

Austrian Economics Newsletter

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The State of Economics in Austria Today: An Interview with Karl Socher

Karl Socher is professor of economics at the University of Innsbruck, Austria.

Q: What is the status of Austrian economics in its homeland today?

A: Poor. It is almost forgotten in Vienna itself. There are two or three economists in Vienna, especially Erich Streissler, who value the Austrian contribution to economics. Most of the other economists in Vienna call themselves Austro-Keynesians. They are not Keynesians in the traditional sense, but they think government should intervene heavily in the market through monetary and fiscal policy. They also believe in a social-market economy, like Germany's, where the social order is linked to the government with a social insurance system and welfare.

Q: Is this view challenged?

A: Not often. The social security system is especially sacrosanct. Even so, the system can be explained by public-choice theory: politicians keep the tax bite for the social insurance low and the payments high. This has created a huge deficit that will be impossible to finance. That is why we need serious reform.

Q: How were you introduced to Austrian economics?

A: While I was studying economics at the University of Vienna in 1950, I attended lectures by Hans Mayer, successor to the chair held by Friedrich von Wieser. Only later was I introduced to Keynesian economics. I was told to adopt the new economics and forget the old.

Q: Were there other Austrian professors at the university while you were a student?

A: Yes, there was Professor Mahr under whose guidance I wrote my dissertation on monetary theory. In my studies, I concluded that Wieser was wrong about his national income theory for microeconomics. In the writings of Mises I found a more correct position. When I broke with Wieser's position, Mayer was not happy about it. He was a fierce supporter of Wieser.



Karl Socher

Q: What about Austrian economics at the University of Innsbruck?

A: We continue to uphold the Austrian tradition; not all of us, but some. In an article Hayek wrote for an Austrian newspaper, he said that Austrian economics is not taught in Austria anymore. So a few of us in Innsbruck wrote him a letter saying we are still Austrian economists in the old sense. We call ourselves Hayekians and Misesians. A well-known economist in Vienna once said the Innsbruck economists do not belong to Austria anymore because of their views.

Q: What is your impression of American Austrians?

A: Very favorable. I am looking into what American

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Austrians are saying so we can re-import Austrian economics to Austria. I was worried that the research here looked backwards and simply re-wrote the old theories. On the contrary, I've found Austrian economics here to be fresh and alive. It is being applied to new developments: to rational expectations, to the theory of market failure, and to explain the stock market crash. I am pleased, and hope that my colleagues and I can learn from this.

Q: *What are graduate studies in economics like at the University of Innsbruck?*

A: We have a University system similar to Germany's. The first grade is the masters; we have the masters in economics and masters in business administration. After the masters, we have the doctor, which is different from your Ph.D. It takes about two years after the masters and you have to write a dissertation. Then we have the habitation, which is publication and research work, something like the Ph.D. Publication is necessary for the right to teach at the University.

Q: *How many students are there and what is the curriculum like?*

A: At Innsbruck we have 4000 business administration students and only 300 students of economics. We offer classes like the theory of economic policy, public choice, and public finance. And we have other fields, for instance sociology and political science. Our students are not as well versed in economic theory as you are in the United States, but we have a broad knowledge of political economy. Our students are also technically trained in mathematics and econometrics, which is not absolutely necessary for an economist, but I think it should be taught. In the doctor's program, there are seminars, but almost no regular classes. It's mostly the dissertation and the seminar work.

Q: *How is the economics curriculum set? Is it hard to introduce Austrian ideas to the graduate students at the University?*

A: We cannot change much because the curriculum

is decreed by the government. The actual content of the lectures is not supervised, so we can have an influence. The lecture may be called political economy, but we can add Austrian economics. If we did that all the time, however, it would be difficult for the students to pass the exams which are prepared by non-Austrians.

Q: *Are you trying to introduce a course in Austrian economics?*

A: Yes, but right now we are teaching it in the "Principles" classes. It gives us a chance to refer to Mises, Hayek, and the Austrian school.

Q: *You once worked at the Austrian Institute for Business Cycle Research founded by Ludwig von Mises in 1926 and at which F. A. Hayek had worked. Is the Institute operating today?*

A: Yes, it is an important and well-known research institute. It has been involved in a long and protracted battle over control. Mises set it up to be financed by businessmen or the chamber of commerce so it would be independent of the government. That idea is still on the statutes. But after the war, the government stepped in and began financing it. A big clash occurred over a speech by the director of the Institute, Dr. Nensuc because it was favorable to free markets, Mises, and Austrian economics. After the speech, the government tried to close the Institute, but there was an outcry. Today the Institute is open, independent, and largely free from government control. The finance ministers all depend on its reports.

Q: *Is there any remnant of Austrian economic influence left?*

A: There are no Austrian economists there. They are Keynesians and Keynesianism is spread via this institute. The published reports do not advise the government directly, but through informal meetings with government officials they advise interventionist policies. This problem has improved recently and the Institute is more favorable toward free markets, not because of Misesian influence, but to keep up with the climate of opinion in Germany, Britain, and elsewhere. The whole world is going in this direction. So the influence of free markets came via Germany, Britain, and the United States back to the institute.

Q: *Are there any free-market institutes in Austria besides the Carl Menger Institute?*

A: There is an institute attached to the liberal party, but it doesn't do much. I have seen only two small publications. And there is the Institute for Higher Studies, which is not so attached to a political party. But the Carl Menger Institute is the main institute for free markets.

Q: *Is the current monetary system in Europe an example of Hayek's competing monies?*

Contributors to this Issue

David Conway is lecturer of philosophy at Middlesex Polytechnic University in England.

Hans-Hermann Hoppe is associate professor of economics at the University of Nevada, Las Vegas.

Gerard Radnitzky is professor of the philosophy of science at the University of Trier in West Germany.

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George Selgin is visiting assistant professor of economics at the University of Georgia.

