevitable outcome of freedom, even if at times it leads to unfortunate outcomes for some. The past is very much a foreign land in Knight's view, making freedom he wrote an "historical anomaly. A few generations ago the opposite was the case; conformity and obedience were moral norms of social life" (Knight, 1960, p. 112). Complaints about inequalities, big business and monopolies are for Knight borne out of a romanticism, and he argued this is not the way to confront the real economic problems we face, though he is by no means denying the seriousness of the problems that exist. What is essential for Knight is that such romantics need to see freedom as the core sentiment, if we are fully to understand economic society.

POWER

Ultimately—and this is at the heart of Knight's welfare approach—social policy must deal with power and weakness as well as freedom. He finds Hazlitt's conception of freedom problematic and ignorant of the problems of weakness and rivalry. He argued that Hazlitt failed to address adequately the relations between freedom and power, and this is related to his treatment of equality and inequality. A proper treatment would recognize that "serious inequality of power, especially economic power, limits the effective freedom of the weaker party, and, if extreme, destroys it, making him helpless" (Knight, 1960, p. 174). Freedom thus effectively depends on power, which is power an individual possesses with meaningful content only insofar as the person has means and effective freedom to exercise their power, which for half the normal population means little, as they have no such power or means.

As noted, people will aspire to improve their position, which they will do by improving their wealth and income and by gaining distinction and power, and they will do this in any way open to them. This means using whatever power they possess to persuade and influence. To get influence they must get attention, which is what people want anyway, and he says it is at "this point that social rivalry is most acute, and free society often seems to be mostly a phenomenon of competitive "screaming" for notice in one connection or another" (Knight, 1960, p. 173). Such attention-seeking, he says, refined people find repugnant, while the Marxists would hope their dictatorship would educate this out of human nature.

Hazlitt's individualism, in Knight's view, ignored these problems of power, weakness, rivalry and inequality. For Knight, "the family, not the individual, is the effective unit in society, because he explained "differential inheritance—particularly of wealth—entails an unequal start in the competition of life, which violates fundamental individualistic ethics" (Knight, 1960, p. 174). Knight typifies Hazlitt's approach as an ideal of a primitive society or small tribal groups with face-to-face interaction, and he operated under what Knight called a "cheerful assumption" that if society let men be they will cooperate rationally based on known rules. In contrast, Knight has a somewhat Augustinian view of human nature, and as such believed something akin to original

sin militates against any such hope. In contrast, Knight's understanding is that people—to be moral—must change themselves and then by mutual understanding change the world. This is what he means by discussion. This is also a very theological approach to the problem, found in conservative and Augustinian schools of theology. To paraphrase Luther, you can try and rule the world with the Gospel, but you better fill it with real Christians first. In other words, we remain in a world of conflicted values.

So, what kind of discussion of values can we have? Perhaps we can conclude that Knight fails on his own terms, because as he himself states, people are “screaming” for attention for their cause, and whatever change results is likely to be disagreeable to others. He is certainly right about the screaming, though goodness knows what he would make of today's presidential primaries or the attempts to pull down monuments of the past because of racial politics. Knight is not against change, and he certainly does not want to see things stay as they are. Neither is he a progressive.

A WORLD OF INDULGENCE IN NEED OF COOPERATION

In concluding this lecture, I want to set out in a Knightian way how we can come to terms with the moral question of modern capitalism. In the Knightian view, there is inevitability about inequality and the conflict between various desires. The problem of equality and inequality lies at the confluence of welfare, freedom and power. We see inequalities in developed nations and emerging nations. We see different levels of poverty. There is not sufficient time to go into the nuances of these differences. It must suffice to say when we think of extreme poverty in Africa, for instance, the causes are similar to our own—it is more a matter of scale. The problems of Africa, and the contradictions of wealth and poverty on that continent, reflect the same root cause I am about to unpack in drawing this conclusion. Just as capitalism brought many out of poverty in the west, so it can in Africa and elsewhere. The nations cry out for a legal and political system complementary to capitalism and technical assistance, but are at the mercy of corruption and skewed property rights.

All of which brings me to today and the problem I identify of indulgences, of which there are many, but I will unpack the main

kinds. I suggest we live in an era of emotionalism, or emotional indulgence, where what one thinks is less important than expressing what one feels. Rationality does not trump giving offense. This emotionalism leaves many people in a spiritual search in the economy and in this search they are looking for easy ways, looking for indulgences. I borrow the term indulgences from the turning point of the medieval period that led to the Reformation, and a new age of enlightenment. As we all know, Martin Luther railed against the selling of indulgences in the Western Catholic Church as an easy morality, a forgiveness of sins without conforming to God's will. It was merely the buying of a certificate.

Today's indulgences come in the form of cash till receipts for free trade and organic produce, as people scream out the "gotcha" examples of extreme poverty in Africa and environmental damage caused by "big business." It comes in the form of Occupy Wall Street and other protests, as they point the finger at the bankers and financiers. It comes in the form of celebrities campaigning for a better world and against capitalist greed, which naturally they do as CEOs of their own multinational businesses. It comes in the form of the runaway sales of the book on capital and inequality, by French economist Thomas Piketty. All these instances admirably demonstrate I suggest that the specter of inequality is never far away in the consciences of the Left, but very distant in terms of solving the actual problem of inequality.

For what is inequality? If we listen to Knight, it just is. It is unavoidable. We can do something about inequality in a limited sense, but only through discussion and cooperation. Perhaps the instances I just suggested are Knightian discussions. After all the celebrities and protesters are all discussing the problem aren't they? Well, yes, but in a somewhat self-serving way. They are long in talking and "caring" about the problems, but well short of a realistic solution. The challenge is to solve the problem, which is why Knight argued passionately in favor of capitalism. It helps far more than it hinders, a reversal of the Leftist view, so we need a balance or nuance in our understanding of capitalism if we are to make the world a better place, and even then we are unlikely to make it a better place for everyone due to human nature.

If we take the working class of which Marx wrote so passionately, it has improved its lot greatly. Indeed, in his own terms many of

the working class has become bourgeois. This change is a process of embourgeoisement, though this was reportedly dismissed for good by sociologist John Goldthorpe back in 1963. But the world has changed a great deal since Goldthorpe was writing. The “working class” today takes foreign holidays, owns property and even goes to the opera on occasion. The definition of poverty today is more related to how many cars or TVs you have, rather than subsistence. More significantly, poverty today is more defined by desire, in terms of satisfaction of wants and social aspirations, than needs. What we have to some extent is an inequality in satisfaction of desires rather than needs, though again I hasten to point out that middle classes and liberal protesters seem to have their desires satisfied by taking to what they see as the high moral ground. It is because the problem is one of desire that resentment has been breeding amongst the middle classes, especially since the 2008 recession.

The reality is that in terms of income, the poor have benefitted from the creation of wealth under capitalism; this is its great strength. We have all seen the graph of income as flatlining from the exit to the Garden Eden until the 1750s, and then moving on a steep upward curve ever since. While communists under Stalin and Mao were being executed, the poor in the western economies were buying their own homes. During the time of communism, however, intellectuals and leftists could always pretend there was an alternative. Their economic theorists could posit alternative universes. The fall of communism, and the victory of the market, appeared to show there is only one economic system—albeit flawed—but as Knight argued it is flawed because it is a system that deals with scarcity amongst flawed humanity. This system may have triumphed, and poverty may have changed, but what has not changed is the socialist bourgeois guilt over the continuing presence of the poor; hence the popularity of the Piketty book and the crowds at Occupy Wall Street gigs as they contemplate their own difficulties. Though, as I stated just now, I suspect the problem has much more to do with resentment than guilt.

Whatever it is, guilt or resentment, the fall of communist and socialist systems due to capitalist economic change, and I would add the inevitable impact of reality, has broken apart Marxism, socialism and communism. However, they have not disappeared altogether. There may be a systemic breakdown, but the same

instincts remain, and these instincts are dispersed in the shattered pieces that remain in the range of causes and groups that challenge the basic assumptions of capitalism in much the same way as these grand movements tried to do. Yet, while they are dispersed, they are not freely blowing in the wind. They have become part of the capitalist system itself. To which I may add there is a significant market for these causes. Radical chic sells.

There is another indulgence, which you can find on both sides of a narrative about the ills of capitalism. On one side, we have the "social responsibility" executives, who have both the wealth and the salve for their consciences. They jostle for attention alongside the Wall Street protesters I mentioned who seem to have the time, technology and money to camp on the streets instead of working or looking for work. This is a far cry from the working classes that needed to break apart their chains; it seems they are the workers who simply prize open their wallet. Thus, the problem of inequality is a middle class problem. Of course, there has always been an air of the snob around the left, a middle class enclave that looks down at the working class as their own personal playground. This thought came to me recently, on another continent, when I heard a Corporate Social Responsibility person say how they wanted to visit poor areas, to see how "real" people live in the particular country we were visiting. It seems the Left has to travel further distances, and expand their carbon footprint, to fulfill their fantasy of how the poor live in need of their help. The so-called "anti-capitalists" and "anti-globalization" camps that periodically spring up, oddly in times of recession, are the modern day kibbutz for the spoiled to search for meaning in their own life. They still imagine a life of the greedy boss and the despoiled and alienated worker.

Such a view is out of touch with reality. Companies today are focused on employee engagement, because recognizing the engaged and interested worker is more productive. This is the antidote to alienation. Indeed, alienation is not the preserve of the factory worker or the low-paid. Many people in the workplace and in society feel this way. Managers and government bureaucrats alike can feel alienated from the workplace or the goals of the business as well. They too can be trapped by the mortgage or the sense that they lack advancement. The path to better engagement is dialogue, connecting people to each other in the workplace in

a common cause, not trying to find reasons to divide them. Ultimately, in searching for our material satisfaction, we ought to be questioning what we are searching for beyond the economy not just within it. Before we get carried away with this, however, we have to recognize that whatever our search, and whatever our role in the economy, it is curbed by human nature, both ours and others'. As Jean-Paul Sartre said, hell is other people.

Of course none of this is very romantic. It is essentially a question of power. In the economy people can feel powerless, and the same may be said of our political system, both points made by Knight. It is wonderful that the market economy has moved so many out of poverty and low incomes, but it seems that we are a generation that remains in search of spiritual meaning. Our material status does not answer the spiritual problem, except perhaps in the mundane terms of retail therapy. It is simply the other side of a coin. To use again Marx's famous image, we can see this as the switching of one set of chains for another. The historical move we have seen is the freeing of the chains of poverty for vast swaths of the population only to find themselves feeling chained by the materialism and indulgences of our age. This is what is revealed by the middle class recession we witnessed these past few years, because the working class has become middle class in relative terms and a larger middle class, overextending and indulging itself through debt and property speculation, got caught out by the inevitable force of economic gravity and resent the impact. After all, when house prices were going up I don't recall anybody ever complaining to me how much their home is "worth," so why complain on the way down? What suffered was their desire and expectations, and this impacted their pocket and consciences.

No matter how successful our economy, or even if humanity triumphed in the way the Left dreams, the problem will not be solved on material terms. Our economy is a reflection of our human condition. It puts numbers on what we truly care about, and this has to be the starting point of any moral understanding of the economy. Knight is correct. We do need to face the brutal reality of inequality, and we ought to recognize the inheritance deficit and help others to have a start in life, but what policies and social attitudes are necessary to tackle these is the question. There also needs to be a point where we say enough is enough, and not

allow the emotionalism to dictate economic policy, which has two impacts in terms of how we might cooperate to tackle inequality and social welfare. First, we need to educate people better in fundamental economics at school so we can have better informed and more realistic discussion about economic matters, which will make cooperation more informed. We obsess about teaching God and sex, so why not money? Second, we need to turn away from the emotionalism of our times and recover the enlightenment idea that we are not simply sentient creatures; we are creatures of thought. Cooperation is a rational activity, not an emotional one, and indeed emotions tend to get in the way of cooperation. The curmudgeonly Knight may have set a high bar on this point, perhaps too high, but I fear we will make little progress politically or economically in these times if this attachment to emotionalism does not change in favor of economic realism.

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IS THERE SUCH A THING AS A SKYSCRAPER CURSE?

ELIZABETH BOYLE, LUCAS ENGELHARDT, AND MARK THORNTON

ABSTRACT: There is an emerging literature on the subject of skyscrapers and business cycles. Lawrence (1999) first noticed the correlation between important changes in the economy and the building of record-breaking skyscrapers. Thornton (2005) established a theoretical link between the two phenomena. Several papers have subsequently examined the impact of skyscraper building on the economy and in particular on the role of psychological factors on the building of record-breaking skyscrapers. Not surprisingly, most people scoff at this notion, and Barr et al. (2015) present extensive empirical evidence that skyscrapers do not cause changes in GDP, but precisely the opposite. Here we show what the skyscraper curse actually is, and show that the entire empirical literature on this subject supports the existence of a skyscraper curse, including most of Barr et al. (2015). In addition, we present new empirical evidence supporting the skyscraper curse.

KEYWORDS: Skyscraper Curse, business cycle, Austrian School

JEL CLASSIFICATION: B53, E32, E37, R11

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INTRODUCTION

On March 28, 2015, the *Economist* magazine published an article that is the title of this paper. They came to the conclusion that there should be great doubt about the existence of the skyscraper curse. "In other words, you cannot accurately forecast a recession or financial panic by looking at either the announcement or the completion dates of the world's tallest building." The *Economist* article is just the latest installment of the increasing fascination of the financial and news media with the skyscraper curse.

There has also been an increasing attraction of economists to the relationship between skyscraper building and economic crises. Several economists have examined the data and tried to make sense of the suggested correlation to determine the underlying causes and relationships. This all began with Andrew Lawrence (1999), the founder of the skyscraper index who coined the phrase "skyscraper curse." He believed building booms were the result of easy credit conditions and expansionary monetary policy. Lawrence focuses on "over investment, monetary expansion and speculation" as the basis of building record-breaking skyscrapers and that when this pattern cannot be sustained the economy falls into economic crisis. Thornton (2005) provides both a theoretical model for the skyscraper curse and additional evidence in support of the curse.

In contrast, another thread in this literature is based on the idea that skyscraper building is rational and that skyscraper construction does not cause economic crises. In particular, Barr et al. (2015) present extensive empirical evidence that skyscraper construction is rational and that skyscraper construction does not cause changes in GDP. The argument presented here is that *all* the empirical evidence in this literature actually confirms the same thing: the existence of the skyscraper curse. This in turn provides for a more complete understanding of just what the skyscraper curse means, as well as its cause.

HISTORY AND DEBATE

Lawrence (1999) bases his correlation on an examination of the record-breaking skyscrapers that occurred over the previous 100

years. He begins with the Singer Building and the Metropolitan Life Building, which were completed in 1908 and 1909 respectively. These new records occurred concurrently with the Panic of 1907. He notes that there is a remarkably accurate relation between the two variables over the next century, with the exception of the Woolworth Building which was completed in 1913.

Lawrence's article and research was the jumping off point for many economists to follow. Thornton (2005) shows how artificial interest rates¹ link skyscraper height and economic crises. Artificially low interest rates and sustained easy credit conditions allow for both a booming economy and record-breaking skyscrapers. The causal link is based on three different Cantillon effects involving artificially induced structural changes that occur throughout the economy. The three effects work together to both cause an abnormally large expansion in the economy and the building of record-breaking skyscrapers.

