

The Myth of Efficiency

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[Reprinted from *Time, Uncertainty, and Disequilibrium*, Mario Rizzo, ed. (Lexington, Mass: DC Heath, 1979), pp. 90-95; *The Logic of Action One: Method, Money, and the Austrian School* (Cheltenham, UK: Edward Elgar, 1997), pp. 266-273. The pagination of this edition corresponds to *Logic*.]

I am delighted that Dr. Rizzo, in chapter 4 [of *Time Uncertainty, and Disequilibrium*], is calling the highly touted concept of "efficiency" into grave question. I would like to carry his critique still further.

One of Rizzo's major points is that the concept of efficiency has no meaning apart from the pursuit of specified ends. But he concedes too much when he states, at least at the beginning of his paper, that "of course it [the common law] is efficient" relative to certain specified goals. For there are several layers of grave fallacy involved in the very concept of efficiency as applied to social institutions or policies: (1) the problem is not only in specifying ends but also in deciding *whose* ends are to be pursued; (2) individual ends are bound to conflict, and therefore any additive concept of social efficiency is meaningless; and (3) even each individual's actions cannot be assumed to be "efficient"; indeed, they undoubtedly will not be. Hence, efficiency is an erroneous concept even when applied to each individual's actions directed toward his ends; it is *a fortiori* a meaningless concept when it includes more than one individual, let alone an entire society.

Let us take a given individual. Since his own ends are clearly given and he acts to pursue them, surely at least *his* actions can be considered efficient. But no, they may not, for in order for him to act efficiently, he would have to possess perfect knowledge—perfect knowledge of the best technology, of future actions and reactions by other people, and of future natural events. But since no one can ever have perfect knowledge of the future, no one's action can be called "efficient." We live in a world of uncertainty. Efficiency is therefore a chimera.

Put another way, action is a learning process. As the individual acts to achieve his ends, he learns and becomes more proficient about how to pursue them. But in that case, of course, his actions cannot have been efficient from the start—or even from the end—of his actions, since perfect knowledge is never achieved, and there is always more to learn.

Moreover, the individual's ends are not *really* given, for there is no reason to assume that they are set in concrete for all time. As the individual learns more about the world, about nature and about other people, his values and goals are bound to change. The individual's ends will change as he learns from other people; they may also change out of sheer caprice. But if ends change in the course of an action, the concept of efficiency—which can only be defined as the best combination of means in pursuit of given ends—again becomes meaningless.

If the concept of efficiency is worthless even for each individual, it is *a fortiori* in far worse straits when the economist employs it in an additive way for all of society. Rizzo is being extremely gentle with the concept when he says that it amounts "to little more than maximizing gross national product" which immediately breaks down once externalities are introduced into the system." The problem, however, is far deeper. For efficiency only makes sense in regard to people's ends, and individuals' ends differ, clash, and conflict. The central question of politics then becomes: *whose* ends shall rule?

The blindness of economic thought to the realities of the world is systematic and is a product of the utilitarian philosophy that has dominated economics for a century and a half. For utilitarianism holds that everyone's ends are *really* the same, and that therefore all social conflict is merely technical and pragmatic, and can be resolved once the appropriate means for the common ends are discovered and adopted. It is the myth of the common universal end that allows economists to believe that they can "scientifically" and in a supposedly value-free manner prescribe what political policies should be adopted. By taking this alleged common universal end as an unquestioned given, the economist allows himself the delusion that he is not at all a moralist but only a strictly value-free and professional technician.

The alleged common end is a higher standard of living, or, as Rizzo puts it, a maximized gross national product. But suppose that, for one or more people, part of their desired "product" is something that other people will consider a decided detriment. Let us consider two examples, both of which would be difficult to subsume under the gentle rubric of "externalities." Suppose that some people pursue as a highly desired end the compulsory

equality, or uniformity, of all persons, including each having the same living conditions and wearing the same shapeless blue garment. But then a highly desired goal for these egalitarians would be considered a grave detriment by those individuals who do not wish to be made equal to or uniform with everyone else. A second example of conflicting ends, of clashing meanings allotted to the concept of "product," would be one or more people who greatly desire either the enslavement or the slaughter of a disliked ethnic or other clearly defined social group. Clearly, the pursuit of product for the would-be oppressors or slaughterers would be considered a negative product, or detriment, by the potential oppressed. Perhaps we could jam this case into an externality problem by saying that the disliked social or ethnic group constitutes a "visual pollutant," a negative externality, for the other groups, and that these external "costs" can be 'should be?) internalized by forcing the disliked group to pay the other groups enough to induce the latter to spare their lives. One wonders, however, how much the economist wishes to minimize social costs, and whether or not this proffered solution would really be "value-free."