A: No. When Hayek wrote about free choice in currency, he was speaking of individuals choosing the currency which they thought was best. In Europe, the government chooses it for you. It is similar to Hayek's because the individual governments want to choose a currency which is stable or, at least, fix their currency to another stable currency. Currency markets have become more stable and inflation rates are lower, but only because central banks and governments have learned that it is better to have a stable currency.

Q: Will Europe soon have a European central bank?

A: I hope not because it is a very bad idea. The push for it is mainly coming from countries, especially France, that do not like the stability of the German mark. They want a more inflationary policy than the Bundesbank provides. A European central bank would be more inflationary because it would

follow a policy that averages the aims of all the countries. Each central bank would have one vote. Germany would have to follow the dictates of the European Central Bank, creating a Federal Reserve-type stop-and-go policy. Under the current system, with each country pursuing independent monetary policies, there is more competition and a more stable currency system.

Q: The Bundesbank is often criticized for slowing growth in Europe with its conservative monetary policy. What's your view?

A: The criticism is incorrect. The Bundesbank simply slowed the rate of inflation. They still have unemployment, but it is not Keynesian unemployment where the remedy is high inflation. It is structural unemployment which is due to the conditions of the labor market. The wage policies of the government, and the structure of the labor market creates

Kluwer Academic Publishers and Austrian Economics

The Ludwig von Mises Institute is pleased to announce that Kluwer Academic Publishers, the publishers of the *Review of Austrian Economics*, volume 4, has requested that the Mises Institute increase the publication of the *RAE* from the present once a year to a tri-annual. Kluwer said they have been impressed with the quality of the *RAE* and its potential for having a large impact on economic thought not only in the United States but throughout the world. The *RAE*, edited by Murray Rothbard and co-edited by Walter Block, is now in its fourth year.

The shift to publishing the *RAE* to more than once a year will probably occur in 1991, according to Mises Institute president Llewellyn H. Rockwell, Jr. It will appear in a hard-back version for international and library distribution and a low-priced paperback for general distribution.

Kluwer has also approached the Mises Institute about expanding its book series, "Studies in Austrian Economics." Under the general editorship of the Institute, Kluwer wants to publish a minimum of three book-length manuscripts per year on all aspects of Austrian thought. The first in the series was Hans-Hermann Hoppe's *A Theory of Socialism and Capitalism*.

Next in line in the series is *Money, Method, and the Market Process*, a collection of essays by Ludwig von Mises, many of which have never been published, and *The Meaning of Ludwig von Mises*, a collection of essays drawn from a Mises Institute conference of the same name, edited by Professor Jeffrey Herbener of Washington and Jefferson College.

Other possible forthcoming books in the Series are several collections of essays: Murray Rothbard on Austrian economics; Roger Garrison on capital theory; and a number of Austrian banking scholars on the Federal Reserve System with papers drawn from a Mises Institute conference. The Mises Institute welcomes other manuscripts to be considered for publication as part of the series.

Kluwer cited events in Eastern Europe as a confirmation of their view that free-market thought will play an important role in re-shaping economics in the 1990s and beyond. They think all forms of statist economics, whether Marxian or Keynesian, to be on the decline. Along with Austrian economics, Kluwer is looking more closely at the Chicago and Public Choice Schools.

Money, Method, and the Market Process

Essays by
Ludwig von Mises

Selected by
Murray von Mises

Edited with an Introduction by
Richard M. Ebeling

unemployment. Perhaps there are too many academics and not enough good workers. But a looser monetary policy would do nothing to reduce unemployment.

Q: Are strong labor unions a major reason for the unemployment?

A: Yes, especially from 1975 to the beginning of the 1980s. In Austria we have a centralized federal labor union that is very powerful in making economic policy. There is no competition between the labor unions. In Austria we also have structural unemployment, but not because wages are too high. Faced with all this unemployment, the union knows it cannot overdraw.

Q: Labor union bosses have said they don't want to disturb monetary policy. Does the labor union now realize the benefits of a stable monetary system?

A: Yes. The labor union endorsed fixing the exchange rate to the Deutschmark. Practically all the influential politicians in Austria also favored it. They now know that high wage increases endanger the exchange rate, so they have opted for stable prices and keeping wages down. Labor was told that high wages do damage. The firms would not be able to export and this would create more unemployment in the export sector. If, however, wages increase according to a monetary target, productivity would increase and so would wages. But these increases won't affect the general price level.

Q: What are the prospects in Europe for privately issued money, gold-backed money, and more freedom in capital markets?

A: Capital controls and exchange controls are set to be lifted this year, and there is a good chance that will happen. But as long as money is stable, there is little chance for a gold-backed currency or private money. If the inflation rate reaches 10 percent or more, and exchange controls are lifted, banks could promise to pay in the most stable currency, whatever it is at the time. And if one country, say Luxembourg, opened a bank that began issuing money that was accepted in other countries, people would use it. This would be a form of private money.

Q: What about a gold currency?

A: It doesn't have much of a chance, but it is not impossible if a small country began to issue bank notes redeemable in gold. At the moment, such a currency would be too volatile. As long as the gold price fluctuates because of differing expectations about inflation, I don't see it succeeding.

Q: What do you think about free banking?

A: I'm still thinking about it. I don't know if it would be stable. Applying the Austrian theory of entrepreneurship to a free-banking system, it seems that the entrepreneur would look for new profit opportunities by issuing too much money.

Maybe the market would slow it down if it gets too high. But if a large bank is doing the issuing, it might do harm to the value of the money by the time it is stopped. A free-banking system would surely be more stable than the system in the U.S. But I am not sure whether it would be more stable than the Swiss or German system has been in the recent years. If you had a solid monetary constitution, with rules mandating that the central bank maintain a stable currency, this would also bring about a stable monetary system.

Q: Would you have sanctions to punish the directors of the bank?