The first Cantillon effect is the impact of the rate of interest on the value of land and the cost of capital. A lower interest rate causes land values to increase, especially in high-value areas such as metropolitan cities. Lower rates increase land prices due to, among other things, the decreased opportunity cost of owning land. Higher land prices lead builders to build taller, more capital intensive structures in order to better maximize profits. This is well-known through theory and experience (Capozza and Li, 1994) and this effect is also confirmed empirically in some of the papers reviewed below.

The second Cantillon effect from artificially low interest rates is an increase in the size and scope of firms. A lower cost of capital encourages firms to grow in size and to become more capital intensive and to take advantage of new technologies and economies of scale. In particular, it encourages firms to engage in more roundabout production processes. An example of adopting a more roundabout production process would be when local dairy firms are replaced by regional dairy firms. As local firms

¹ Artificially low interest rates occur when actual rates are below levels that would have existed if they were solely determined by market forces. As such, pure market rates are not observable and are difficult to estimate although you can get some sense of their effect by examining data on total lending in the economy.

are replaced by regional firms and regional firms are replaced by national and international firms, there will be an increased demand for office space for corporate headquarters, especially in central business districts of major metropolitan cities. Empirical support for this effect can be seen in Harford (2005) who shows that merger waves are dependent on “sufficient overall capital liquidity” and that such waves do not occur in the absence of this liquidity.

The third Cantillon effect from artificially low interest rates is the development of new technologies and production processes needed to produce record-breaking skyscrapers. Record breakers typically require new innovations and efficiencies in order to effectively reach record heights. In terms of construction, building higher structures often requires new types of cranes, cement pumping systems, etc. In terms of the actual structure, building higher often requires newer and faster elevators, lighter cables, new efficiencies in moving water and sewage, space saving temperature control systems, etc. Ali and Moon (2007) show that designers and engineers have a tremendous desire to innovate with technology in order to conserve on the size of building systems or to increase the capacity of those systems. For example, just one standard elevator shaft of 2x2 meters would take up the space of 10 efficiency apartments in a 100 story building. At standard speeds, it would take about 10 minutes to get from the ground floor to the top floor of the Burj Khalifa Tower, plus the time it took for the elevator to arrive at the ground floor. Therefore as building height rises, technology must also advance to conserve on the building systems footprint. Ames (2015) reports, for example, that KONE engineers have created a new elevator cable that weighs less than 7 percent of the weight of traditional steel cables, which weigh over 20 tons for a 400 meter building.

Cantillon effects explain why buildings are built taller, firms become larger, and technologies are developed that would otherwise be uneconomical all during periods of artificially low interest rates. There are two things to take note of here. First, these effects are not limited to the record-breaking buildings, but are present throughout the economy. Second, it might at first seem that some of these effects, such as technological change, are beneficial, but they are all inconsistent with the most efficient use of resources. All three effects are typically revealed when interest rates adjust

to market-determined levels as a cluster of entrepreneurial errors consisting of unrealized profits, foreclosures, bankruptcies, unemployment, and often bailouts.²

In addition to describing the Cantillon effects that give rise to the Skyscraper Curse, Thornton (2005) shows that the Woolworth Building—which Lawrence saw as an exception to the curse—was not really an exception because World War I intervened lifting the US economy out of a steep slide into recession. Thornton also extends Lawrence’s data to include the late 19th century—showing that record height buildings in that period also followed the Skyscraper Curse.

Kaza (2010) supports Thornton’s arguments concerning the role of Cantillon effects, and entrepreneurs are not immune to the errors that are eventually revealed as an economic contraction. He also supports Thornton’s position that the Woolworth Building was not an exception to the Skyscraper Curse. He points out that the Woolworth Building and other less severe cycles match up well, but not consistently with cycle data provided by the National Bureau of Economic Research. Kaza also shows that there is some evidence of the skyscraper curse at the state level as exemplified by the history of tall buildings in Arkansas and Michigan and that the tallest building in 40 of the 50 US states were completed during economic contractions, as defined by the National Bureau of Economic Research

Loeffler (2011) also examined record-breaking skyscrapers to determine whether they can be used to forecast US stock returns. He finds that during the five years after construction of a record-breaking skyscraper, the stock market returns are substantially lower than they were in the years prior. Loeffler shows this result is due to “over optimism” in the economy which gives rise to skyscraper building, but also leads to an overvalued stock market. Using data from the US from 1871–2009, Loeffler’s statistical analysis shows a relationship between the building of skyscrapers and in changes in the stock market. Loeffler finds that stock returns are associated with the information regarding

² In the event that interest rates are not allowed to return to higher market-determined levels, keeping interest rates from rising requires a commitment to expanding the money supply at an increasing rate—which runs the risk of hyperinflation.

the start of a record-breaking skyscraper and then the two years following. Loeffler uses these findings to test the determinants of skyscraper building, and notes that they are able to capture market conditions such as risk and confidence. His prior analysis shows weak evidence of overvaluation, but through these tests he is able to conclude that there is a stable and significant relationship over time. He finds that the “predictive content of tower building is at least partly related to overvaluation” (Loeffler, 2011, p. 2).

Jason Barr has examined different determinants of skyscraper height in several papers. Barr (2010) began by examining Manhattan, once the skyscraper capital of the world. Here he looked at skyscraper height in Manhattan from 1895–2004 as both a function of economic variables and “builder competition.” Here a skyscraper is defined as a building over 100m in height. He identified skyscraper building cycles that appear to last about twenty five years, giving rise to the thought that “their construction is determined by major economic, demographic, and political forces” (Barr, 2010, p. 568). In areas such as Manhattan, height is the easiest way to make the most of the relatively scarce land, in turn maximizing profit. However, Barr also expresses the notion that building height is also affected by “builder competition”—the builder’s desire to “obtain a degree of societal status” (Barr, 2010, p. 569).

Barr shows that there is a high degree of correlation between the number of completions and the height of each completed building. This demonstrates that fertile economic conditions encourage taller buildings to be built. He also shows that the level of building activity is dependent on employment in the finance, insurance and real estate industries as well as the stock market and other economic factors such as building material prices and interest rates.

He then expands his model to include ego variables to look for a trend between completions and heights. Barr finds that since the beginning of the 20th century, height trends have been determined by economic factors that affect building costs. He considers that if ego was playing a significant role in the height of skyscrapers, there would have a trend between height and completion of buildings in the surrounding area. However, Barr did not find such evidence, so that his time series tests provide “support for the profit maximization hypothesis, rather than the ego hypothesis” (Barr, 2010, p. 570). However, Barr still believes that “record breaking height

appears to be due to the right combination of ego and economics" (Barr, 2010, p. 592) because ego competition can only take place once the economy is in a solid position to build.

Barr (2012) next examines skyscraper height as a function of cost, benefits of construction and "height competition." He finds that skyscrapers "not only provide profits but also social status" for both the city and for the architect because a new skyscraper announces to the world that a city has arrived as an economic power. To a builder, a record-breaking skyscraper is also strategic. By standing out in the city skyline and the record books, the architecture and construction companies "build" status in society and their business communities. Social status can be viewed as ego in the height competition between builders or between cities.³ He employs a variety of models to test responsiveness to nearby buildings and he determines "that builders positively respond to the height decisions of nearby buildings." To start, Barr creates a model of the height of skyscrapers in New York from 1895–2004. Through various economic variables Barr is able to measure construction costs and profits. He is able to determine which of the skyscrapers were economically too tall at the time they were built and which buildings responded to the building of nearby skyscrapers. His results show support for the "height competition" hypothesis, i.e., ego matters, and that height competition is at its peak during times of economic expansion, when the "opportunity cost of seeking social status is lower." Barr also finds evidence that economic factors such as a fall in interest rate and building costs or an increase in population and job growth all increase height.

To look further into the strategic interaction underlying the competition hypothesis, Barr (2013) looked for evidence of building competition between New York and Chicago to determine if there is a "height race" and "strategic interaction" between the two cities (Barr, 2013, p. 369). In order to test to see if there is competition Barr creates an annual time series of the number of skyscraper completions in each city. For each city Barr uses a different cut off in defining what buildings qualify as a skyscraper. In Chicago he uses 80 meters, and in New York he uses 90 meters. From the data of

³ Helsley and Strange (2008) had previously presented a game-theoretic model for skyscraper height, which suggests the hypothesis that Barr (2010b) is testing.

the qualifying buildings, Barr creates a time series of the number of skyscrapers in each city to determine if building in one city had an impact on the other. Based on the assumption that such competition would take place at the highest level of buildings, he looks at the tallest building completed in each city during each year since 1885.

Barr does indeed “find evidence for skyscraper interaction across cities. That is, New York skyscraper decisions have impacted Chicago decisions and vice versa.” (Barr, 2013, p. 370). Barr also examines zoning regulation changes over this time period and is able to see that as zoning regulation intensifies in one city, building in the other city increases. This suggests that the cities not only act as complements to one another, but also as substitutes. That is, when building is increasing in one city, it will also be increasing in the complement city. However, when zoning restrictions are intensifying in one city, building will increase in the other city. Although Barr does find evidence of height competition, he suggests that this height competition is only evident when the opportunity cost of competition is low.

In the most recent article by Barr, with coauthors Bruce Mizrach and Kusam Mundra (2015), the existence of the Skyscraper Curse is brought into question. In order to test for the Skyscraper Curse, Barr et al. (2015) examine record-breaking skyscraper building patterns and compares that with announcement dates and opening dates to determine if there is a correlation with GDP growth. They determined that there was “no relationship between record-breakers and recessions” (p. 149). Additionally, they used vector auto regression analysis for the annual time series of the tallest buildings completed in US, Canada, China and Hong Kong and their respective real GDP per capita. From these regressions they performed Granger causality and cointegration tests to determine the relationship between real GDP per capita and the time series data of tallest buildings completed in each country. They concluded that real per capita GDP and height are cointegrated, meaning that height and GDP per capita share a common pattern. Additionally, they find that “there is unidirectional causality from GDP to height.” They therefore conclude that “height is not a useful predictor of the business cycle, and that while height may temporarily deviate from output, over the long run height and output move together.” They believe these “temporary deviations”

are the result of builder competition that results in taller buildings that are economically too tall, and that during a correction period construction height falls back towards a level consistent with GDP. Their evidence appears to create a strong dispute of the existence of the Skyscraper Curse.

The most current academic paper on this topic is Engelhardt (2015). He uses a Bid Rent function in residential cities to show what a buyer would be willing to pay for a given piece of land at a given time. Bid Rents decrease as one moves further from the city center due to the increase in transportation costs, leaving less money to spend on rent. Using this model he found that, “land prices will vary in proportion with rents, and will vary in inverse proportion with interest rates” (Engelhardt, 2015, p. 4). Therefore one can arrive at the conclusion that “land prices in the city center are typically higher than in the periphery” (Engelhardt, 2015, p. 4). He finds that height will increase if building up, or adding height, is less expensive than building out, or a more spread out building. “Land prices increasing will occur if land rents increase, or if interest rates decrease” (Engelhardt, 2015, p. 5). He also asserts that interest rates have an impact on wage rates. “A decrease in the interest rate leads to greater demand for labor... and therefore higher wages” (Engelhardt, 2015, p. 6).

Engelhardt uses these findings to demonstrate that higher wages from lower interest rates, increases the cost of transportation from the opportunity cost of not working. This shows that the increased incomes will change the demand and budgeting for rent, raising the bid rent function. This function is additionally steepened by the higher cost to transportation from the higher opportunity cost of a commute. This demonstrates that the boom increases demand for living in the city center. These effects will give rise to an increase in land prices in the city, due to the new higher income and due to the decrease in interest rates. These new higher land prices make it more cost efficient for buildings to build up rather than out, thus economizing their land usage.⁴

In looking at the various papers and research, there appears to be considerable uncertainty and doubt regarding the Skyscraper

⁴ Chau, Wong, Yau, and Cheung (2006) find similar results—that optimal building heights rise when land is scarce.

Curse. Some papers seem to conclude that record-setting skyscrapers are indeed a curse. Several papers offer evidence of a variety of causes of the curse including monetary policy, various supply and demand factors, as well as psychological factors such as overvaluation, builder competition and ego. There is also a suggestion that the Skyscraper Curse, like other stock market indicators, is a figment of our imagination and the result of happenstance. In the next section we show there is much less disagreement than it appears.

THEORY AND HARMONY

When considered together, current research seems to conform to the theoretical description provided by Thornton (2005). Clearly there is a coincidence of economic expansion, higher stock prices, psychological changes and skyscraper construction prior to an economic crisis. If all of these phenomena share a common cause, then it should be no surprise to find that they are empirically connected. As Thornton (2005) establishes, lower interest rates serve as that common cause. So, while there is a Skyscraper Curse—in that skyscrapers are an omen of sorts—the skyscrapers do not cause the financial collapse that often follows. They are simply a very visible manifestation of the business cycle phenomenon brought about by artificially low interest rates.

Despite the general agreement regarding some of the key elements of the Skyscraper Curse story, there are certain deviations among the empirical papers. Thornton (2005) describes the Skyscraper Curse in terms of a rate of interest in the market that deviates from the pure market-determined rate of interest—a deviation that is unsustainable. Loeffler (2011) believes that unjustified economic optimism leads to both skyscraper building and stock market overvaluation. The two agree, then, that the Skyscraper Curse is brought on by a temporary, passing phenomenon that must be followed by some correction, while they disagree about the precise cause. Thornton supports the case for an economic cause in the form of a distortion in interest rates while Loeffler and others support the case for a psychological cause in the form of undue optimism.

So there are really two threads in the literature regarding the skyscraper curse. Lawrence (1999), Thornton (2005), Kaza (2010)

Thornton (2014), Engelhardt (2015) and Engelhardt and Thornton (2015) all rely on the notion of a distortion of interest rates and the resulting monetary and credit expansion to explain the connection between record-breaking skyscrapers and economic crises. The other thread involves various psychological explanations, including Barr (2010) “builder competition” which involves ego and social status, Loeffler (2011) “over optimism,” Barr (2012) “height competition,” Barr (2013) “height race and strategic interaction.” Lawrence, Thornton, Kaza, and Engelhardt provide no hard evidence, only connections to the obviously low rates of interest and credit expansion. In contrast, Barr and Loeffler do provide hard evidence to back their stories of pop psychology. No matter who is right, the primary point is that both sides basically agree that there is some kind of distortion that helps correlate skyscraper construction with significant economic turns of the business cycle.

The one paper that does appear to openly quarrel with the existence of the Skyscraper Curse is Barr et al. (2015), which concludes that there is no curse. There are two primary points that would suggest their opposition to the curse. First, they show that the date of announcements and openings for record-setting skyscrapers do not empirically fit the pattern of changes in GDP growth. Second, they show that skyscrapers do not (Granger) cause economic crises and that both are part of a common trend i.e. cointegrated. However, a reinterpretation of Barr’s work can allow it to support the existence of the Skyscraper Curse.

First, Barr (2013) suggests that skyscraper building is a combination of ego and economics—but that ego appears to only be unleashed when economic conditions are right. This lines up well with Thornton (2005)’s pro-Skyscraper Curse argument. When interest rates are artificially lowered because of credit expansion, skyscraper building is unleashed. In the end, skyscraper builders overestimate the value of height, an idea supported by Engelhardt (2015). Low interest rates also decrease the cost of pursuing social status. So, Barr’s observations in this regard are supportive of the Skyscraper Curse.