In these cases of conflicting ends, furthermore, one group's "efficiency" becomes another group's detriment. The advocates of a program—whether of compulsory uniformity or of slaughtering a defined social group—would want their proposals carried out as efficiently as possible; whereas, on the other hand, the oppressed group would hope for as *inefficient* a pursuit of the hated goal as possible. Efficiency, as Rizzo points out, can only be meaningful relative to a given goal. But if ends clash, the opposing group will favor maximum *inefficiency* in pursuit of the disliked goal. Efficiency, therefore, can never serve as a utilitarian touchstone for law or for public policy.

Our cases of clashing ends bring us to the question of minimizing social costs. The first question to raise is: why *should* social costs be minimized? Or, why *should* externalities be internalized? The answers are scarcely self-evident, and yet the questions have never been satisfactorily addressed, let alone answered. And there is an important corollary question: even given the goal of minimizing costs, for the sake of argument, should this goal be held as an absolute or should it be subordinated, and to what degree, to other goals? And what reasons can be given for any answer?

In the first place, to say that social costs *should* be minimized, or that external costs *should* be internalized, is not a technical or a value-free position. The very intrusion of the word *should*, the very leap to a policy position, necessarily converts this into an ethical stand, which requires, at the very least, an ethical justification.

And second, even if, for the sake of argument, we consent to a goal of minimized social costs, the economist still must wrestle with the problem: how absolute should this commitment be? To say that minimized social costs must be absolute, or at least the highest-valued goal, is to fall into the same position that the cost-benefit economists scorn when it is taken by ethicists: namely, to consider equity or rights heedless of cost-benefit analysis. And what is their justification for such absolutism?

Third, even if we ignore these two problems, there is the grave fallacy in the very concept of "social cost," or of cost as applied to more than one person. For one thing, if ends clash, and one man's product is another man's detriment, costs cannot be added up across these individuals. But second, and more deeply, costs, as Austrians have pointed out for a century, are subjective to the individual, and therefore can neither be measured quantitatively nor, *a fortiori*, can they be added or compared among individuals. But if costs, like utilities, are subjective, nonadditive, and noncomparable, then of course any concept of social costs, including transaction costs, becomes meaningless. And third, even within each individual, costs are not objective or observable by any external observer. For an individual's cost is subjective and ephemeral; it appears only *ex ante*, at the moment before the individual makes a decision. The cost of any individual's choice is his subjective estimate of the value ranking of the highest value foregone from making his choice. For each individual tries, in every choice, to pursue his highest-ranking end; he foregoes or sacrifices the other, lower-ranking, ends that he could have satisfied with the resources available. His cost is his second-highest ranking end, that is, the value of the highest ranking end that he has foregone to achieve a still more highly valued goal. The cost that he incurs in this decision, then, is only *ex ante*; as soon as his decision is made and the choice is exercised and his resource committed, the cost disappears. It becomes an historical cost, forever bygone. And since it is impossible for any external observer to explore, at a later date, or even at the same time, the internal mental processes of the actor, it is impossible for this observer to determine, even in principle, what the cost of any decision may have been.

Much of chapter 4 [in *Time, Uncertainty, and Disequilibrium*] is devoted to an excellent analysis demonstrating that objective social costs make no sense outside of general equilibrium, and that we can never be in such equilibrium, nor could we know if we were. Rizzo points out that since disequilibrium necessarily implies divergent and inconsistent expectations, we cannot simply say that these prices approximate equilibrium, since there is an important difference *in kind* between them and consistent equilibrium prices.

Rizzo also points out that there is no benchmark to enable us to decide whether existing prices are close to equilibrium or not. I would simply underline his points here and make only two comments. To his point that tort law would not be needed in general equilibrium, I would add that torts themselves could not be committed in such a situation. For one feature of general equilibrium is certainty and perfect knowledge of the future; and presumably with such perfect knowledge no accidents could possibly occur. Even an intentional tort could not occur, for a perfectly foreseen tort could surely be avoided by the victim.

This comment relates to another point I would make about general equilibrium; not only has it never existed, and is not an operational concept, but also it could not conceivably exist. For we cannot really conceive of a world where every person has perfect foresight, and where no data ever change; moreover, general equilibrium is internally self-contradictory, for the reason one holds cash balances is the uncertainty of the future, and therefore the demand for money would fall to zero in a general equilibrium world of perfect certainty. Hence, a money economy, at least, could not be in general equilibrium.