A: Yes, punish them if they do not have a policy of high stability.

Q: What would you do?

A: You could shorten or lengthen the duration of the directors' terms based on the inflation rate. The higher the inflation rate the shorter the term. You could also fix the nominal income of the directors. If there is inflation, their real income goes down. You would also need negative double indexation so the directors wouldn't deflate either.

Q: Are there centers of public choice ideas in Austria?

A: It is part of the political economy. We think the main ideas of public choice are Austrian. They come from Schumpeter, with his book on democracy, and Mises, with his theory of bureaucracy. All this is very popular in Austria. After James Buchanan had lectured in Vienna and several other cities, he said the discussion in Innsbruck was the best in a long time. I was very proud of my students and the questions they asked.

Q: Did you ever meet Ludwig von Mises?

A: Only once. It was at a meeting of the Mont Pelerin Society, in 1967, I think. We were hotly debating the relative merits of flexible versus fixed exchange rates. At the end, Ludwig von Mises stood up and said, "stability doesn't depend on the international monetary system, on whether you have more or less cooperation among the central banks, or on a new system of exchange-rate fixing. It depends on the monetary policy of each country. Each country must have a stable currency and a good monetary policy." We all agreed, and that was the end of the conference.

Q: Was it unusual for everybody to agree?

A: Yes, especially at the Mont Pelerin Society.

Professor Socher was interviewed by Mark Thornton and Parth Shah while he visited Auburn University to present a paper to the Austrian Economics Colloquium.

Short-Changed in Chile: The Truth about the Free-Banking Episode

by George Selgin

Admirers of Professor Rothbard's trenchant critique of interventionism in the marketplace expect him to hold no punches. Nevertheless, in his recent analysis of Chile's free-banking episode (*AEN*, Winter 1989) Rothbard plays down nefarious government interventions that reaped havoc with Chile's monetary and banking system in the 1860s and 1870s. Uncharacteristically and uncritically he embraces the mainstream view that Chile's troubles were due to its overly liberal banking legislation. According to Rothbard, Chile's *laissez-faire* banking policy encouraged its bankers to inflate recklessly.

It is necessary to stress that Rothbard's position is *against* freedom in banking and (implicitly) *in favor of* increased government intervention, notwithstanding his call for "freedom ... within a firm matrix of 100 percent specie reserves." Chile's banking law of 1860 did not exclude the possibility of 100-percent reserve banking; the law merely permitted bankers and their customers to engage *voluntarily* in fractional-reserve banking contracts. Those Chileans who favored hard money could refrain from holding fractionally-backed bank notes so long as the letter of the law of 1860 was upheld: the proponents of free banking in Chile were no more opposed to 100-percent banking *for those who wished it for themselves* than proponents of free speech are opposed to monastic vows of silence. In contrast Rothbard's attack on the law of 1860, based upon the mainstream view that it promoted inflation, constitutes an implicit defense of State-imposed restrictions on economic freedom.

Moreover, the mainstream interpretation of what happened in Chile does not stand scrutiny. Even a careful reading of Frank A. Fetter—allowing for his *a priori* conclusions based more upon prejudice against free banking than on any inferences drawn from evidence—indicates clearly that *unwarranted government interference* rather than the free-banking law of 1860 was responsible for Chile's monetary troubles.¹ Chile's free-banking system was undermined by (1) its bimetallic legislation of 1851 and (2) its sanctioning of inconvertible currency to ease the government's fiscal burdens in connection with its war with Spain and again in 1878.

Chile's wartime suspension of specie payment in 1865-66 was due entirely to the government's desire for fiscal support and *not*, as Rothbard asserts (p. 2), to any general banking crisis stemming from overissue of bank notes. Indeed, prior to the outbreak of the war the banking law of 1860 had led to only a minor expansion in note issues.² The government's sanctioning of irredeemable issues—first by the new Banco Nacional de Chile and then

by other banks—had nothing to do with any bank runs or crises excepting perhaps the government's own budgetary crisis. It speaks well of the general integrity of the free banks at this date that only one of them (the Banco de Mac-Clure y Cia) in addition to the National Bank took advantage of the government's generous provisions for the issuance of irredeemable paper.

No proponent of free banking, including Courcelle-Seneuil, has ever defended a government's right to undermine that system's natural checks and contractual obligations by encouraging banks to suspend payment. For this reason the events of 1865-66 hardly warrant a condemnation of free banking. Indeed the government's fiscal crisis could just as well have served as a pretext for its abandonment of 100-percent reserve banking, had such a system been in force. Would anyone then have been justified in condemning 100-percent reserve banking because it failed to withstand government encroachments aimed at securing low-interest loans?

Although the government of Chile was preparing to engineer a much vaster expansion of irredeemable currency in 1866, the closing of hostilities with Spain made this unnecessary and convertibility of all notes was



George Selgin

restored on August 31, 1866. In fact, despite the government's irresponsible behavior the entire war episode passed without any serious depreciation of the currency. The period from 1866 to 1874 was exceptional in that the government refrained from interfering with the free-banking law or with the principle of convertibility. The consequence was an era of remarkable growth and prosperity, free of monetary crises.³

Regrettably that era of unadulterated freedom in banking did not last long as unwarranted government interference once again began to take its toll. A banking crisis which began in 1874 culminated in the suspension of specie payments in 1878. Fetter blames this crisis and subsequent disorders on the free-banking law of 1860, and Rothbard embraces this interpretation. Yet the facts do not support Fetter's conclusion. They suggest, rather, that the events leading to the suspension of specie payments in 1878 were largely a consequence of Chile's *bimetallic legislation of 1851* fixing the legal rate of exchange of silver to gold at 16.39:1. This legal restriction alone accounts for the crisis of 1874; to point to the banking law of 1860 is unnecessary and unjust. Fetter's position is to some extent understandable as it reflects a preconception common to all economists of his era: Fetter set out to write his book convinced that free banking must lead to disaster; he could not resist interpreting the evidence in light of that common belief. That Rothbard should follow Fetter is less easy to understand, however, as Rothbard is well aware of free banking's *relatively non-inflationary character* compared to centralized banking (a feature of free banking stressed by Rothbard's teacher, Ludwig von Mises). The theory of free banking gives no grounds for assuming that bank reserve ratios will be driven below levels required to support routine requests for redemption.