Second, there is no particular reason that announcement, record setting, or opening dates should have a specific, precise relationship with business cycle peaks. There is no theoretical reason offered by Lawrence (1999) or Thornton (2005) that any of these dates

can serve as a variable in a regression, for example. Skyscraper building is, at best, imprecise in its timing. All major construction projects are subject to idiosyncratic variations arising from work stoppages, regulatory delays, accidents, fires, and so on. The Skyscraper Curse is imprecise by nature. While this imprecision may invalidate (or at least complicate) statistical testing of the Curse, it does not invalidate the underlying logic of the Curse. So, Barr's observation that there is no strict correlation between these dates and business cycle peaks does not invalidate the existence of the Skyscraper Curse. The problem of using announcement and opening dates in this type of analysis is discussed more fully in Engelhardt and Thornton (2015). Thornton (2014) shows that groundbreaking and topping off dates are more relevant dates than announcement and opening dates.⁵ The reader can compare the relationship between announcement, record breaking, and opening dates of record skyscrapers with historic economic crises in Table 1 below.

⁵ Thornton (2014) claims that ground breaking dates should be used as for a "skyscraper alert" for future economic trouble and that record-breaking dates should be used for "skyscraper signals" that suggest economic danger is imminent.

Table 1

Building	Announcement	Record Completion	Opening	Economic Crisis
Auditorium Building-Chicago		1889		Baring Crisis—Panic of 1890
Pulitzer (New York World)	Jun 1889	1890	Dec 1890	Baring Crisis—Panic of 1890
Masonic Temple-Chicago		1892		Panic of 1893
Manhattan Life	Feb 1892	1894	May 1894	Panic of 1893
Park Row	Mar 1896	1899	Apr 1899	No Crisis
Singer Building	Feb 1906	1908	May 1908	Panic of 1907
Metropolitan Life	Jan 1907	1909	Jan 1910	Panic of 1907
Woolworth	Jul 1910	1913	Apr 1913	World War I 1914
40 Wall Street	Mar 1929	1930	May 1930	The Great Depression
Chrysler	Oct 1928	1930	Apr 1930	The Great Depression
Empire State	Aug 1929	1931	Apr 1931	The Great Depression
World Trade Towers	Jan 1964	1970-1971	Dec 1970/Jan 1972	Bretton Woods-Stagflation, Au standard
Sears Tower	Jul 1970	1973	Sep 1973	Bretton Woods-Stagflation, Au standard
Petronas Towers	Aug 1991	Mar 1996	Sep 1999	Asian Financial Crisis
Taipei 101	Oct1997	2004	Dec 2004	Asian Financial Crisis—Tech Bubble
Burj Khalifa	Feb 2003	Jul 2007	Jan 2010	The Great Recession

Third, Barr et al.’s (2015) work suggests that in terms of Granger causality (which is designed to establish timing rather than

true causality in a scientific sense), increases in GDP Granger-cause building height. That is: economic booms begin before buildings begin increasing to record heights. Because of this, it is unreasonable, according to them, to suggest that the building of record-setting skyscrapers causes economic crises. However, this observation is perfectly consistent with the Skyscraper Curse. The Curse suggests that both skyscraper building and unsustainable economic booms are caused by the same underlying phenomenon: artificially low interest rates that fuel unsustainably easy credit conditions. It is, in fact, no surprise that, on average, economic booms precede increased building height in time. Buildings—skyscrapers especially—take a great deal of planning before they can be undertaken. This planning creates a lag between the initial cause (the low interest rates) and the effect (record-breaking skyscrapers). This lag may certainly be longer than the average lag for many or most interest-rate sensitive businesses. Those industries that can respond to interest rates more quickly do so—leading to the beginning of the boom. Those that can only respond more slowly—like skyscraper construction—only respond with a substantial lag.

How then can we explain the apparent disagreement? One possibility is that the seeming disagreement comes from an underlying methodological difference between the proponents of the Skyscraper Curse and those who deny it. The proponents—Lawrence (1999) and Thornton (2005) especially—rely on an underlying explanatory logic, and accept that any attempt to use data to make precise predictions about the onset of a crisis are likely doomed to failure. The connection in the timing is, by nature, imprecise. Record-breaking skyscrapers are unique events, and the timing of any particular date (announcement, record-setting, or opening) in relation to the larger business cycle is going to be imprecise, especially as the building of the skyscraper has no direct causal connection with the crisis. Much like the canary in the coal mine serving as indicator of toxic air conditions in a mine, skyscrapers can indicate that the economy has experienced an unsustainable credit expansion that must reverse itself in an economic downturn. Unlike the canary, skyscraper construction takes a long time to respond to economic conditions, and takes a long time to complete—and both of these lags allow

for idiosyncratic variations. These variations, however, do not invalidate the underlying logic.

Those who deny the existence of the Skyscraper Curse tend to rely heavily on the necessity of data to show its existence. This method faces serious challenges for some reasons already described. First, the timing of skyscraper construction is influenced by many factors other than the phase of the business cycle. Second, record-breaking skyscrapers in particular provide only a very small sample size. Thus, we see that Barr, et al. (2015) only has 14 examples of record-breaking skyscrapers with which to test the prediction hypothesis—as a result, any statistical test is likely to be underpowered, and they simply note that there is a wide range of lags between skyscraper announcement and opening dates and business cycle peaks and troughs. But, simply looking at the range of a data set only tells us that the relationship is affected by factors outside those being considered or that the quantitative relationship is not perfectly constant. But, proponents of the Skyscraper Curse do not claim that skyscraper records are the cause of the business cycle, nor do they claim that the relationship is going to be quantitatively constant.

That said, to provide some kind of statistical evidence to call into question the work of Barr et al. (2015), we provide some very simple statistical evidence on the odds of being in a NBER-declared recession 12 months after a record breaking skyscraper on Table 1 was completed. The concerns that this evidence hopes to answer are threefold: (1) By considering months rather than skyscrapers, the sample size increases substantially—from 16 skyscrapers to 1510 months, allowing statistical approaches that Barr et al. (2015) could not use. (2) By considering only record breaking skyscrapers, this work is more true to the Skyscraper Curse's claims than Barr et al.'s (2015) Granger-causality tests using average construction height. (3) By allowing a reasonably long window of 12 months, the test does not assume a specific number of months passing between skyscraper completion and recession. (So, we are testing the idea that, after skyscraper completion, the economy will be in a recession some time during the next year—not that the recession will start exactly 12 months after the skyscraper is completed.)

For our data, we constructed two dummy variables. The first took the value of one if the NBER considered that month to be part of a recession, and zero otherwise. The second took the value

of one if there was a record-breaking skyscraper completed in that calendar year, and zero otherwise. In performing the analysis, each month’s values were based on the current recession dummy and the skyscraper dummy from 12 months prior. (So, a value of one in March 2008 indicates that a record-breaking skyscraper was completed at some point in 2007.) These dummy variables were used to divide every month from January 1890 through October 2015 into one of 4 categories: (1) No skyscraper, no recession, (2) No skyscraper, recession, (3) Skyscraper, no recession, (4) Skyscraper, recession. If the Skyscraper Curse were strictly true, then sets 2 and 3 would be entirely empty. However, recall that the Skyscraper Curse claims to predict major financial crises—not necessarily every recession. Rather than attempt to define what constitutes a “major financial crisis,” we simply point out that the Skyscraper Curse would just predict that recessions are more likely following skyscraper construction than not following skyscraper construction.

Table 2

	Skyscraper Completed (Lag)	No Skyscraper Completed (Lag)	Totals
In Recession	108	304	412
Not in Recession	84	1014	1098
Total	192	1318	1510

Table 2 summarizes the results. To check for a significant difference in the odds of a recession following skyscraper construction, we can do a simple comparison of the proportions involved. In months shortly after a record breaking skyscraper was constructed, there is a 56.25 percent chance of being in a recession. In months that are not shortly after a record breaking skyscraper was constructed, there is a 23.07 percent chance of being in a recession. This difference of 33.18 percentage points has a z-value of 8.82 in the comparison of these proportions—so this difference is statistically significant. Subjectively, though, this difference seems to be not just statistically significant, but economically so. After all, the months following skyscraper construction have a more than 50 percent chance of being in a recession. Those not following skyscraper construction have a less than 25 percent

chance. On a pure forecasting basis, it seems that knowing that a record-breaking skyscraper was built in the previous calendar year can significantly increase the odds of a correct recession forecast.

One substantial caveat to this result: Here, skyscrapers were used to predict the existence of a recession—not the onset of a recession. If we attempted to forecast the onset of a recession, we would again run into a possible small sample problem, as there have only been 26 recessions (and therefore 26 first months of recessions) in that time. Preliminary work using a “first month of a recession” dummy suggests a positive, but not statistically significant, relationship between skyscraper construction in the previous calendar year and the first month of a recession. However, the small sample size suggests that the insignificance could be driven by this test simply being underpowered. That is, even if the relationship exists statistically, the sample size is too small to provide the degree of confidence needed to establish that relationship.

A second caution: there is obviously substantial autocorrelation in the dummy variables. Obviously, February in a calendar year in which a skyscraper is completed follows January of that same year. Also, months in which there are recessions tend to be followed by months in which there are recessions. As a result, some of the strength of this relationship may be the result of autocorrelation. To get around this problem, we performed a very rough Granger-causality-style test using the dummy variables. These are the results:

$$\text{Recession}_t = 0.0199 + 0.0478 \text{ Skyscraper Dummy}_{t-12} + 0.9048 \text{ Recession}_{t-1}$$

(3.5658) (3.3215) (84.0972)

Numbers in parentheses are t-statistics from the regression. So, while the economic significance of the skyscraper dummy is diminished once recession inertia is accounted for, the skyscraper dummy does show a positive and statistically significant impact on the odds of a recession. This result is held up against that of Barr et al. (2015), where they showed that height does not Granger-cause output. Here, we show that the building of a record-breaking skyscraper does Granger-cause recessions. How do we reconcile these two results? Simply put: Barr et al.’s results are affected by all construction—not only record-breaking skyscraper construction—and are also impacted by the severity of the business cycle. Ours

only considers record-breaking skyscraper construction and the existence of a recession—regardless of its severity. If we believe that height generally increases over the business cycle, but that record-breaking skyscrapers precede crises, then a Barr et al (2015) style analysis will find almost no Granger-causality—as the years in which record-breaking height does predict a downturn will be counterbalanced by the (more common) years in which height is gradually increasing over the course of a boom (or decreasing through a recession).

Once we set aside demands for a precise statistical relationship, however, we can see a great deal of agreement between the papers dealing with the Skyscraper Curse. This relationship can even be found by loosening the relationship that is being considered. For the most part, skyscraper building can be understood as profit-maximizing—and the profit-maximizing height increases during economic booms. This does not deny the possibility that economic booms may induce psychological motives other than profit—like ego and height competition—to increase the height of buildings.

CONCLUSION

The debate surrounding the Skyscraper Curse has raged around two issues. First, there is substantial theoretical disagreement regarding the underlying causes of the Curse which reflect the underlying theory of construction. Some (Lawrence (1999), Thornton (2005), Engelhardt (2015), Barr et al. (2015)) present skyscraper construction as being primarily a profit-maximizing enterprise. Thus, the Skyscraper Curse would arise if economic conditions arose which simultaneously made skyscraper construction profitable and sowed the seeds of an unsustainable boom. Others (Loeffler [2011], Barr [2012, 2013]) allow more room for psychological factors in skyscraper construction. In this case, the Skyscraper Curse would arise if the same psychological factors that lead to overvaluation in asset markets also lead to skyscraper construction.

Second, there is the question whether something like the Skyscraper Curse exists empirically. That is: can skyscraper construction be used for economic forecasting? Lawrence (1999), Thornton (2005, 2014), and Loeffler (2011) all suggest that the answer is yes. Barr et al. (2015) suggest that the answer is no. Rather

than building height predicting output, output predicts height. We provide new evidence that, by sacrificing a certain degree of precision (regarding the depth of recessions), the completion of record-breaking skyscrapers do predict recessions one year later—though the test used here does not distinguish between the onset or the continuance of a recession.

The debates surrounding the Skyscraper Curse draws out an important fundamental point: forecasting turns in the business cycle is—and will continue to be—art as much as science. There will always be a role for entrepreneurial judgment. However, having an understanding of the underlying theory allows one to interpret the signs that surround us. Included among these signs: skyscrapers, which serve all at once as a monument to the successes of the past and as a harbinger of the suffering that is to come.

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THE ECONOMIST EUGEN V. BÖHM-BAWERK

On the occasion of the tenth anniversary of his death

LUDWIG VON MISES

Originally published in the *Neue Freie Presse*, Vienna
August 27, 1924

TRANSLATOR'S NOTE

A transcript of the German language original under the title “Der Economist Eugen v. Böhm-Bawerk—Zu seinem 10. Todestage” has been found in one of Bettina Bien Greaves’s books at the Mises Institute. The text was originally published in the *Neue Freie Presse* (New Free Press), a Viennese newspaper which was founded by Adolf Werthner, Max Friedländer, and Michael Etienne. It existed from 1864 until 1938. Böhm-Bawerk’s last publication “Unsere passive Handelsbilanz” (“Our passive balance of trade”), from which Mises quotes, was also published in this newspaper, and has, to our knowledge, never been translated into English.

Karl-Friedrich Israel

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Eugen v. Böhm-Bawerk will remain unforgotten for all those who have known him. The students, who enjoyed the fortune of attending his seminars, will never lose what the acquaintance with such a strong mind has given them. For the politicians, who have met him as a statesman, the integrity of his ethos and his altruistic commitment to duty will continue to be exemplary. And no citizen of this country shall forget the minister of finance, the last Austrian minister of finance, who, in spite of all obstacles, earnestly aimed at balancing the public budget and preventing the upcoming financial catastrophe. But even when the lives of all those who had known him personally have come to an end, his scientific *oeuvre* shall live on and bear fruit.

In his scientific work Böhm-Bawerk focused from the outset on the central problem of theoretical economics, the interest problem. At the age of twenty-five, in the spring of 1876, he gave a lecture on the interest on capital in the Knies¹ seminar in Heidelberg, which already contained the main features of what would later become his famous *agio* theory of interest. Before he could however publish his work, there were difficult preliminary questions to answer. It was to these questions that he dedicated his work. Always keeping the ultimate object in mind, he published *Rechte und Verhältnisse vom Standpunkte der volkswirtschaftlichen Güterlehre* in 1881, *Die Geschichte und Kritik der Kapitalzinstheorien* in 1884, *Grundzüge der Theorie des wirtschaftlichen Güterwertes* in 1886, and finally his *Positive Theorie des Kapitals* in 1889.² His work was thereby brought to completion. As Senior Legal Secretary and Head of Division in the ministry of finance, as k. u. k.³ Minister of Finance and President of the Senate of the Higher Administrative Court, he had very little leisure in the following years to perform any scientific work. Only after 1904, when he retired from office for the third and last time, could he devote himself again undisturbed to his research. A series of excellent works is the fruit of

¹ *Translator's note:* Karl Knies (1821–1898), an adherent of the German Historical School, was professor of political economy (*Staatswissenschaften*) at the University of Heidelberg for more than thirty years.

² *Translator's note:* The four books have been translated into English as *Whether Legal Rights and Relationships are Economic Goods*; *History and Critique of Interest Theories*; *Basic Principles of Economic Value*; and *Positive Theory of Capital* respectively.