I would also endorse Rizzo's critique of attempts to use objective probability theory as a way of reducing the real world of uncertainty to certainty equivalents. In the real world of human action, virtually all historical events are unique and heterogeneous, though often similar, to all other historical events. Since each event is unique and nonreproducible, it is impermissible to apply objective probability theory; expectations and forecasting become a matter of subjective estimates of future events, estimates that cannot be reduced to an objective or "scientific" formula. Calling two events by the same name does not make them homogeneous. Thus, two presidential elections are both called "presidential elections," but they are nevertheless highly varied, heterogeneous, and nonreproducible events, each occurring in different historical contexts. It is no accident that social scientists arguing for the use of the objective probability calculus almost invariably cite the case of the lottery; for a lottery is one of the few human situations where the outcomes are indeed homogeneous and reproducible, and, furthermore, where the events are random with no one possessing any influence upon its successors.

Not only is "efficiency" a myth, then, but so too is any concept of social or additive cost, or even an objectively determinable cost for each individual. But if cost is individual, ephemeral, and purely subjective, then it follows that no policy conclusions, including conclusions about law, can be

derived from or even make use of such a concept. There can be no valid or meaningful cost-benefit analysis of political or legal decisions or institutions.

Let us now turn more specifically to Rizzo's discussion of the law, and its relation to efficiency and social costs. His critique of the efficiency-economists could be put more sharply. Let us take, for example, Rizzo's discussion of the Good Samaritan problem. As he poses the problem, he supposes that B could save A "at minimal cost to himself," and he concludes that, from the point of view of the efficiency theorists, B should be liable for injuries to A if B doesn't save A. But there are more problems with the efficiency approach. For one thing, there is the characteristic confusion of monetary and psychic costs. For, since B's costs in this case are purely psychic, how can anyone but B, say a court, know what B's costs would entail? Suppose indeed that B is a good swimmer and could rescue A easily, but that it turns out that A is an old enemy of his, so that the psychic costs of his rescuing A are very high. The point is that any assessment of B's costs can only be made in terms of B's own values, and that no outside observer can know what these are.¹ Furthermore, when the efficiency theorists put the case that, in Rizzo's words, "clearly . . . A would have been willing to pay B more than enough to compensate his costs in order to be rescued," this conclusion is not really clear at all. For how do we know, or how do the courts know, if A would have had the money to pay B, and how would B know it—especially if we realize that no one except B can know what his psychic costs may be?

Furthermore, the question of causation could be put far more sharply. Rizzo's quotation from Mises on nonaction also being a form of "action" is praxeologically correct, but is irrelevant to the law. For the law is trying to discover who, if anyone, in a given situation has aggressed against the person or property of another—in short, who has been a tortfeasor against the property of another and is therefore liable for penalty. A nonaction may be an "action" in a praxeological sense, but it sets no positive chain of consequences into motion, and therefore cannot be an act of aggression. Hence, the wisdom of the common law's stress on the crucial distinction between misfeasance and nonfeasance, between a wrongful aggression against someone's rights, and leaving that person alone.² *Vincent v. Lake Erie Transport* was a superb

¹ Marc A. Franklin, *Injuries and Remedies* (Mineola, NY: Foundation Press, 1971), p. 401.

² There is no distinction more deeply rooted in the common law and more fundamental than that between misfeasance and nonfeasance, between active misconduct working positive injury to others and passive inaction, a failure to take positive steps to benefit others, or to protect them from harm not created by any wrongful act of the defendant." Francis H. Bohlen, "The Moral Duty to Aid Others as a Basis of Tort Liability," *University of Pennsylvania Law Review* 56, no. 4 (April 1908): 219-221; cited in Williamson M. Evers, "The Law of Omissions and Neglect of Children," *Journal of*

decision, for there the court was careful to investigate the causal agent at work—in this case, the boat, which clearly slammed against the dock. In some ways, tort law can be summed up as: "No liability without fault, no fault without liability." The vital importance of Richard Epstein's strict liability doctrine is that it returns the common law to its original strict emphasis on causation, fault, and liability, shorn of modern accretions of negligence and pseudo-"efficiency" considerations.

I conclude that we cannot decide on public policy, tort law, rights, or liabilities on the basis of efficiencies or minimizing of costs. But if not costs or efficiency, then what? The answer is that only *ethical principles* can serve as criteria for our decisions. Efficiency can never serve as the basis for ethics; on the contrary, ethics must be the guide and touchstone for any consideration of efficiency. Ethics is the primary. In the field of law and public policy, as Rizzo wittily indicates, the primary ethical consideration is the concept that "dare not speak its name"—the concept of justice.

One group of people will inevitably balk at our conclusion; I speak, of course, of the economists. For in this area economists have been long engaged in what George Stigler, in another context, has called "intellectual imperialism." Economists will have to get used to the idea that not all of life can be encompassed by our own discipline. A painful lesson no doubt, but compensated by the knowledge that it may be good for our souls to realize our own limits—and, just perhaps, to learn about ethics and about justice.