Rothbard should have realized that something other than excessive freedom in banking had to be behind the events of 1874-78. Part of that something was bimetalism. Here is what Rothbard himself has to say elsewhere on this subject:

Under bimetalism, a nation recognized gold and silver as moneys, but set an arbitrary price, or exchange ratio, between them. When this arbitrary price differed, as it was bound to, from the free-market price (and this became ever more likely as time passed and the free-market price changed, while the government's arbitrary price remained the same), one money became overvalued and the other undervalued by the government. Thus, suppose that ... the government set the ratio between [gold and silver] at 16 ounces of silver:1 ounce of gold. The market price, perhaps 16:1 at the time of the price control, then changes to 15:1. What is the result? Silver is now being arbitrarily undervalued by the government and gold arbitrarily overvalued.... The same consequences now follow as from any effective price control.... Gold goes begging for silver in unsold surplus, while silver becomes scarce and disappears from circulation. Silver disappears to another country ... and gold, in turn, flows into the country.⁴

This description fits the events in Chile after 1874 almost to a "T" save for the fact that in Chile the market value of silver *fell* after 1851 relative to that of gold: whereas prior to 1874 the market value of silver was above the official rate of 16.39:1; it fell early in 1874 to 17.623:1.⁵ The official rate, which had previously overvalued gold, now overvalued silver—almost all of which had been melted down and exported in the preceding decades. All of a sudden there emerged a vast demand for gold to

export: holders of bank notes rushed to redeem them in the newly undervalued metal. The banks, having little silver to offer in place of gold to meet these exceptional demands for redemption, were left with no alternative but to watch their specie reserves dwindle while taking steps to reduce their liabilities as quickly as possible.⁶

Referring to the outbreak of the crisis Fetter says that the banks, encouraged by "loose banking practices" and a desire to minimize their losses, allowed their "margin of safety" to decline in response to the loss of gold—thus causing the system to suspend in 1878.⁷ Amazingly, though, evidence supplied by Fetter himself (and cited by Rothbard as well) contradicts this claim. The average percentage figures for reserves to deposits for note issuing banks were 7.6%, 9.1%, and 7.4% respectively for 1876, 1877, and 1878.⁸ Notwithstanding the impression conveyed by Rothbard these figures are not terribly low by historical fractional-reserve standards (in Scotland in the 1830s, for example, rates of around 2% were typical.) Furthermore (as Rothbard also points out) average figures disguise the fact that many banks kept much higher reserve ratios: the averages reflect to a large extent the irresponsible policies of a few

The theory of free banking gives no grounds for assuming that bank reserve ratios will be driven below levels required to support routine requests for redemption.

"bad apples." Still more significantly, the average figures themselves are not low *relative to those from the period prior to the appreciation of gold*: as Fetter himself shows (and Rothbard reiterates) the average reserve on December 31, 1869 was 8% of the combined value of notes and deposits. (The figure of 5% appearing on p. 3 of Rothbard's account appears to be a misprint). As this is the *only* reserve figure given by Fetter for the pre-1874 period, it is difficult to accept his conclusion that banks allowed their "margin of safety" to decline after changing relative prices forced a switch in the *de facto* standard from gold to silver! On the contrary, the banks appear, overall, to have succeeded admirably in preserving their "margin of safety" despite exceptional, legislatively-inspired demands to convert notes and deposits into gold.

No proponent of free banking has ever defended bimetallic legislation. To blame free banking rather than bimetalism for Chile's banking troubles after 1874 is no better than blaming the housing shortage in Berkeley on "unbridled capitalist exploitation" instead of rent control. Moreover it seems that even

bimetallism was not alone sufficient to undermine the convertibility of bank notes in Chile after 1874. Once again the Chilean government's unquenchable appetite for funds was the ultimate reason for the suspension—a reason which, to repeat, could likewise cause the downfall of *any* convertible-currency system, fractional-reserve or not.

To tell the complete story of the events leading to the suspension of mid-1878—which Chile's more prudent bank managers appear to have been prepared to avoid *despite* the adverse effects of bimetallism—we must take a closer look at the “bad apples” mentioned above and see just what they were up to during the preceding weeks. In the early 1870s the government ran small budget deficits. But the situation changed dramatically after 1874 when gold began to leave the country, provoking a severe shortage of credit and causing fiscal revenues to plummet. In June 1878 the government once again sought financial support from the banks.⁹ Nine banks in all agreed to purchase over 2.5 million pesos of two-year, 9% Treasury notes in return for their notes (up to four times the value of their individual loans) being declared publically receivable until 1888. Thus a privilege previously limited to the National Bank and the Banco de Agustin Edward y Cia was extended to seven others. In turn the two previously favored banks were given a small annual side payment as a consolation prize.

The inequity of these arrangements did not pass without notice. At least one member of the Chamber of Deputies attacked the loan, saying it would pave the way to suspension “because the government would authorize inconvertibility before it would allow the banks to fail.” It was not long before this prophecy was borne out. By early July three of the nine banks which had participated in the June loan saw their reserves fall to exceptionally low levels—in one case to below 3% of liabilities. Rather than contract their obligations as other banks had done, the imperiled three continued recklessly to extend credit. The Directors of the National Bank in particular continued to make generous loans to themselves which increased greatly in value in the crucial weeks leading to the suspension.¹⁰ Finally a committee of representatives from the troubled banks, led by the representative from the National Bank, approached the government to request permission to suspend payment. To rescue these ill-managed banks (and perhaps to fulfill the implicit terms of the June loan agreement) the government authorized a suspension *for the nine banks that were a party to the June loan only*. (The remaining two banks, which had not increased their loans in the previous weeks, were up to this point in no danger of default.)