³ *Translator's note:* Meaning *kaiserlich und königlich* (Imperial and Royal) and referring to the empire of Austria and the kingdom of Hungary.

tireless effort during the last decade that he was allowed to live. He died on August 27, 1914, when the Austrian armies were about to fight the first battles of the Great War in Poland and Eastern Galicia.

Böhm-Bawerk's scientific work has quickly found the recognition it richly deserves. His *magnum opus* was translated into English by William Smart as early as 1890; shortly afterwards a French edition followed. In England, the United States, France, Italy, the Netherlands, Sweden, and Denmark, his doctrine became the starting point for further in-depth analyses and studies. Sure enough, in Germany an understanding of Böhm-Bawerk's achievements was long absent. The prevailing doctrine at the universities ignored him. It took decades before the accomplishments of the "Austrian School" were recognized in the Reich. Today, however, it is considered a grave misfortune that only Böhm-Bawerk's *magnum opus*, which is already in its fourth German language edition, is easily accessible. His shorter writings, which are indispensable for any friend of economic enquiry, are rather difficult to access. It is therefore a thankworthy enterprise to republish them in a collected edition. A student of Böhm-Bawerk, well known for several scientific works, has addressed himself to this task.⁴ The well-endowed volume, which is graced with a felicitous portrait of Böhm, contains the above mentioned work *Rechte und Verhältnisse*, along with a tract on general theory and methodology, essays on the theory of value, and finally an essay that has been published on January 6, 8, and 9, 1924 in the *Neue Freie Presse*, entitled "Unsere passive Handelsbilanz." It starts with a short biographical introduction by the editor, Dr. Franz X. Weiss. The essays on capital and interest, which are not contained in this collection, shall be republished in a separate volume.⁵

To praise the tremendous value of the theoretical works collected in this volume would be like bringing owls to Athens.⁶ For the experts and numerous intellectuals who are concerned with

⁴ *Gesammelte Schriften von Eugen von Böhm-Bawerk*, edited by Franz X. Weiss and published by Hölder-Pichler-Tempsky A.G., Vienna and Leipzig, 1924. [footnote in the original]

⁵ *Translator's note*: In fact, his works on capital and interest, including his two larger treatises, have been republished in the well known three volume edition. The third volume contains *Further Essays on Capital and Interest*.

⁶ *Translator's note*: This is an ancient Greek proverb. The owl was the symbol of the city of Athens. Owls adorned the roof of the old Pantheon as well as the

economic questions, this would hardly constitute anything new. Let us, however, quote some sentences from the above mentioned essay on the passive balance of trade, merely to emphasize the sharpness with which Böhm has early on pointed to the fundamental problem underlying our state finances. It reads:

[T]hrift is never popular.... If parliaments have historically been the guardians of thrift, they now have turned much rather into its sworn enemies. Nowadays, the political and national parties—maybe not exclusively in our own country, but certainly also here—tend to develop a certain covetousness, almost considered to be dutiful, for all kinds of benefits for their own electorate at the expense of the general public. And when the political situation is relatively convenient, that is to say, if it is relatively inconvenient for the government, one's ends can be achieved through political pressure.

Our population suffers from economical megalomania. This is among other things shown by the “investments from the public purse.” One is often mistaken when using the famous slogan of “indirect productivity” of public spending, even if at times the indirect advantages of public enterprises, which are unprofitable by themselves, may exceed the amount that has to be paid from public funds for their passive operations. The “blind eulogists of frivolous investment policies” will feel the mistakes of their approach

...only when, like these days, the capital stock has been exhausted by the public sector over many years to a degree that capital is lacking for the most important and vital private businesses in all spheres, only when many enterprises begin to stumble, many projects have to remain undone, and all suffer severely from the increased rate of interest.

These were the last words that Böhm-Bawerk addressed to Austria's financial authorities. Today they will be valued more highly than at the time when they were first published in this newspaper.

self-minted Athenian silver coins. Hence, “bringing owls to Athens” means doing something unnecessary or superfluous.

REPLY TO DR. HOWDEN ON OPPORTUNITY COSTS

EDUARD BRAUN

INTRODUCTION

Howden (2016) dedicates a large part of his response to criticizing my way of dealing with and classifying the concept of opportunity costs in my book (Braun, 2014). I must start by saying that the main arguments in my book do not depend on my approach to the cost problem. The main reason why I considered it necessary to abandon the opportunity cost concept is that I found it impossible to apply it to the analysis of human action in the passing of time. For this purpose, the concept of costs as employed in business life, where profits are traditionally not calculated on the basis of opportunity costs but as historically incurred monetary expenses,¹ are much more useful. It appeared to me that if “the interest rate expresses itself in

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¹ Though government intervention has partly changed this in recent years (see Huerta de Soto, 2012, pp. xxiv–xxix).

the difference between income and costs at each stage" (Huerta de Soto, 2012, p. 557), the costs must not be understood as foregone opportunities but as historical outlays.

CRITICAL REFLECTIONS ON THE OPPORTUNITY COST DOCTRINE

Most Austrians agree that costs are a praxeological phenomenon. Each action implies the incurrence of costs. In the terminology of Rothbard (1962, p. 104; see also Mises, 1949, p. 97), the objective of human action, i.e., psychic profit, can be expressed as follows:

$$\text{psychic profit} = \text{psychic revenues} - \text{psychic costs}$$

When it comes to analyzing the actions of entrepreneurs the term "psychic" is substituted by the term "monetary" as it is the purpose of business enterprises to generate monetary, not psychic income. We therefore get:

$$\text{monetary profit} = \text{monetary revenues} - \text{monetary costs}$$

These statements are uncontroversial. The disagreement between Howden and myself consists in that I do not define the costs in these formulas in the same way as do most Austrian economists or, for that matter, mainstream economists. They consider *all costs to be opportunity costs*. Opportunity costs are usually defined as the evaluation placed on the most highly valued alternative or opportunity that was rejected in a choice among alternatives. In the following, I will point out what I consider to be the rather questionable implications of the opportunity cost doctrine.

In his discussion of market calculation, Rothbard (1962, pp. 606ff.) provides an example of an entrepreneur who has invested 5,000 ounces of gold in his business and therefrom earns a net income of 1,000 ounces over a one-year period. According to traditional accounting principles, these 1,000 ounces are profit. Rothbard (1962, p. 607) however argues that the entrepreneur still has to deduct from this net income "his implicit expenses, i.e., his opportunities forgone by engaging in the business." Only then has the entrepreneur arrived at a figure that denotes his profit or loss.

Rothbard gives the following (hypothetical) numbers for these “opportunities foregone”: The entrepreneur could have earned 250 ounces of interest if he had not invested his 5,000 ounces in his business; he could have earned 500 ounces in wages if he had sold his labor on the market; and 400 ounces if he had rented out his land instead of using it in the business. Together, he could have made 1,150 ounces if he had not engaged in the business. Therefore, Rothbard (*ibid.*) argues, “the entrepreneur suffered a loss of 150 ounces over the period.”

In short, although our entrepreneur has earned 1,000 ounces, Rothbard claims that he has made a loss of 150 ounces because the entrepreneur could have earned 150 ounces more if he had invested his resources outside of his business – in other words, because his opportunity costs were higher than his revenues.

I am not the only one who considers this kind of reasoning to be questionable. Reisman (1996, p. 460) gives an analogy to Rothbard’s procedure: “One gains ten pounds, but might have gained twenty pounds. This is then taken to mean that one has lost ten pounds.” Reisman (*ibid.*) then goes on to state the implications of the opportunity cost doctrine as propagated not only by Rothbard, but by most economists:

It follows from the opportunity-cost doctrine that precisely to the degree that one is confronted with profitable ways to invest one’s capital, and precisely to the degree that one’s services are in great demand, one’s income must be less—in a word, that one must suffer by virtue of possessing the very qualities that create one’s success.

In my book, I drew on Reisman’s critique and formulated my reservations in the following way: According to the opportunity cost concept, “the possibility of choosing between several alternatives—a possibility that one would think to be beneficial from the point of view of the person choosing—appears to be something bad, even destructive” (Braun, 2014, p. 32). The better the alternatives among which one can choose, the smaller the resultant profits.

It is in the context of this argument that I provide the example of the two friends and their apples that Howden (2016) discusses at length. The point of this example is that according to the opportunity cost doctrine there is a great difference between the case

where friend A is allowed to *choose* which one of the two apples of his friend B he prefers and the case where A simply *gets* one of B's apples without being asked to choose. If A is allowed to choose between the two apples, the apple he does not pick constitutes the opportunity costs of his decision. If the apples should happen to be very similar, the revenues of A (the apple he chooses) would almost be matched by his costs (the apple he does not choose) and his psychic profit would be minimal. As opposed to that, if A simply received an apple without having to choose, his profit would be much greater because his revenue would not be matched by any offsetting costs.²

The purpose of the example is to show that if one takes the opportunity cost concept seriously, having options is worse and leads to less profit than having no options at all. This is the reason why both Reisman and I do not find it helpful.

Reisman's and my criticism of the said doctrine does not imply that we question that the prices of production factors are influenced by the value of the alternative uses to which they might be put (for the following, see Reisman, 1996, p. 461). The price of the quantity of wheat that is employed in the production of bread is not only influenced by the demand for bread, but also by the demand for other products this input, wheat, could have been employed to produce. The money price of wheat emanates from the demand for all the different products which it helps or might help to produce. Alternative uses actually matter, and the choices of consumers between different consumer goods actually determine the market prices of these goods and of the producer goods that help to produce them. But to say that choices and alternative uses matter does not imply that alternative uses constitute costs. Reisman's (1996, p. 461) summary of his argument is well worth reading:

The supporters of the opportunity-cost doctrine generally recognize the process by which money costs are determined, then confuse the alternative opportunities whose competition in bidding gives rise to the money costs with the phenomenon of cost itself, and thereafter

² Howden (2016) objects to this example on the grounds that I have assumed (in my book) that both apples are alike, which in his point of view implies that it is impossible to choose between them. In order to show that this assumption is unnecessary, I have dropped it in the above rendition.

ignore the necessity of a money outlay actually being present. In other words, they identify a cause of the determination of money costs, confuse the cause with the effect, and proceed to ignore the effect, which is nonetheless essential.

Alternative uses do matter, of course, and it is important to any decision-maker to be aware of the options he has before choosing a certain alternative and rejecting others. But it leads to confusion if these alternative uses are called *costs*. Particularly, as I said above, it becomes difficult to discuss the role of time in human action if costs are supposed to relate to choices. *Choices* are instantaneous, timeless. Only *actions* have a time dimension; and in action, costs must be understood as historical costs. As I show in my book, this approach to costs and action allows for a praxeological explanation of originary interest that avoids the shortcomings of the traditional Austrian analysis of this topic pointed out by Hülsmann (2002).

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“FINANCE BEHIND THE VEIL OF MONEY”: A REJOINDER

DAVID HOWDEN

In *Finance Behind the Veil of Money*, Eduard Braun (2014, pp. 30–36) takes the minority view that opportunity costs are not only unnecessary but even unhelpful to understanding choice.¹ In doing so he follows George Reisman (1996, p. 460) who also views the “doctrine of opportunity cost” as not only unnecessary to ascertain how one makes better decisions, but that its “sole contribution is obfuscation, not perception.” Both Braun and Reisman believe that it is unnecessary to include foregone alternatives in the calculus of cost since it implies that “one must suffer by virtue of possessing the very qualities that create one’s success [i.e., better opportunities]” (Reisman, 1996, p. 460).

Such a view errs by overlooking the difference between the actor’s *ex-ante* expectations of an action with the *ex-post* results. More importantly, it mistakes what role costs in general, and opportunity costs by extension, serve in economic theory.

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¹ Although Braun claims that “the main arguments in [his] book do not depend on [his] approach to the cost problem”, there is no doubt that his variant of cost theory derives a distinct theory of interest which is of utmost importance in valuing financial assets, one of the main themes of his book.

In his "Reply" in this issue, Braun demonstrates this misunderstanding of the ex-ante and ex-post roles of opportunity costs when he criticizes Rothbard's (1962, p. 606–607) analysis of the relationship between monetary and psychic profits.² In Rothbard's example, an investor spends 5,000 gold oz. to earn 1,000 oz. net profit. The foregone alternatives are comprised of 1) 250 oz. he could have earned by investing his capital at the prevailing interest rate of 5 percent, 2) 500 oz. he could have earned by working for a competing firm, and 3) 400 oz. of lost income since he used his factory instead of renting it out. With total opportunity costs of 1,150 oz., Rothbard concludes that the "entrepreneur suffered a loss of 150 ounces over the period. If his opportunity costs had been less than 1,000, he would have gained an entrepreneurial profit" (Rothbard, 1962, p. 607).

Braun objects to Rothbard's conclusion for two reasons. First, he finds it questionable that Rothbard constructs "arbitrary" figures to define the investor's opportunity costs. Yet while these figures may seem arbitrary to Braun, they are an assumption by Rothbard and real to the hypothetical investor. The 1,150 oz. in foregone income is actually what the investor could have earned had he used his resources differently. The investor knows these figures through the benefit of hindsight, and from them he can determine from an *ex post facto* perspective the sum his foregone opportunities could have yielded.

Second, Braun objects to the conclusion that the entrepreneur made a loss. He did, after all, come out of his investment 1,000 oz. richer than he started and this is, as Braun correctly states, profit according to "traditional accounting principles." The point of Rothbard's example is not to show that the investor did not earn a monetary profit, but rather to show that he could have done better. The fact that he earned an entrepreneurial loss provides a signal that he must do better in the future or be forced out of the market. To forestall one objection to this conclusion, one could counter that as long as the firm earns positive monetary profits it will not risk insolvency and thus will remain in the market. Such an objection fails to realize that the firm would be forced out of the market if

² Although Reisman does not cite this example from Rothbard, he argues against several similar examples (1996, pp. 459–460).

all other competing firms changed their activities in a way that maximized their entrepreneurial profits while one firm continued incurring entrepreneurial losses (as in this example). This is because a firm must not only earn positive (*absolute*) monetary profits to remain in business, but must also earn positive entrepreneurial profits *relative* to other firms, lest those firms undercut its business and steal market share (as in Carilli and Dempster, 2001, p. 326; Huerta de Soto, 2006, pp. 664–671). No firm can continue earning entrepreneurial losses indefinitely and so an *ex post facto* assessment of the relevant opportunity costs is an essential part of the entrepreneurial process.

Constraining cost to a specific monetary expenditure instead of a general opportunity foregone does a great injustice to the decision-making process. The beauty of Rothbard's (1962, 606–607) example is that the entrepreneur now realizes he has erred. Braun places the goal of maximizing money income as primal for the entrepreneur (Braun, 2014, pp. 109, 115, 116 and *passim*), yet his approach leaves no method for the entrepreneur to see if he has, in fact, done so.

Although Braun focuses on this example from Rothbard, his (and Reisman's) largest objection to the opportunity cost doctrine is that it leads to the conclusion that having more options is worse for the individual, since they believe that the more options one has, the greater will be the cost of the foregone alternative. In this regard, I will (re)address Braun's (2014, p. 32) apple example:

Let us suppose friends X and Y are on a trip in the mountains. X has two apples in his bag. Y loves apples, but has forgotten to pack one. During the first break, X permits Y to take one of the apples. Well, one could say this is a great deal for Y! However, things look differently if one takes into account opportunity cost. As soon as Y takes one of the two apples, he abstains from taking the other one. If we assume, for simplicity, that the two apples are alike, then the disadvantage in this decision is just as great as the advantage. According to opportunity-cost theory, Y is not better off at all although he has received an apple for free. His preference for one of them cost him the other one.

This case has two solutions. The first is to treat the two apples as they are in the example: alike (or, as I [Howden, 2016, p. 125fn1] have shown in more conventional terms, that X is indifferent between the

two apples). I addressed previously the unconventional nature of this problem for the Austrian-school economist, not least because the assumption of indifference is not well accepted (see, e.g., Rothbard, 1956), and I provided one method to analyze this problem within an Austrian framework (Howden, 2016, p. 126).³

In his “Reply” in this issue, Braun relaxes the assumption that the hiker is indifferent between the two apples. His basic result is the same, which leads Braun to conclude that “[t]he purpose of the example is to show that if one takes the opportunity cost concept seriously, having options is worse and leads to less profit than having no options at all.”

On the one hand, if Braun’s hiker had “no options at all,” he would starve, which is likely a worse outcome than having two apples to choose from. But there is an apparent grain of truth to the statement. The more options one has at his disposal, the more satisfying will be the “next-best alternative” the actor must forego for any course of action. While one might believe that this leads to an increase in opportunity cost for the actor a close analysis reveals this is not the case.

Assume the thirsty and hungry hiker has the following preference ranking:

Table 1: The Hiker’s Preference Ranking

Rank	Alternative
1 st	red apple
2 nd	yellow apple
3 rd	granola bar
4 th	1 st reading, Braun (2014)
.	.
.	.
(<i>n</i> -1) th	death
<i>n</i> th	2 nd reading, (Braun 2014)

³ A second objection to Braun’s analysis is that Braun combines two choices into one alternative. In actuality, the hiker first has the option of choosing an apple or starving, and second he must choose between which apple to consume. I (2016, p. 125) alluded to the similarities with Buridan’s ass in the first of the two choices, and I thank Jonathan Newman for pointing out the second.

Faced with the option of consuming either the red or yellow apple, the hiker chooses the more highly valued red apple and expects to earn the psychic profit from the difference in his preference between the red apple and the best foregone alternative, the yellow apple, leaving him with the expectation of psychic profit x as in Table 2.

Table 2: Revenues, Costs and Profit

Expected Psychic Revenue	Red Apple
Less: Foregone Alternative	Yellow Apple
Expected Psychic Profit	x

Now assume that the offer of the yellow apple was retracted, and the hiker was offered the choice between only the red apple and a granola bar. Using Braun and Reisman’s logic, since the granola bar is less highly valued than the yellow apple, his foregone alternative will be less and thus his psychic profit will increase. Taking this extension to its conclusion, if the friend only offers a red apple, the foregone alternative will be death. Forgoing this lowly valued alternative would leave the hiker with the largest amount of psychic profit. It is this logic that Braun and Reisman have in mind when they consider having more options to be bad for the actor since more options *seem, ceteris paribus*, to reduce psychic profits.

As any hungry hiker can attest, the fact that the hiker is nourished but will only receive a seemingly small amount of psychic profit (both *ex ante* and *ex post*) must strike the reader as odd. He did, after all, forestall death by having one apple presented to him, and surely being offered either of two apples must be better yet. The reconciliation to this paradox comes from using the opportunity doctrine within its proper domain.

The first use of opportunity cost is to determine which alternative to pursue by focusing on that which foregoes the least valuable alternative. In Table 3 we can see that there are only two possible best foregone alternatives. For the 2nd through n^{th} ranked options the best foregone alternative will be the 1st ranked alternative (i.e., the red apple). For the 1st ranked option, the best foregone alternative will be the 2nd most highly ranked alternative (i.e., the yellow apple). Since the red apple is preferred to the yellow

apple, pursuing the 1st ranked alternative will result in the lowest opportunity cost.

Table 3: Opportunity Costs

Rank	Alternative	Opportunity Cost
1 st	red apple	yellow apple
2 nd	yellow apple	red apple
3 rd	granola bar	red apple
4 th	1 st reading, Braun (2014)	red apple
.	.	.
.	.	.
(<i>n</i> -1) th	death	red apple
<i>n</i> th	2 nd reading, (Braun 2014)	red apple

Alternatively, one can see that choosing the most highly ranked option will also result in the highest amount of expected psychic profit. The first ranked alternative will be the only one that incurs an opportunity cost valued less highly than it is. Thus only the first ranked alternative can create a positive amount of expected psychic profit, as in Table 4.

Table 4: Psychic Profit

Rank	Alternative	Opportunity Cost	Psychic Profit
1 st	red apple	yellow apple	positive
2 nd	yellow apple	red apple	negative
3 rd	granola bar	red apple	negative
4 th	1 st reading, Braun (2014)	red apple	negative
.	.	.	.
.	.	.	.
(<i>n</i> -1) th	death	red apple	negative
<i>n</i> th	2 nd reading, (Braun 2014)	red apple	negative

Note that adding more options does not change this analysis. The hiker will still choose the red apple even if we add a new

alternative (except if the new alternative is more highly ranked than the existing red apple). Braun is incorrect in stating that “having options is worse and leads to less profit than having no options at all.” Adding a new option to the actor’s preference ranking will either: 1) create a new negative expected psychic profit (which is of no relevance since the option will not be pursued), if the alternative is ranked 2nd or lower on the preference rank, or 2) increase the expected psychic profit if the newly introduced option takes the 1st place on the preference rank.

The second use of opportunity costs is an *ex post facto* assessment to determine if the chosen option was the correct one. It is this use that Braun and Reisman invoke often, though to illustrate (incorrectly) buyer’s remorse.⁴ While the previous *ex ante* role of opportunity cost rests on expectations of both revenues and profits, in the *ex post* role we actually know how events did turn out. Of course it could be that we chose wrong, e.g., the red apple might have been rotten. With this new knowledge we can revise our preference ranking, perhaps shifting the red apple lower in the expectation that other similar apples may also be rotten. In this way, we partake in a trial-and-error process that improves our decisions in light of newly revealed information concerning the nature and relationship of expected psychic revenues and resultant opportunity costs. Buyer’s remorse is not a sign that the use of opportunity costs is deficient, but that our estimations of what those costs could have been differed from their actual realization.

Braun insists that all costs be treated as historical money costs. Of course it is one of the great advantages of the price system that money prices provide a common denominator in which all values can be distilled to and compared with. The common denominator of money is thus essential to compare different foregone alternatives on an even footing, so Braun is half right when he focuses on money costs. He errs, however, to the extent that money revenues comprise only some of the opportunities foregone.

⁴ Strangely, Reisman does not use this *ex post* role of opportunity costs in “ascertaining how one might do better” (1996, p. 460). In a similar way, Braun does not realize that when he laments that the opportunity cost doctrine “neglects costs when they actually arise—in action” that it is this *ex-post facto* assessment that allows the actor to use opportunity costs with the benefit of the hindsight that his action allows for (Braun, 2014, p. 33). (I deal with this latter objection by Braun in Howden (2015, pp. 579–580).)

In the simplest example used by every Principles of Economics instructor, the cost for the student to pursue a university degree is four years of tuition plus four years of time foregone. Four years of tuition is easily valued and (before discounts and scholarships) equal for all students (e.g., four years at \$40,000 per year). The time foregone can only be compared with this monetary cost if it is valued in money terms. Since the particular monetary value on time will differ depending on one's opportunities the easiest method to value these four "lost" years is with wages foregone. If one could have worked at a job for \$20,000 per year, the value of these four years will be \$80,000. Taken together, the total opportunity cost of a university education is \$240,000, of which \$160,000 will be an actual money outlay and the remainder lost wages. The student will register for university if he values the four-year degree more than the value of the foregone alternatives, \$240,000.

Braun wants to throw the baby out with the bathwater in ignoring the lost wages, since they are not a historically incurred monetary cost. This would set the bar much lower for students to decide to go to university (among other decisions) since, e.g., in the above example only two thirds of the foregone alternatives were in a historically incurred monetary form. It is trivial to state the importance of the value of the non-monetary foregone alternatives since they can, in many cases, make the monetary costs negligible.⁵

I will close by asking how Braun would solve the following question without resorting to non-historically incurred monetary costs.

Students *A* and *B* value a university education the same, and also must pay the same tuition rate. *A* has few opportunities in life and the best foregone use of the four years is a minimum wage job (i.e., \$80,000). *B* has an offer to play basketball for the Cleveland Cavaliers for \$13 mn. for the first three years, with an option to

⁵ I would venture that the vast majority of our decisions have no monetary component, and can only be decided on by comparing expected psychic revenues. My decision to watch Real Madrid play soccer instead of FC Barcelona can be explained with tables 1 through 4 by substituting watching Real Madrid as my most preferred alternative and FC Barcelona as my second ranked option. No money changes hands, but only one choice will have a positive expected psychic profit. Braun could counter that he focuses on business decisions, which generally have a money component. This would only beg the question as to why a different decision-making process is necessary for businesses than individuals.

play a fourth year for \$6 mn. *B* opts to not go to university, while *A* registers in an undergraduate economics program.

Given that the preferences and historically incurred monetary costs are identical, how does Braun propose to explain the difference in choice?⁶

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⁶ The interested reader can find the correct answer in Howden (2016b).

BOOK REVIEW

MONETARY REGIMES AND INFLATION: HISTORY, ECONOMIC, AND POLITICAL RELATIONSHIPS, SECOND EDITION

PETER BERNHOLZ

CHELTENHAM, U.K.: EDWARD ELGAR, 2015, 240 pp.

PATRICK NEWMAN

The recent financial crisis of 2007–2008 generated a debate among economists over whether the leading central banks' unprecedented monetary intervention would spark a massive inflation and depreciation of currencies in the near future. During the meltdown of the banking system, central banks engaged in enormous monetary expansion and drastically increased member bank reserves in an effort to save the financial system and stimulate the economy. Despite this, inflation, at least judged by reported consumer price indexes, has grown at a relatively moderate rate in the period since the crisis. Why is this? Have we entered into a

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special period where monetary economics is no longer valid, and inflation is no longer a monetary phenomenon? Can central banks around the world now increase their respective money supplies *ad libitum* without suffering any consequences?

Answering these questions is partly one of the justifications for Peter Bernholz, renowned historian of inflation, to publish a second edition of *Monetary Regimes and Inflation*. The first edition of the book, which was published in 2003, concentrated on providing a concise overview of various inflationary episodes over the centuries. Bernholz analyzed inflation under different monetary regimes, such as metallic (i.e. gold or silver) and fiat standards, and what caused them. He also looked at eras with either moderate inflation or hyperinflation, and how they were ended. Overall, the book is a nice, concise survey of various periods of inflation on what caused them, how they compare with other episodes, and what ended them.

With a favorable reception to the first edition in 2003, Bernholz has decided to keep most of the slim volume (roughly 230 pages) intact and add only two new revisions to the second edition in 2014 (pp. x–xi). The first is a section in Chapter 2 about the recent financial crisis and why central banks' monetary expansions have not led to present day inflation, and whether or not they will lead to it in the future. The second is an entirely new Chapter 9 about how historically stable monetary regimes (that is, monetary regimes that were constrained and did not lead to significant inflation) were eroded. Given that these are the two new additions to a book originally published over ten years ago, I will spend the rest of the review on them.

In the new Section 2.1, Bernholz tries to answer the question that everyone was asking in the years after the financial crisis: Where is all of the inflation everyone was worried about? For example, in the United States, from December 2007 to April 2014 M0, or the monetary base (currency in circulation plus member bank reserves) increased by 363.87 percent, yet the rise in consumer prices was nowhere near that amount (p. 4).

Bernholz first answers this using a number of illustrative figures. He first shows that the enormous increase in M0 in various countries led to moderate increases in M2 (p. 5). Although the rise in M0 has

not led to a rise in M2 now, Bernholz concludes that it provides a permanent potential for inflation in the years to come, once banks start to engage in credit expansion (p. 8). Then, even with the current increase in M2, Bernholz argues that the rise in consumer prices was mitigated because velocity during this period fell (i.e., money demand rose) and most of the new money was not spent on consumer goods, but on goods not included in a cost of living index, such as houses and stocks (pp. 8–9). Bernholz concludes by arguing that many banks have not engaged in credit expansion because they are pessimistic about the state of the economy (pp. 9–10).

At the outset, it would have helped Bernholz's argument enormously if he not only provided illustrative figures but also numerical figures. Aside from the precise increases in M0 in the USA, the euro area, and Switzerland from December 2007 to April 2014, he only provides illustrations of M2, the M2 money multiplier, and velocity. Why not also provided quantitative estimates for them as well? For example, it would have been nice to know that from the beginning of December 2007 to the beginning of December 2013 (the latter being the last full year before the book came out), despite the enormous M0 growth of 334.99 percent (27.76 percent per annum), M2 growth in the U.S increased only 47.42 percent (6.68 percent per annum), and the CPI increased even less than that at 10.99 percent (1.75 percent per annum).¹ And so on for velocity, the money multiplier, and housing and stock prices. The figures, while helpful illustratively for understanding the big picture, are not really helpful for those interested in using this section of the book for research.

In addition, when discussing why the increase in M0 did not translate into a concurrent increase in M2, Bernholz should have also mentioned, at least for the United States, the use of the contemporary new policy tool by the Federal Reserve to pay interest on member bank deposits. With this new proviso, banks no longer have as much of an incentive to engage in credit expansion in order to earn interest and to cover the cost of inflation eroding away idle balances. Certainly this, in conjunction with the regime uncertainty and economic malaise from the contemporary political climate, goes a long way towards explaining why the equally sizable M0 increase has not translated to an equally sizable M2 increase.

¹ Data for these numbers is obtained from BLS (2015), BOG (2015), and FRED (2015).

Although not directly related to current events, the other new addition of the book, Chapter 9, seeks to answer two questions: Why did some stable monetary regimes arise when there was no large inflation beforehand to incentivize their adoption, and under what circumstances did stable monetary regimes become abolished? Bernholz answers the first question with the theory that countries enacted stable monetary regimes so they would have an international currency that could be used in foreign trade. Bernholz uses examples from antiquity, such as the Athenian drachms and Corinthian staters, and argues that the sovereigns did not engage in debasement because the long term benefits from having an internationally used currency outweighed the short term benefits of debasement. Bernholz also argues that for some time the US dollar and British pound before World War I enjoyed relative stability for similar reasons. Bernholz answers the second question by arguing that countries are able to dismantle their stable monetary regimes and engage in inflationary policies whenever there is an "emergency." Bernholz provides a brief table of various governments that suspended gold convertibility or devalued their currency with a list of emergencies, ranging from domestic and international wars, government bankruptcy, and economic calamity (such as the Great Depression). To anyone familiar with Robert Higgs' *Crisis and Leviathan* (1987), the idea that emergencies, or crises, allow governments to engage in unprecedented usurpations of economic liberties (which includes money) is unsurprising. But it is nice to see the idea being taken seriously by others. A passage on the inherent incentive of governments to call a "national emergency" is all too revealing:

Given the inflationary bias of governments and politicians we should not be surprised that they grasped any critical situation to declare an emergency with the purpose of eroding or abolishing the factual legal or constitutional limits on their control of the currency. For it is only in emergencies that important changes appear to be warranted. As Carl Schmitt [German professor and early Nazi] pointed out: ... "Sovereign is he who decides on the state of emergency." (p. 209)

Bernholz also argues that the reintroduction of stable monetary regimes has occurred when countries try to mimic other countries who have already adopted a stable monetary regime. But without a first mover, the only other reasons have historically been after

the end of a war or a hyperinflation. This empirical reality is quite unfortunate for anyone who wishes to enact some form of monetary constitution that ensures price stability or deflation (such as a return to the gold standard) in the United States. Will it take a hyperinflation and destruction of the dollar in order for the public and politicians to learn that our present practices are unsustainable?