The notes of the nine banks were declared legal tender in return for their paying to the government 4% annually on their circulations.

As Fetter himself relates “the serious condition of two or three banks, in particular the Banco Nacional de Chile, was the immediate occasion for the suspen-

sion of payments” which these banks themselves requested.¹¹ Contrary to what Rothbard implies there is no reason to assume that other banks were in equal danger of succumbing to the “unfavorable balance of trade.” The suspension of '78—which lasted for almost 50 years (allowing for the brief interlude from 1895-1898) was aimed entirely at bailing out several politically-favored banks. The favored banks had lent generously to the government to rescue it from its own bimetallic legislation, knowing full well that this would lead them to insolvency. They relied upon the government to support them by sanctioning the suspension of payments, and were not disappointed. Had the government abided by a policy of true free banking these ill-managed banks would have been allowed to fail and suspension would have been avoided; with such a policy in place the banks might never have dared to undertake the excessive lending that caused their reserves to be depleted. Moreover, had it not been for bimetallism the government might never have faced the fiscal crisis that led it to seek the aid of the banks in the first place. To his credit, Courcelle-Seneuil foresaw the danger of government bailouts and expressed himself in favor of a policy of allowing ill-managed banks to fail and be liquidated.¹²

Free banking did not fail in Chile. Like many other manifestations of economic liberty it was undermined by government intervention before it could prove itself. Friends of economic freedom should not hesitate to laud Courcelle-Seneuil's noble effort.

Notes

1. A source more sympathetic to the free banking experiment but not cited by Rothbard is Augustin Ross Edwards, *Chile, 1851-1910: Sixty Years of Monetary and Financial Questions and of Banking Problems* (Valparaiso, Chile: Westcott, 1910).

2. Edward H. Strobel, “Cheap Money in Chile.” *Sound Currency* 3, no. 16 (July 1896): 550. According to Fetter only “a few hundred thousand pesos” of notes were in circulation at the outbreak of the war. Frank A. Fetter, *Monetary Inflation in Chile* (Princeton: Princeton University Press, 1931), p. 9.

3. Fetter, p. 16. During this era Chile's railroad and telegraph systems were developed, the port of Valparaiso was enlarged and improved, and fiscal revenues increased by one-quarter. See Victor-L. Tapié, *Histoire de L'Amérique Latine au XXIXe Siècle* (Paris: Aulier, 1945), p. 183.

4. Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash Publishing, 1970), pp. 783-84.

5. Strobel, p. 548. Rothbard is aware of Chile's bimetallic legislation. This important fact is relegated to a footnote, and he makes no mention of the switch from a *de facto* gold standard to a *de facto* silver standard in 1874 and its crucial bearing upon events thereafter.

6. It is apparent that banks took steps to accumulate silver in anticipation of its overvaluation, thereby avoiding an immediate crisis.

7. Fetter, p. 26.

8. *Ibid*; see also Strobel, p. 551, for detailed figures for 1878.

9. Fetter, p. 27.

10. *Ibid*, p. 30; Ross, pp. 37-39.

11. Fetter, p. 29. According to Ross (p. 38), “The debt of the Government served the [National] bank as a pretext for bringing pressure to bear on the Congress in order to wring from it the Law of Inconvertibility.”

12. Ross, p. 80.

Austrian Economics in Denmark

Academic interest in methodological individualism, subjectivism, and Austrian economics is invading the long-established fortresses of welfarism, i.e., the Scandinavian "welfare states." But, while there has been for some years an Austrian following in Sweden and Norway, this is a recent development in Denmark.

For the last three years a group of students from economics, political science, philosophy, psychology, and history, and primarily from the University of Copenhagen, have been trying to spread interest in Austrianism among the Danish academic community.

In the fall of 1987 the group organized, for the first time at any Danish university, a course on Austrian theory. The course on methodology was offered at the Institute for Economics, a part of the University of Copenhagen. A course on "applied Austrian theory" will be offered in the spring of 1990.

In 1988 these students founded the "Praxeologica Project," with the help of Libertas—the Danish Society for the Study of Individual Liberty and Free Market Economics. Their purpose is to hold one or two interdisciplinary symposia each year, where students and professors interested in methodological individualism and subjectivism can present their Austrian research. From these lectures will be published a series entitled *Praxeologica*.

"Theory and Method: The Renaissance of the Austrian School of Economics" was the theme for the First Danish Praxeologica Symposium. Among the speakers were a Danish professor, five students, and Leonard Liggio from the Institute for Humane Studies, who lectured on "Austrian Economics in the U.S.A." Most of the lectures from this symposium were published in 1989 as *Praxeologica I*.

In August, the second Praxeologica Symposium was held with the theme, "F. A. Hayek: The Austrian School and the Social Sciences"; lectures from this symposium were published in December of 1989 as *Praxeologica II*. Among the speakers were two professors, two students, Christian Gandil, former vice president of The Mont Pelerin Society, and Tom Palmer, Institute for Humane Studies, who lectured on "Competitive Processes as Discovery Processes: Hayek and Natural Law."

"Public Choice Theory, Austrian Economics and Modern Theories of the State," the third Praxeologica Symposium was held in November and the lectures from this symposium will be published in 1990 as *Praxeologica III*.

The *Praxeologica* group, which is headed by students Otto Brons-Petersen, Nicolai Juul Foss and Peter Kurrild-Klitgaard may be contacted at: *Praxeologica*, c/o Peter Kurrild-Klitgaard, Matthausgade 16, II t.h., DK-1666 Copenhagen V. Denmark.