Overall, the book is informative about inflation in all periods of human history, and researchers looking for concise overviews will find much use in it.

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BOOK REVIEW

AMERICA'S BANK: THE EPIC STRUGGLE TO CREATE THE FEDERAL RESERVE

ROGER LOWENSTEIN

NEW YORK: PENGUIN PRESS, 2015, 368 pp.

PATRICK NEWMAN

“The problem with economic historians,” Murray Rothbard once quipped, “is that half of them are historians who don’t know any economics and the other half are economists who don’t know any history” (Rothbard, 1986, 0:01:05). After reading *America’s Bank: The Epic Struggle to Create the Federal Reserve* by Roger Lowenstein, I was reminded of Rothbard’s remark, which is as prescient as ever. Succinctly captured in the subtitle, Lowenstein’s book is about the grand—and often secretive—story behind the founding of the Federal Reserve System. It is informative about the unique personalities and interests of the people involved and the historical steps, including various congressional

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maneuvers, leading up to the passage of the Federal Reserve Act in 1913. However, the book suffers some serious shortcomings when describing the economics of central banking (and economics without central banking), in particular the economy of the United States before and after the Federal Reserve. The consequences of this is that Lowenstein overlooks other potential reforms that were advocated to alleviate the contemporary monetary problems and simply assumes that a central bank was the only effective solution, which weakens his analysis of events and understanding of the personal motives of those involved.

To put bluntly, Lowenstein takes a particularly biased point of view regarding American economic history, namely that the country's monetary history in the 19th century was in shambles and wracked with chaos, and that this was due to the general *laissez faire* monetary environment fostered by the anti-central bank mentality of the bumpkin commoners. Lowenstein's view on monetary history and economic theory is succinctly encapsulated when he criticizes James L. Laughlin, who argued for an asset currency reform at the turn of the century, that "[He] and other theorists were supremely naïve; monetary management is far too complicated to submit to an "automatic" guide" (p. 25). In a footnote to this statement he describes Milton Friedman's computer to automatically increase the money supply as "an arbiter with similarly magical properties." While I do not support Friedman's rule, I am sure that if he were to read this he would shoot back that Lowenstein and others are supremely naïve because monetary management is far too complicated to submit to a *discretionary* guide run by imperfect humans! But more importantly to our purposes here, Lowenstein's argument is that monetary *laissez faire*, or free banking on a gold standard, was simply an insufficient institution in order to support a modern industrial economy, or "for societies too advanced to depend on the vagaries of mining gold" (p. 270) and it caused numerous problems for the country before the Federal Reserve.

The main problem with this historical interpretation is that the monetary problems of the country were overblown, and when they did occur, they were generally due to various government regulations that made the system more prone to credit booms and banking panics. And during the period when the federal

government was least involved in regulating banking (1837–1861), the system was actually quite stable. Economic history work showing this, which started to really come out in force in the mid 1970s, is not cited by Lowenstein, which mars his historical overview in the beginning of the book on the monetary history of the United States before the Federal Reserve.

A brief review: first, Lowenstein misunderstands the periods of the First Bank of the United States (1791–1811) and the Second Bank of the United States (1816–1833) by arguing that they effectively restrained credit expansion and when they were removed banks could recklessly inflate credit (p. 3). In fact, the nation's first and second central banks enabled credit expansion and were supported by many state bankers. Excessive monetary creation following the demise of the first bank was due to the War of 1812, when the Treasury printed Treasury Notes which banks could use as reserves to expand credit and monetize the debt (Timberlake, 1978, pp. 13–28). Credit expansion following Jackson's removal of government deposits from the Second Bank and distributing them to state pet banks was not due to reckless credit expansion but instead due to increased reserves from specie inflows (Temin, 1969, pp. 68–82). His analysis of the so called "Free Banking Era" (1837–1861) is similarly erroneous when he describes it as "monetary chaos" (pp. 11–14) with fraudulent note issuance, excessive credit expansion, and numerous bank failures, seemingly relying on various contemporary accounts, including the reminiscences of Jay Cooke. In fact, as an entire literature starting with Rockoff (1975) uncovered, the situation was not nearly as bad as previously thought, and when there were problems they were due to prevailing state government interventions. Note issuance was actually fairly restrained, fraudulent issuance overblown, and losses to note holders actually quite small. Problems were due to the bond backing note requirement—that state banks insure their notes with state government bonds—and prohibitions on branch banking. The first made banks unable to effectively meet customer demands to convert deposits into notes and forced them to pay out specie reserves, which increased the illiquidity of the banks and hence encouraged bank runs. Branch banking prohibition prevented banks from competing across state lines and propped up inefficient poorly diversified banks that were

very failure prone. These problems were exacerbated under the National Banking System instituted during the Civil War, because it encouraged credit expansion and a concentration of reserves in a small number of banks through its three tiered banking structure, which Lowenstein properly notes (p. 14–15). But then he misfires when he argues that the banking class abhorred the Civil War greenbacks and this new system led to a six year long depression from 1873–1879 (pp. 15–16). In fact, the bankers were strong early supporters because they could be used as reserves for the banking system, and the depression lasted only until 1875 (Hammond, 1970, pp. 246–250; Davis, 2006, pp. 106, 115).

Lowenstein continues to err when he writes how the gold standard from 1879–1896 “imposed severe hardships” on the common populace, in particular farmers, who had to deal with falling prices and crushing debt burdens (pp. 16–18). Farmer grievances were overblown, and decreases in nominal interest rates from anticipated deflation mitigated increases in farmer’s debt burdens, most of whom were not heavily mortgaged (Higgs, 1971, pp. 96–102; Morris, 2006, p. 116). Lowenstein cites Friedman and Schwartz (1963, p. 41) for proof that post 1865 prices “skidded relentlessly lower” and fell by more than 50 percent. But then he borders on the disingenuous when he fails to acknowledge the sentence immediately following, where Friedman and Schwartz write, “Not only did it not produce stagnation; on the contrary, it was accompanied and produced by a rapid rate of rise in real income.”

This of course, is not to deny that there were no monetary problems in the United States in the post Civil War era. As stated before, the National Banking System and the continuance of branch banking prohibitions caused difficulties. But these problems, along with others, were not caused by true free banking or an unadulterated gold standard, but rather by government interventions that stifled their self-regulating mechanisms. However, Lowenstein’s poor theoretical framework and empirical evidence—that free banking would result in “monetary chaos”—causes him to miss this and thus give short shrift non-central bank reform plans, such as the Baltimore Plan of 1894, James Laughlin’s asset currency reform from the 1897 Indianapolis Monetary Convention, and the 1902 Fowler Bill, which tried to alleviate the problems by allowing individual banks to better self-regulate the money supply (pp.

20, 25, 33). Not everyone saw that the solution was a further centralization and creation of reserves through a central bank, and this is an important aspect of the road to the Federal Reserve that commonly gets overlooked.

The rest of Part I of the book, “The Road to Jekyll Island” tells the story of how the initial bill to draft the Federal Reserve was created. Here Lowenstein chronicles how German investment banker Paul Warburg wanted an American central bank (and *not* to follow the more decentralized asset currency reform movement). Republican Senator Nelson Aldrich, who would later be crucial to the creation of the Federal Reserve, was initially against any type of central bank. However, after the Panic of 1907, Congress approved the Aldrich-Vreeland Act in 1908, which created a National Monetary Commission, and shortly thereafter Aldrich was convinced of Warburg’s solution and a central bank. After a strategic mistake of waiting a couple of years, which the incumbent Republican Congress could ill afford, in November 1910 Aldrich organized a secret meeting with prominent Wall Street bankers at Jekyll Island in Georgia and drafted the Aldrich bill, which for all intents and purposes became the bedrock for the future Federal Reserve. To readers of the QJAE, the general outline of the story is not new, as Murray Rothbard wrote about it extensively in various publications (Rothbard 2008 [1983], 1984, 1994, 2005 [1999]). However, Lowenstein provides a detailed narrative that should be read by those interested in Aldrich and the New York bankers’ plans to create a central bank.

In this narrative, when discussing the banker’s motivations Lowenstein does say that they thought a central bank would favor powerful bankers, but ultimately, since they also thought it would further the public’s interest, they were “conspirators, but patriotic conspirators” when drafting the bill at Jekyll Island (pp. 54, 119). Here is where a more proper understanding of the history of the United States banking system would have been helpful. If free banking actually worked better than previously assumed, was a central bank still the right direction? Couldn’t the public interest have been to follow through with other reforms and not a centralized banking structure? Since the New York City bankers favored reform in the form of increased centralization but did not support the asset currency reform and removal of branch

banking, which Lowenstein briefly touches upon from (pp. 54–55), then couldn't their self-interested benefits in favor of increased centralization have been a detriment to the public interest? These are important issues that have been at the center of the prior critics of the Jekyll Island meeting such as Rothbard's. When discussing these criticisms, Lowenstein, painting with a broad brush, characterizes all of them as "conspiracy theories" and the critics as "gold bugs, anti-Federal Reserve zealots, and flat-out cranks" (p. 117). For some of these naysayers, Lowenstein singles out Holocaust denier Eustace Mullins, G. Edward Griffin, and a paper presented by the Mises Institute's own Mark Thornton at a conference at Jekyll Island in 2010 (but does not include Rothbard)! A broad brush indeed! Lowenstein writes that Mark Thornton, a "contemporary naysayer," argued that the Federal Reserve is "nothing but a confidence game" and included his work as those against money and credit (p. 118). In reality, Thornton's presentation (2010) was about how Federal Reserve officials and supporters are always bullish on the economy, and about the ability of the Federal Reserve to swiftly and successfully get the country out of problems, even during the turbulent 2007 (something you don't have to be a crank to view as somewhat suspicious, given the Fed's prior track record).

Part II, "The Legislative Arena," deals with the post-Jekyll Island timeline of events leading up to the Federal Reserve, a narrative that Rothbard did not cover as much in depth. Here the older cast of characters, in particular Aldrich, fell out of significance as the bill passed into the hands of a Democratic Congress and got wrapped up in the tumultuous election of 1912. The final Glass bill was extremely similar to the older Aldrich plan and the differences were mostly nominal. While the most significant event, the meeting at Jekyll Island, had already passed, this part is still interesting because it describes how the idea for a central bank survived party transitions, populist criticisms, and various political maneuverings.

Ultimately, *America's Bank* is a mixed bag. Lowenstein tells an important story and describes many aspects of the narrative and the crucial cast in great detail. However, the overall narrative is weakened by the author's poor understanding of various economic events, and this causes him to write with a pro-central bank bias

and be overly supportive of the proponents' motives, when a more proper understanding would have led to examining rival reforms in greater detail and be more skeptical of the need for a central bank.

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BOOK REVIEW

THE ONTOLOGY AND FUNCTION OF MONEY: THE PHILOSOPHICAL FUNDAMENTALS OF MONETARY INSTITUTIONS

LEONIDAS ZELMANOVITZ

LANHAM, MD: LEXINGTON BOOKS, 2015, xxi + 447 pp.

NIKOLAY GERTCHEV

This ambitious new book on the foundations of money and monetary institutions, based on the author's Ph.D. dissertation defended in 2011 at the Universidad Rey Juan Carlos in Madrid, Spain (supervised by Gabriel Calzada), is an impressive interdisciplinary exercise. Part I of the book, "Metaphysics," dwells into the nature, origin, and valuation of money. Part II, "Epistemology," discusses what could possibly be known about monetary phenomena, and how this knowledge can best be acquired. Part III, "Ethics," proposes a framework for a moral assessment of

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monetary arrangements and institutions. The last part, "Politics," which spreads over one third of the book, addresses various issues, such as the history of fiat paper money in the USA, the optimum supply of money and credit, contemporary monetary policy and considerations about the future evolution of money. Five appendices, totaling fifty pages, detail the author's thoughts on topics as diverse as coined money in Greece, dollarization, financial repression and even the resource curse. The book also contains a ten-page glossary and an extensive index, both of which are meant to help the reader cope with the abundant concepts and authorities to which the author refers. Capitalizing on his interdisciplinary approach, Zelmanovitz hopes to reach a large audience that goes beyond the limited circle of scholarly economists. His plan will certainly be challenged by the book's price (in excess of hundred dollars).

The author's research project, though immense, is striking by its clarity: a normative prescription for improving a society's monetary institutions requires knowledge about the nature and value of money, a proper understanding of the limits of that knowledge and a realistic view about how it could be implemented practically, given the political constraints of the real world. This clarity results in a structural consistency that excites the reader's curiosity and renders the book pleasant and engaging. The trouble with it is that, despite bringing together different views from several social disciplines, the book is not entirely convincing. Zelmanovitz possesses a vast knowledge of both authors and issues that he puts on show; but he fails to develop a step-by-step criticism-proof argument that alone could gain the reader's endorsement. The remaining of this review will substantiate this opinion with a discussion of Zelmanovitz's views in three areas that are foundational of his project: the moral assessment of social institutions in general, the moral justification of central banking in particular, and the theory of monetary equilibrium.

WHAT DISTINGUISHES RIGHT FROM WRONG SOCIAL ARRANGEMENTS?

In the author's intellectual framework, a proper answer to this question is essential for grasping the essence of money, because

"the idea is to approach money as a social institution" (p. 1). Thus, the ethical appraisal of present-day monetary arrangements becomes encapsulated in the much broader question of the ethical assessment of social arrangements in general. Zelmanovitz's preferred criterion for right and wrong is heavily influenced by the objectivist philosophy of Ayn Rand: "It seems difficult to think about a better criterion to define what is right and wrong with social arrangements than measuring them in light of their capacity to allow and to promote human flourishing" (pp. 167–167). The more an institution contributes to the development of the individual persona, the more appropriate it is: "Humans by nature have conscience and intelligence and the very purpose of their social arrangements is to enhance their individual opportunities to reach the limits of their potential, to flourish as individuals" (p. 4). This natural tendency of the human being to purposefully seek his own flourishing would, presumably, have the added benefit of deriving irrefutable normative statements from the very essence of beings and things. Whatever promotes individual flourishing would be right and good, and hence morally justified. This criterion would offer a solution to the alleged impossibility to derive normative claims from descriptive statements: "In the same way, that exception to the fallacy of deriving an 'ought' from an 'is' applies to what is instrumental to living beings to realize their potential" (p. 2).

As attractive as might appear this functionalist version of a naturalistic moral philosophy, it is a source of deep confusion. First of all, it lacks universality. What exactly does "human flourishing" mean, and does it have the same meaning for any single individual? Is it to be approximated by improved material welfare, longer life expectancy, more profound spiritual development, reduced frequency of military conflicts, intensified trade, etc.? The author is never explicit about his own understanding, though at some point he declares that "the more a system allows the division of labor, the better it is" (p. 14).¹ The book somehow conveys the impression that human flourishing is to be understood as the individual pursuit of happiness, and that this would naturally result in

¹ Notice that this would imply that monastic communities, compared to worldly cities, are inferior social orders.

an ever-growing division of labor. However, a systematic analysis of the practical means to achieve this very abstract goal, and of its concrete working and implications, is lacking.

Second, Zelmanovitz is conflating *social* with *political* institutions. To be more precise, he sees the latter as ordinary human organizations: “[...] because political societies are no more than groups of individuals and their institutions are no more than forms of interaction among those individuals, with everyone pursuing his or her own interest in different fields” (p. 3). This general description, while not necessarily wrong, fails to make the very important distinction between the two mutually exclusive organizational principles of groups of humans: voluntary cooperation and forceful exploitation. It would hardly be an exaggeration to state that all progress in political and moral philosophy is due to the analysis of the implications of this simple but crucial distinction. While it is hard to believe that the author might not be aware of this, he prefers to avoid a rigorous discussion of how individual cooperation restrained by rightfully acquired private property differs from centrally imposed collaboration. Rather, he prefers to confine his discourse within the framework of notions like unintended consequences and spontaneous outcomes.

An obvious problem with that approach is that it grants to the political means of acquiring wealth as much legitimacy as to the economic means, to borrow a famous distinction made by Franz Oppenheimer (1926, pp. 24–27). Spoliation of others’ production and their accumulated property, i.e. the political means, becomes as moral as the initial appropriation through one’s own labor, production and exchange, i.e. the economic means. Put differently, violence becomes legitimized in all circumstances. Such a conclusion, which incidentally empties any social political theory from its scope and meaning, could not possibly be true: a society that would admit indiscriminate violence is self-destructing by design.

The insufficient analysis of what is or is not legitimate violence implies that the very important distinction between the social class of the exploited and the social class of the exploiters is missing from the book. Hans-Hermann Hoppe has shown that these categories are crucial for understanding social evolution (Hoppe, 2001, 2012). In addition, there can be no proper understanding of the state-organized redistribution of resources, as opposed to

the market-driven distribution of incomes, without recourse to this same opposition between producers and exploiters. Thus, it comes as no surprise that the author does not discuss at all state monopolies of money production in relation to their impact on wealth redistribution. Nowhere is there any mention of the well-known Cantillon effects, which have become the cornerstone of the Austrian economic and political analysis of fiat paper monies (Thornton, 2006; Dorobăţ, 2014). Furthermore, had the author given a proper place to the analysis of political institutions, he would not have sought to integrate, at any cost, the catallactic with the chartalist theories of money. This endeavor, which is the core of Part I of the book, arrives at a dubious conclusion: “One must ask, can the state *create* value? I think that the answer to that question is undoubtedly yes and all forms of fiat money in circulation today are evidence of that” (p. 44, our emphasis). That fiat money, or for that matter any other good supplied by a monopoly, has value is no proof that its value is *created* by the monopoly producer. Fiat money value still springs out of its usefulness as appreciated by money users. Consequently, the determination of its purchasing power is subject to the market process, not to a decree that spells out the will of the monopoly producer. Any accommodation with the chartalist view implies a contradiction with the subjectivist theory of value, and hence great difficulties with providing a realistic account of monetary phenomena.²

IS CENTRAL BANKING LEGITIMATE?

The entire chapter seven is dedicated to a discussion of the rationale for central banking. Zelmanovitz rightly discards, even though without much discussion, the most common economic justifications. The question he raises is whether a good political reason for government involvement in money production could be found. He believes he has identified such a good reason thanks to the “qualitative distinction, both legal and moral, between taxation and expropriation” (p. 197). While the book does not offer a systematic presentation of that distinction, the author’s

² A case in point is an extreme monetary phenomenon such as a hyperinflation. A consistent chartalist must take hyperinflations as desired and designed by the state.

argument is quite clear. There are emergency situations when the protection of society against enemies could not be organized efficiently without confiscating individual resources. Inflationary money printing, which is one method of resource confiscation, is therefore admitted. This is confirmed by monetary history itself, which shows that governments have monopolized money production when they needed resources for their war efforts. This fact of life proves that central banks are morally justified. Each one of these three steps of the rationalization of state monopolies in monetary affairs deserves individual scrutiny.

First, is it true that centralized confiscation of individual property is an efficient means for gathering the supposedly large pool of resources needed to defeat a foreign enemy? The author himself explicitly provides the arguments for negating centralized confiscation, but oddly enough he draws the opposite conclusion: “Therefore, if protection of life and property is of personal value for all individuals, in different circumstances, different efforts may be necessary, *regardless of their individual preferences*” (p. 210, our emphasis). To the extent that this confiscation is at odds with individual preferences, it is undesired and thereby revealed as reducing people’s welfare. As a matter of fact, in the absence of individual agreement, the confiscator is no longer protector; he becomes the aggressor. Consequently, centrally commanded expropriation could not logically be a means for defeating a foreign enemy. After all, an enemy is defined precisely by his assaulting on individuals’ private property! It is still possible that the author has in mind a kind of a “market failure” situation, in which for technical reasons the “public good” security could not be provided in any other way but through central planning. However, the point that the market could not provide the much needed security against foes would have needed to be substantiated much more deeply, especially in light of the argument that either there is an economic science that establishes the superiority of the competitive principle in all areas of human activity, or there is no economic science at all (Molinari, 2009). Similarly, the author could have subjected the efficiency analysis of a centrally organized war economy to the logical test of the economic calculation argument (Mises, 2008, pp. 201–232).³

³ Generally speaking, Zelmanovitz adheres to the Hayekian intellectual universe, in which the achievements of the economic science are closely linked to the deeper

Based on this premise, which we believe is contestable, the author builds up his moral case for central banking: "If a central bank is understood as a modern proxy to the monetary prerogatives of government in general, only to be used in cases of extreme emergencies, then a moral defense for its existence may be found in this work" (p. 232). Let us note first that nowhere does the author discuss the mechanisms through which monopolized money production and inflation allow the central authority to seize the resources deemed necessary. The proof of the so-called "fiscal proviso" would have been a welcome occasion to present the Cantillon effects, which we already noted are missing in this work. Moreover, given that other means for collecting resources, such as taxation or bond issuance, are also available, the superiority of inflation should have been established. As far as the argument itself is concerned, it is straightforward that even if the premise were valid, it would justify central banking exclusively in the very specific cases of presumably rare emergencies. Would not this imply that, once the emergency has been resolved, the central bank should be declared unjustified in the new circumstances, and therefore dismantled? Fearing this type of criticism, the author comes up with a really astonishing defense.

Zelmanovitz provides a condensed summary of Rothbard's monetary history of the United States (Rothbard, 2002), in which he shows how fiat paper money and central banking became institutionalized in the context of budget deficits in need of funding. The whole point of this narrative is to convince the reader that the historical events rendered the acceptance of the "fiscal proviso" inevitable: "[...] to understand the 'fiscal proviso' as a mere act of force, deprived of any moral justification, even utilitarian ones, seems very unrealistic in light of the future events in the monetary history of the United States" (p. 220). In the concluding remarks to this chapter, the author becomes even more explicit: "This attitude of disregard for individual property rights is the 'natural' response of different governments in different historical moments. It is a 'fact of life'" (p. 231). In other words, the very existence of central banks, understood as the natural response of governments

integration and application of such notions as subjectivity, knowledge and expectations. The author is definitely not a proponent of the Misesian approach, which is firmly anchored in the entrepreneurial market process itself and its prerequisites, one of which are the objective conditions for rational economic calculation.

to somehow inevitable historical circumstances, provides a moral case in their defense.⁴ Two objections could be spelled out. First, the argument confuses historical explanation and moral justification, which are two distinct thought processes. Were they one and the same, all things would be right by virtue of their merely being what they are. Second, and this is related to the observations from the previous section, a full-fledged theory of the government would have been needed in order to show how the progressive setting-up of a central bank as a monopolist producer of fiat paper money is, indeed, in the nature of growing governments.

Even though the author believes that he has proved a moral case for central banking, he still describes himself as an advocate for a monetary reform that would allow the individual to fully accomplish his potential. This is the last point that needs to be reviewed in some detail.

THE THEORY OF MONETARY EQUILIBRIUM AND ITS IMPLICATIONS FOR MONETARY REFORM

It is unfortunate that, in his quest for an interdisciplinary approach to money and banking, the author does not present a structured exposé of the economic analysis of money, and more specifically of an economy's monetary equilibrium. Nevertheless, several of his comments suggest that he is a proponent of the real bills doctrine, which puts him at odds with the Austrian approach to money and banking.⁵ As a result of this view about monetary equilibrium,

⁴ Another general feature of Zelmanovitz's work is that practical facts often take pre-eminence over theoretical considerations. A case in point is his confession that "Ultimately, the argument in favour of a 100 percent reserve requirement that convinced me is Buchanan's argument that once base money is no longer expensive to produce, there is no more reason to have a banking system designed to economize on it" (p. 342). But this practical argument only begs the question why, then, fractional reserve banking still persists. The answer would require a thorough theoretical study, *inter alia* of redistribution effects and their links to vested political and economic interests.

⁵ Zelmanovitz is heavily influenced by the monetary disequilibrium theory of Leland Yeager. However, while Yeager (1986) conceptualizes about the monetary (dis)equilibrium in real terms, Zelmanovitz's discussion is exclusively in nominal terms. Both authors share the view that prices convey information and incentivize human action.

he is advocating a reform that would ensure the flexibility of the money supply in order to accommodate changes in the demand for money, while guaranteeing the stability of money's value. Finally, this reform would be driven by an ongoing tendency towards a higher level of abstraction and a growing dissociation between the unit of account and the medium of exchange functions. Let us elaborate on each of these points.

Zelmanovitz introduces the supply of and the demand for money in two very short paragraphs (pp. 238–239) and represents a neoclassical type of equilibrium in a chart (p. 244). He does not explain which forces actually bring about the monetary equilibrium, and what their impact on prices is. Had he done so, he would have discovered the real cash balances doctrine, according to which changes in the demand for money imply increased selling or buying of other goods against money, and hence changes in monetary prices. Whatever the stock of nominal units of money, i.e. whatever the supply of money is, price changes always guarantee that this nominal stock can satisfy any demand for real cash balances. The conclusion that changes in the purchasing power of money ensure monetary equilibrium at any time is the greatest achievement of the Austrian theory of money and banking. Building upon its foundations, Murray Rothbard declared “that there is no such thing as ‘too little’ or ‘too much’ money, and *that, whatever the social money stock, the benefits of money are always utilized to the maximum extent.* An increase in the supply of money confers no social benefit whatever; it simply benefits some at the expense of others, [...]” (Rothbard, 2009, p. 766, original emphasis).

The author adopts the exact opposite view, claiming that there are great social benefits to be expected from a flexible supply of money:

A relatively constant amount of money chased by a sudden increased demand will force fire sales and economic disruption. Even under relatively calm circumstances, a relatively inflexible monetary supply is not necessarily one that would adjust automatically to changes in the demand for money without somewhat important changes in money value (p. 326).

The idea that deflationary pressures are disruptive is recurrent: “If the government keeps the supply of money constant in face of an increased demand for money, or worse, allows its contraction, it

will force asset liquidations beyond the misallocations that need to be corrected, producing even bigger economic devastation, human suffering, and social unrest" (p. 242). The contraction referred to is specific to the fractional reserve banking system where loss of confidence during the downturn implies a decrease in the money supply: "[...] the banks are forced to 'deleverage,' that is, to call back the loans they made in order to repay the investors/depositors. Since the very essence of the system is the creation of multiple financial claims over the same amount of base money, [...], that liquidation becomes problematic" (p. 207). Only an accommodative monetary policy would alleviate these alleged problems:

Therefore, while the current monetary constitution remains in place, any decision by the central bank of not providing more liquidity for the banks, and consequently forcing all economic agents, in their increased demand for cash balances, to compete for a fixed supply of money, would represent an additional effort of adaptation from society on top of the effort required to liquidate all the existing misallocations (pp. 253–254).

There are at least three major problems with the contention that changes in the demand for money need to be matched by changes in the supply of money in order to avoid economic disruptions. First, as already pointed out, the monetary equilibrium is restored through market-driven price changes that both reflect individuals' new preferences to hold more or less money relative to other goods and adjust the demand to hold real cash balances to the existing nominal supply of monetary units. Second, the alleged social disruptions and hardship triggered by liquidations that would go beyond those necessary to correct malinvestments are pure myths (Bagus, 2015, pp. 94–108). Should prices go below what they would have been, this would imply that those entrepreneurs that buy assets at below-equilibrium prices make profits that are explained by the corresponding losses of the selling asset-holders.⁶

⁶ Notice also that the deflationary recovery situation is fundamentally different from that of an inflationary unsustainable boom. The deflation facilitates the redistribution of existing assets from failed entrepreneurs to capitalists that consider themselves better at the art of managing assets. The deflation does not lead to waste of resources. On the contrary, the inflationary boom consists in wrong investment decisions that imply aggregate net losses and waste of resources due to the non-convertibility of some capital goods.

Speculation and arbitrage would consume these possible gains until prices are restored to their equilibrium levels. From that point of view, it is even difficult to claim that there is an optimal level of liquidations corresponding to some needed adjustments, as these adjustments and liquidations are determined by the market process itself. Third, one of the book's themes is that limitations on our individual knowledge lead to a skepticism that is "reflected in doubts about the ability to know what the quantity of money existing in society is at any given time" (p. 141). If according to the author even the supply of money cannot be known exactly, how could the authorities know what the changed demand for money is, and how could they know how to accommodate it? It seems to us that if there were knowledge limitations, they would immediately discard the very possibility for a designed policy that could do better than the natural market process.

Based on his approach to monetary equilibrium, Zelmanovitz offers a very general blue-print for monetary reform that relies on the need for a built-in flexibility of the money supply. He sees two salient features of such a reform, which he also considers historically inevitable: "The time for a monetary system in which the unit of account will be entirely abstract and all monetary merchandise will be securities is very close" (p. 318). In other words, a double dematerialization of money should occur. First, securities alone would become the most commonly used media of exchange. The author does not provide a complete explanation of why this would be so. However, one could imagine that this is the case because the issuance of securities would provide the needed flexibility for the supply of money to automatically adjust to changes in the demand for money. Second, accounting would be conducted in an independent abstract unit, so that the flexibility of the medium of exchange would not be restrained in any way whatsoever.

How realistic is this proposal for reform? Without entering into much detail, let us mention what we consider as two stumbling blocks. First, while a unit of account could exist without also being used as the unit of measure for the medium of exchange, both units are bound to be linked to each other. If that were not the case, then the function of unit of account would be overtaken by the medium of exchange itself. For instance, the *French livre* has been indeed a pure accounting unit. However, at any given

moment, it was defined as a specific quantity of *sous*, *deniers* or *francs*. Even though this specific quantity has varied at different times, the link itself between the *livre* as a unit of account and the units of the circulating medium of exchange has been permanent. This practical example is not the result of a historical contingency; things could not have been otherwise. A completely abstract unit of account would imply that accounting itself has become abstract, i.e. disconnected from reality. This is logically impossible, as accounting has one purpose only, namely to provide the most faithful possible account of reality in monetary terms. For that account to be inter-subjectively communicable within a given community of individuals, the monetary terms in which it is expressed must be universally accepted within that community. This already implies that securities, each with its own characteristics and risks, could not become universal media of exchange, i.e. money. To the contrary, money appeared precisely as a solution to the tremendous problem of appreciating the liquidity of goods and assets with unknown marketability. To consider that securities could ever become the “monetary merchandise” implies one of two things. Either this would be a *de facto* return to barter, with all its implications in terms of hindered economic calculation, and hence reduced division of labor. Or this would imply that each security issuer has become an issuer of his own money. The result of this type of monetary freedom has been predicted long ago by the banker Henri Cernuschi (Mises, 2008, p. 443).