Book Reviews

Time and Public Policy

by T. Alexander Smith
University of Tennessee Press, 1989

Reviewed by Larry J. Sechrest

Several interdisciplinary works of interest to economists have appeared in recent years: F. A. Hayek's *The Fatal Conceit*, Robert Higg's *Crisis and Leviathan*, and Charles Murray's *Losing Ground* come readily to mind. Perhaps the most intriguing of such efforts is T. Alexander Smith's *Time and Public Policy*, for it represents a conscious attempt to examine modern political institutions and public policies utilizing the concept of time preference, a notion usually found only in treatises on economics.

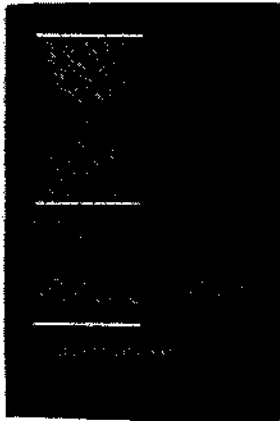
Indeed, as Smith is aware, time preference is of little consequence even to mainstream economists; only the Austrian school has treated time and time preference as the centrally important concepts they are. Moreover, Smith—who is a professor of political science—is clearly much impressed with the great body of Austrian theory, not merely with the treatment of time preference. The Hayekian approach to business cycles, the nature of interest, the heterogeneity of capital, free banking, the classic gold standard and the rejection of the standard model of "perfect competition" are all mentioned favorably. And there are numerous references to the works of specific Austrians; the names of Hayek, Mises, Rothbard, Lachmann, Shackle, and Kirzner appear prominently. It must not be supposed, however, that this is a work of an economic dimension only. Smith borrows and blends ideas from several disciplines aside from economics and political science: sociology, psychology, political philosophy, history, legal theory, etc. This is a very ambitious and largely successful effort.

The basic theme of the book is the claim that stability, freedom, and prosperity are all simultaneously enhanced in an environment characterized by (1) low time preference, (2) free markets and, (3) the "rule of law" (as that term has been used by theorists such as Hayek and Oakeshott). In contrast, Smith points out that most contemporary Western democracies—especially the United States and the United Kingdom—suffer from a pervasive cultural, political, and economic decay that has led to very high time preference, widespread intervention into economic life, and highly partisan "promissory politics."

As Smith argues, long time horizons (i.e., low time

preference) imply frugality, hard work, and a trust in the future; they are literally the "sociological glue" that holds things together. Free markets complement this by providing (1) "the best means for coping with the diversity of producer and consumer tastes and knowledge" and (2) the "necessary condition for political freedom." The rule of law (common law) has the desirable effect of slowing the tempo of social change and reducing the uncertainty that is the result of rapid alterations in the legal environment. Thus, these three factors interact to bring about a society that protects individual rights and fosters long-term growth.

The cultural facet of the decay which Smith so deplores is exemplified by the widespread rejection of what he terms the "Bourgeois Ethic." This bourgeoisie, or "older middle class," was characterized by (1) being both owner and manager of their firms, (2) possessing an "inner-directedness" that led them to defy customs and their peers on occasion, (3) lengthy time horizons, (4) a commitment to the ideal of balance and moderation, and (5) a reluctance to be seduced by envy (a result of their strong Christian faith). Above



all, this bourgeois class exuded a powerful confidence in the future; they accepted as a tenet of faith that thrift, hard work, and honesty would bring rewards—as indeed they usually did during the last century. Today, as Smith sees it, the Bourgeois Ethic is generally seen as "reactionary" and "atavistic." The focus is on the superficial self and its immediate sensory gratification instead of on family and the future. The results are all around us: drugs, violence, teenage sex, crime, divorce, etc.

What specifically, one may ask, has brought about this dramatic change? Smith offers several answers to this, but he seems to focus on three in particular: "the decline of the Judeo-Christian faith," the rise of a new middle class, and the Keynesian denigration of saving and exhortation to spend.

Smith's argument on religion is the usual one that the erosion of religious belief has led to loneliness and alienation (and higher time preference) for many individuals; regardless of the nature of one's religious

belief (or non-belief), it is difficult to deny the accuracy of that observation. The new middle class, as he points out, differs radically from the old bourgeoisie in that they are technocrats and managers rather than entrepreneurs and merchants. They believe that monetary rewards should be based on "merit," on some sort of "objective" standards—such as degrees earned or job seniority, rather than upon the "subjective" valuations of the market. This difference leads the new middle class to resist market forces on the one hand (e.g., to refuse to take wage rate cuts in times of recession) and, on the other hand, to embrace certain short-run political "solutions" (e.g., affirmative action and comparable worth). Smith's attack upon Keynesian theory will warm the hearts of all free-market advocates, especially Austrians. He argues that Keynes and his followers have contributed mightily to the dissolution of the bourgeoisie. Instead of depending on true saving and capital accumulation to sustain growth, modern nations have opted for the Keynesian prescription of discretionary fiscal and monetary policies, an approach that leads inexorably to inflation and capital consumption. Smith is particularly critical of the duplicitous "tradeoff" of the infamous Phillips curve. The central role of the Phillips relation within so much of public policy is truly "a dagger aimed at the heart of saving."

Political decay in our age may be understood by contrasting the status of *political man* with that of *economic man*. As Smith puts it, *homo economicus* is widely believed to exhibit raw greed and cultural insensitivity while *homo politicus* is supposed to be generous and "public-spirited." Moreover—and critical to Smith's thesis—it is often assumed that *economic man* displays short-time horizons while *political man* takes the long-term view. Yet Smith contends that "contrary to what is usually supposed, time horizons are more likely to be short when we occupy political instead of economic roles." This, he argues, follows inevitably from (1) the nature of majoritarian democracies and (2) the rise of the welfare state ideology.

As political parties compete ever more intensely for votes they offer patronage and privilege to more and more special interest groups. Coupled with the commonly-held belief that the state can and should alter the social and economic status of certain groups via redistributionist schemes (what is known as "social reform"), this of course produces a climate of opinion in which the "quick political fix" is deemed appropriate, even necessary. In other words, time preferences rise significantly.

In this context Smith makes an observation which, while not original, is nevertheless rather provocative: that many modern conservatives (e.g., George Will and Irving Kristol) are *not* enthusiastic defenders of free markets, despite a media-managed image to the contrary. Thus they, like modern liberals, believe that the state performs a valid function by managing time

preferences in the "public interest." The contrast of both groups with libertarians is clear.

The final manifestation of the decay which concerns Smith is that of economic theory: the supplanting of Say's supply-oriented Law of Markets by Keynes's "effective aggregate demand management." Readers of this newsletter will be very familiar with the basic issues involved here so only a few points of interest will be touched on.

After quite ably summarizing each of the above two approaches, Smith arrives at three conclusions. First, he points out the fundamental contradiction of Keynes: since to supply is to "create value" and to consume is to "exterminate value," then one can only demand to the extent that one can continue to supply. In other words, "inadequate demand" is, in truth, a withholding of supply (cf. W. H. Hutt's excellent book, *The Keynesian Episode*). Second, he sees Keynes as concerned with distribution of a fixed "economic pie" and thus conducive to pessimism and high time preference; while Say was concerned with production of an ever-growing "pie" and so conducive to optimism and low time preference. Finally, Smith concludes that the debate also possesses a powerful moral dimension since the controversy centers upon the relative values one places upon saving versus consumption. As he puts it: "Say's Law and the Bourgeois Ethic are symmetrical ... [the Keynesian approach] is to rationalize present gratification and selfishness at the expense of the future."

The foregoing is the core of Smith's thesis. However, two items of tangential importance must be mentioned in passing. First, what the of so-called "Post-Industrial Society?" Such a world, according to writers like Daniel Bell and Alvin Toffler, will exhibit material superabundance, high technology, much leisure and "self-actualization" and values that will be decidedly anti-bourgeois. Smith understands well that such a scenario is a contradiction in terms. Without bourgeois values, there will exist little saving, little capital accumulation, little wealth and little leisure. Second, are there any bright stars in the constellation of Western democracies, or do all such nations suffer from the malaise Smith has identified? The one exception seems to be Switzerland, a land of strong bourgeois beliefs, mostly local (cantonal) political decision-making, low crime rates, low inflation rates and a renowned banking system. In short, "Political Man has been kept more in abeyance in Switzerland than in other nations."

Time and Public Policy is a lucidly written and thought-provoking book that deserves a very wide readership. Nevertheless, it is not without several minor flaws. For example, Smith argues that low time preference is bolstered by the Christian proscription of envy. Yet, if that is true, why do so many Hispanics and blacks (two passionately religious groups) exhibit such high time preference? Surely the critical factor is ethnic group or cultural norms or socio-economic

status rather than religion. Also, when Smith discusses the courting of the "moderate center" by the major political parties in the United States he seems at a loss to explain why that "center" has become increasingly collectivist and statist in its beliefs. A focus upon the perversion of the concept of freedom from its classical liberal ("negative") interpretation into the modern liberal ("positive") interpretation might be of benefit here. Finally, Smith's contention that the "rule of law" can be applied successfully even in the realms of government "social welfare" and educational policies seems highly problematic. The negative income tax, to take one of his proposals, would indeed remove the stigma from income transfers by making them automatic and anonymous. However, by doing so, it would also greatly encourage individuals to seek such welfare in the first place. How is that going to decrease either the scope of government or the burden on taxpayers?

Despite these few problems, this is a book that should prove eminently satisfying to anyone with a predilection for free markets and limited government. And it should be required reading for all political science majors as well as all public office holders.

Social Contract, Free Ride: A Study of the Public Goods Problem

by Anthony de Jasay
Oxford University Press, 1989

Reviewed by Gerard Radnitzky

The schoolbook reason why even selfish men, lacking any feeling for nation and community, are supposed willingly to obey the political authority is their imperative need for public goods like civil order, defense, a clean environment, social security, and the other underpinnings of civilized society. If each were not forced by the state to contribute to the cost of such goods, each would prefer to let others carry the burden while he enjoys a free ride.

Social Contract, Free Ride: A Study of the Public Goods Problem, by Anthony de Jasay is an unusual book. Starting from the nature of contracts and games, it provides a radically new understanding of social coexistence and a novel account of the public goods dilemma and it dismantles the conventional theory. The author, who was a Fellow of Nuffield College, Oxford, where he taught economics up to 1962, later established himself as an investment banker and eventually became a political philosopher. Without relying on any assumption about "man's better nature," he deduces that the pursuit of maximum utility is sufficient to induce groups of rational individuals spontaneously to allocate

among themselves, however "unfairly," the cost of the public goods they value highly enough.

The standard approach to public goods problems is that they are typically "prisoners' dilemmas," where uncoerced contribution to the public good is irrational. Jasay shows that this is but a special case among other possible incentive structures or "games." If the "productivity" of public provision is sufficiently superior to private-good substitutes, other incentive structures arise whose normal solution is that some people contribute and others free-ride on the public good thus created. Social roles are then either *self-selected*—some are "suckers," others are free riders—which involves "unfairness," or, alternatively, they can be *imposed* by "social contract": everybody must contribute (typically by taxation). This, however, reintroduces free riding by the back door, *via* overconsumption of certain public goods and redistribution of the incidence of taxation.

Up to chapter 7 a utility-maximizing approach is used: all the results are deduced from strict utility maximization. Then further possibilities are admitted (chapter 8) that have in addition various moral motivations.