CONCLUSION

Overall, despite the weaknesses highlighted above, Zelmanovitz’s book will be appreciated by the initiated reader. It raises a very large number of relevant questions and puts together, in a thought-provoking way, a wealth of notions and concepts. However, these very same qualities that distinguish the diversified erudite are also pretext for some uneasiness, mostly related to the approach chosen.

First, the interdisciplinary approach is bound to economize on a systematic presentation of any of the specialized branches of knowledge that it exploits. This makes any such project both very difficult to understand by beginners and exposed to easy criticism

by specialists. Given these unavoidable pitfalls, Zelmanovitz succeeds rather well in this delicate exercise in versatility. However, the question remains to what extent this approach deepens our knowledge of money and of monetary institutions and policy. In particular, what is its superiority to an exclusively economic study of a very specific issue that would carefully elaborate on the existing (narrow) theory?

Second, interdisciplinarity often goes hand in hand with an attempt at reconciling various epistemologies and schools of thought. This is also the case with Zelmanovitz's book, which expresses his "convictions about the possibility in the future to recreate a consensus about good economics" (p. xxi). However, in science, truth alone is the single criterion for goodness. To the extent that concessions and compromises with the truth are needed for deriving an ecumenical position, consensus-building appears unscientific. Moreover, progress in science does not need consensus. Truth is out there to be studied and analyzed by all interested students, and arguably the discoveries of its various aspects have been consensus-breaking, rather than consensus-building. Admittedly, this is a much broader debate, which falls beyond the limited scope of this review.

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BOOK REVIEW

BOURGEOIS EQUALITY: HOW IDEAS, NOT CAPITAL OR INSTITUTIONS, ENRICHED THE WORLD

DEIRDRE McCLOSKEY

CHICAGO: UNIVERSITY OF CHICAGO PRESS, 2016, 787 PP.

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If it's true that Wayne Booth inspired Deirdre McCloskey's interest in the study of rhetoric, then it's also true—happily, in my view—that McCloskey has refused to mimic Booth's programmatic, formulaic methods and boorish insistence on prosaic succinctness. *Bourgeois Equality* is McCloskey's third volume in a monumental trilogy that began with *The Bourgeois Virtues* (2006) and *Bourgeois Dignity* (2010), each published by the University of Chicago Press. This latest volume is a Big Book, alike in kind but not in theme to Jacques Barzun's *From Dawn to Decadence* (2000), Camille Paglia's

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Sexual Personae (1990), or Herald Berman's *Law and Revolution* (1983) and *Law and Revolution II* (2006). It's meandering and personal, blending scholarship with an essayistic style that recalls Montaigne or Emerson.

McCloskey's elastic arguments are shaped by informal narrative and enlivened by her plain and playful voice. At times humorous, rambling, and deliberately erratic, she gives the distinct impression that she's simply telling a story, one that happens to validate a thesis. She's having fun. Imagine Phillip Lopate articulating economic history. McCloskey is, in this regard, a latter-day Edward Gibbon, adopting a mode and persona that's currently unfashionable among mainstream historians, except that she's more lighthearted than Gibbon, and unashamedly optimistic.

Writing with an air of confidence, McCloskey submits, *contra* Thomas Piketty, that ideas and ideology—not capital accumulation or material resources—have caused widespread economic development. Since 1800, worldwide material wealth has increased and proliferated; the quality of life in poor countries has risen—even if it remains unequal to that of more prosperous countries—and the typical human being now enjoys access to the food, goods, services, medicine, and healthcare that, in earlier centuries, were available to only a select few in the richest parts of the globe. The transition from poverty to wealth was occasioned by shifting rhetoric that reflected an emerging ethical consensus. The rhetorical-ethical change involved people's "attitudes toward other humans" (p. xxiii), namely, the recognition of shared experience and "sympathy," as Adam Smith stated in *The Theory of Moral Sentiments*. Attributing human progress to ideas enables McCloskey to advocate the norms and principles that facilitated economic growth and social improvement (e.g., class mobility and fluidity) while generating extensive prosperity. Thus, her project is at once scholarly and tendentious: a study of the conditions and principles that, in turn, she promotes.

She argues that commercialism flourished in the eighteenth century under the influence of ideas—such as "human equality of liberty in law and of dignity and esteem" (p. xxix)—that were packaged in memorable rhetoric and aesthetics. "Not matter, mainly, but ideas" caused the Great Enrichment (p. 643). In other words, "[t]he original and sustaining causes of the modern world

[...] were ethical, not material," and they included "the new and liberal economic idea of liberty for ordinary people and the new and democratic social idea of dignity for them" (p. xxxi). This thesis about liberty and dignity is clear and unmistakable if only because it is repetitive. McCloskey has a habit of reminding readers—in case you missed her point the first, second, or fifty-seventh time around—that the causes of the Industrial Revolution and the Great Enrichment were ideas, not "narrowly economic or political or legal changes" (p. 470). She maintains, to this end, that the Scottish Enlightenment succeeded in combining the concepts of liberty and dignity into a desirable form of equality—not equality of outcomes, of course, but of opportunity and treatment under the law. And the Scottish model, to her mind, stands in contradistinction to the French example of centralized, top-down codification, command, planning, and design.

A perennial villain lurks in the pages of her history: the "clerisy," which is an "appendage of the bourgeoisie" (p. 597) and often dubbed "the elite" in regular parlance. McCloskey calls the clerisy "the sons of bourgeois fathers" (p. xvii) and "neo-aristocratic" (p. 440). The clerisy includes those "artists, intellectuals, journalists, professionals, and bureaucrats" who resent "the commercial and bettering bourgeoisie" (p. xvi). The clerisy seeks, in different ways at different times, to extinguish unfettered competition with exclusive, illiberal, irrevocable grants and privileges that are odious to free society and offensive to the rights of average consumers. "Early on," says McCloskey, referring to the period in Europe after the revolutionary year 1848, "the clerisy began to declare that ordinary people are misled in trading, and so require expert protection and supervision" (p. 609). The clerisy since then has been characterized by paternalism and a sense of superiority.

Because the clerisy is shape-shifting, assuming various forms from time to time and place to place, it's a tough concept to pin down. The word "clerisy" does not appear in the book's index to permit further scrutiny. By contrast, McCloskey's general arguments are easy to follow because the book is separated into parts with questions as their titles; subparts consisting of one-sentence headings answer those questions.

In a massive *tour de force* such as this, readers are bound to take issue with certain interpretive claims. Historians will find McCloskey's

summaries to be too breezy. Even libertarians will accuse her of overlooking manifest wrongs that occurred during the periods she surveys. My complaints are few but severe. For instance, McCloskey is, I believe, either careless or mistaken to announce that, during the nineteenth and early twentieth century,¹ “under the influence of a version of science,” in a territory that’s never specifically identified, “the right seized upon social Darwinism and eugenics to devalue the liberty and dignity of ordinary people, and to elevate the nation’s mission above the mere individual person, recommending, for example, colonialism and compulsory sterilization and the cleansing power of war” (p. xviii).

Let’s hope that it’s innocent negligence rather than willful distortion that underlies this odd, unqualified, categorical assertion. Adam Cohen’s *Imbeciles* (2016) and Thomas C. Leonard’s *Illiberal Reformers* (2016) describe how, in the United States, social Darwinism and eugenics were adopted primarily, though not exclusively, by the Left, not the Right. These recent books come on the heels of several scholarly treatments of this subject: Thomas M. Shapiro’s *Population Control Politics* (1985), Philip R. Reilly’s *The Surgical Solution* (1991), Joel Braslow’s *Mental Ills and Bodily Cures* (1997), Wendy Kline’s *Building a Better Race* (2001), Stefan Kuhl’s *The Nazi Connection* (2002), Nancy Ordovery’s *American Eugenics* (2003), Christine Rosen’s *Preaching Eugenics* (2004), Christina Cogdell’s *Eugenic Design* (2004), Gregory Michael Dorr’s *Segregation’s Science* (2008), Paul A. Lombardo’s edition *A Century of Eugenics in America* (2011), and Alexander Minna Stern’s *Eugenic Nation* (2016). These represent only a small sampling.

Is McCloskey unaware of these texts? Probably not: she reviewed Leonard’s book for *Reason*, although she did so after her own book reached press. At any rate, would she have us believe that Emma Goldman, George Bernard Shaw, Eugene Debs, Marie Stopes, Margaret Sanger, John Maynard Keynes, Lester Ward, and W. E. B. Du Bois were eugenicist agitators for the political Right? If so, she should supply her definition of “Right,” since it would go against commonly accepted meanings. On the matter of colonialism and

¹ McCloskey is vague about the period to which she refers, but the reader may infer, based on surrounding references to the nineteenth and twentieth centuries, that she is locating this trend in the period I have identified.

war, self-identified members of the Old Right such as Albert Jay Nock, John Flynn, and Senator Robert Taft advocated precisely the opposite of what McCloskey characterizes as “Right.” These men opposed, among other things, military interventionism and adventurism. The trouble is that McCloskey’s muddying of the signifiers “Left” and “Right” comes so early in the book—in the “Exordium”—that readers may lose trust in her, question her credibility, and begin to suspect the labels and arguments in her later chapters.

Other undefined terms only make matters worse, ensuring that McCloskey will alienate many academics, who, as a class, are already inclined to reject her libertarian premises. She throws around the term “Romanticism” as if its referent were eminently clear and uncontested: “a conservative and Romantic vision” (p. xviii); “science fiction and horror fiction [are] ... offshoots of Romanticism” (p. 30); “[Jane Austen] is not a Romantic novelist ... [because] [s]he does not take Art as a model for life, and does not elevate the Artist to a lonely pinnacle of heroism, or worship of the Middle Ages, or adopt any of the other, antibourgeois themes of Novalis, [Franz] Brentano, Sir Walter Scott, and later Romantics” (p. 170); “Romanticism around 1800 revived talk of hope and faith and a love for Art or Nature or the Revolution as a necessary transcendent in people’s lives” (p. 171); “Romantic candor” (p. 242); “the late eighteenth-century Romantic literary critics in England had no idea what John Milton was on about [*sic*], because they had set aside the rigorously Calvinist theology that structured his poetry” (p. 334); “the nationalist tradition of Romantic writing of history” (p. 353); “Romantic ... hostilities to ... democratic rhetoric” (p. 510); “[i]n the eighteenth century ... the idea of autonomy triumphed, at any rate among the progressive clerisy, and then became a leading Romantic idea, á la Victor Hugo” (p. 636); and “the Romantic conservative Thomas Carlyle” (p. 643).

To allege that the clerisy was “thrilled by the Romantic radicalism of books like *Mein Kampf* or *What Is to Be Done*” (p. xviii) is also recklessly to associate the philosophies of, say, Keats or Coleridge or Wordsworth with the exterminatory fantasies of Hitler and Lenin. McCloskey might have guarded against this misleading conflation by distinguishing German idealism or contextualizing Hegel or by being more vigilant with diction and definition. Her loose language will leave some experts (I do not profess to be one)

scratching or shaking their heads and, more problematic, some non-experts with misconceptions and misplaced targets of enmity. One imagines the overeager and well-meaning undergraduate, having read *Bourgeois Equality*, setting out to demonize William Blake or destroy the reputation of Percy Shelly, about whom Paul Cantor has written judiciously.² Wouldn't originality, imagination, creativity, and individualism—widely accepted markers of Romanticism—appeal to McCloskey? Yet her unconditionally derogatory treatment of Romanticism—which she portrays as a fixed, monolithic, self-evident thing—undermines aspects of that fluctuating movement, period, style, culture, and attitude that are, or seem to be, consistent with her *Weltanschauung*.

But I protest too much. These complaints should not diminish what McCloskey has accomplished. Would that we had more grand studies that mapped ideas and traced influences across cultures, communities, and eras. McCloskey takes the long view, as we all should. Her focus on rhetoric is crucial to the future of liberty if, given the technological advances we have made, the “work we do will be more and more about decisions and persuading others to agree, changing minds, and less and less about implementation by hand” (p. 498). Equally significant is her embrace of humanomics—defined as “the story [of] a complete human being, with her ethics and language and upbringing” (p. xx)—which materializes in casual references to Henrik Ibsen's plays, challenges to the depiction of John Milton “as a lonely poet in a garret writing merely to the starry heavens” (p. 393), analyses of Jane Austen's novels, and portrayals of Elizabethan England. Her historical and narrative arc enables us to contextualize our own moment, with all of its troubles and possibilities.

Best of all, her book is inspiring and exhilarating and brimming with rousing imperatives and moving calls to action. “Let us, then,” she says at one point, “not reject the blessings of economic growth on account of planning or pessimism, the busybody if well-intentioned rationalism of some voices of the French Enlightenment or the adolescent if charming doubts of some voices of the German

² See, e.g., Paul Cantor (1997). It is both surprising and disappointing that McCloskey never references Paul Cantor in her book, not even in her chapters on Shakespeare. Cantor might have added some interesting nuance to McCloskey's treatment of Dickens. See, e.g., McCloskey at pp. 156, 165, 274, 557, 591–592, 600, 626, and Cantor and Cox (2009) at pp. 50–52, 54–56, 61–62, 85–87, 90, 92–93.

Romantic movement, fashionable though both attitudes have long been among the clerisy. As rational optimists, let us celebrate the Great Enrichment, and the rhetorical changes in freer societies that caused it" (p. 146). At another point she encourages her audience to guard against "both cynicism and utopianism" (p. 540), and elsewhere to heed "trade-tested cooperation, competition, and conservation in the right mix" (p. 523). These little nudges lend her credibility insofar as they reveal her true colors, as it were, and demonstrate that she is not attempting—as is the academic wont—to hide her prejudices and conceal her beliefs behind pretended objectivities.

Poverty is relative and, hence, permanent and ineradicable, despite McCloskey's claim that we can "end poverty" (p. 8). If, tomorrow, we woke up and the wealth of each living person were magically to multiply twentyfold—even fiftyfold—there would still be people at the bottom. The quality of life at the bottom, however, would be vastly improved. The current manifestation of global poverty shows how far we as a species have advanced in the last few centuries. McCloskey is right: We should pursue the ideas that accelerated and achieved human flourishing, that demonstrably brought people out of distress and destitution. Hard sciences and mathematical models are insufficient in themselves to convey the magnitude and splendor of these ideas and their accomplishments. Hence we should welcome and produce more books like McCloskey's that undertake a "rhetorical-ethical Revaluation" to both examine and celebrate "a society of open inquiry," one which not only "depends on rhetoric in its politics and in its science and in its economy," but which also yields intellectual creativity and political freedom (p. 650). In McCloskey's approach, economics and the humanities are not mutually exclusive; rather, they are mutually illuminating and, in fact, indispensably and inextricably tied. An economics that forsakes the dignity of the human person and his capacity for creativity and aesthetics does so at its own peril and to its own disgrace. All economics is, at its core, humanomics. We could do without the latter term if we understood the former.

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