The true role of the state is not, as we had been taught, forcibly to channel resources into the production of public goods we would not otherwise get. It is, instead, to ensure that the distribution of public burdens and benefits is decided by collective political deliberation rather than by the free interactions of

Jasay ... shows how and why [the] naive quest for "fair" distribution is bound to fail.

autonomous individuals. Jasay, with impeccable logic, shows how and why this naive quest for "fair" distribution is bound to fail, bringing about chronic overconsumption of public goods and stimulating the free riding it was meant to interdict.

In an earlier book—Anthony de Jasay, *The State* (Blackwell, Oxford 1985), which is now starting to exert an influence—the author presented a theory of how the natural conflict between state and society transforms both state and society in a process from which only historical luck lets us escape. The emergence of a relatively free society, "The Rise of the West," is the result of happy accidents in history, and it is an endangered species. In his book *Social Contract, Free Ride*, Jasay forces us to face the prospect that even our constitutionalist-liberal doctrines are not liberal enough to protect us from the unintended and automatic crowding out of individual choice by collective will. After the grotesque mid-Atlantic mis-

use of the word "liberal" it should be pointed out that Jasay used it in the sense of classical liberalism, i.e., to refer to a broad presumption in favor of deciding individually any matter whose structure lends itself to both individual and collective choice.

Both books are examples of the successful application of the economic approach and of game-theory arguments in political science and political philosophy. Jasay's arguments bring a breath of fresh air to both fields.

A Theory of Socialism and Capitalism

by Hans-Hermann Hoppe
Kluwer Academic Publishers, 1989

Reviewed by David Conway

Hans-Hermann Hoppe's *A Theory of Socialism and Capitalism* in essence is given over to establishing two theses concerning the comparative merits of capitalism and socialism. The first—which shall be referred to below as *the economic thesis*—is that capitalism is economically superior to any form of socialism, in the sense that, given the economic resources of any society, the average standard of living per member of that society will be higher if its economic structure is capitalist than it would be if its structure were socialist in any form, to any degree. The second thesis—which shall be termed in what follows as *the moral thesis*—is that capitalism is morally superior to any form of socialism, in the sense that capitalism respects, whereas every form of socialism violates, property rights belonging to some members of society.

The two theses themselves are by no means novel, nor are the arguments which Hoppe offers in support of the economic thesis. So far as the theses themselves are concerned, they are the stock-in-trade of that species of libertarianism propounded by Murray Rothbard to whom the author signals the greatest intellectual debt in his acknowledgments and to whose writings numerous references are made in the text itself. Likewise the arguments advanced on behalf of the economic thesis can, by and large, be found in the economic writings of Rothbard and, earlier still, of Ludwig von Mises, who, next to Rothbard, is the author to whose works most references are made in Hoppe's text. What is novel about Hoppe's book is, first, the great care with which the author distinguishes between the different possible forms of socialism and then explains with respect to each why it is economically inferior to capitalism, and, second, his argument for the moral thesis.

At the base of his conception of both capitalism and socialism in all its various forms, and, in addition,

underlying the moral thesis, is a certain account of property rights which Hoppe calls *the natural theory of property*. The essence of the natural theory is that whoever first uses a scarce resource acquires (natural) ownership of it. This entails that each person owns his (or her) own body (being the first to use it), and also owns in addition whatever other scarce resources he (or she) either is the first to make use of or else is given—either in some contractual exchange or as a free gift—by some previous (natural) owner of that resource. First-use forms, for Hoppe, “an objective, intersubjective ascertainable link” between an individual and some scarce resource which can be transferred to another individual through gift or exchange. *Pure capitalism*, for Hoppe, is simply that social systems are based on the natural theory of property. By contrast, *socialism* is any social system “that assigns rights of exclusive control over scarce means ... to persons or groups of persons that can point neither to an act of previous usership of the things concerned, nor to a contractual relation with some previous user-owner” (p. 18).

Armed with this general conception of socialism, Hoppe is able to distinguish no less than four different specific forms of it. These are: (1) *Socialism Russian-style*, exemplified by the communist countries of the Eastern bloc; (2) *Social-democratic Socialism*, favored by socialist and social-democratic parties of Western Europe as well as by so-called “liberals” in the U. S. A.; (3) *The Socialism of Conservatism* most notably by France and Italy, but still more graphically exemplified by fascist Italy and Nazi Germany; (4) and *The Socialism of Social Engineering*, currently favored in the U. S. A.

Hoppe has little difficulty in showing with respect to each of these forms of socialism that “it is less efficient at producing and conserving wealth than capitalism. Thus, for example, with respect to *Socialism Russian-style*, we are told that, among its other economic shortcomings, by disallowing private ownership of means of production, this form of socialism prevents the formation of market prices in means of production which in turn prevents managers of economic resources from being able to calculate the monetary costs of production and thereby from being able to determine the optimum way to utilize the means of production. In consequence, misallocation of resources is almost inevitable. This, and many of the other arguments advanced by Hoppe for the economic thesis, should be familiar to those acquainted with Austrian economics. On the whole, the arguments which Hoppe presents for the economic thesis are sound and clearly formulated. Moreover, Hoppe goes on to show how, in the light of these arguments, we can make sense of a whole host of otherwise disconnected empirical facts: such as why the Eastern bloc is less affluent than the West; why, within the West, the U. S. A. is more affluent than Western Europe; why, within Western Europe,

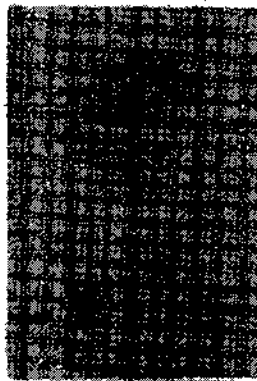
France and Italy are less affluent than West Germany, and so on. Hoppe’s book is well worth reading for the light which it sheds on these hard facts of economic reality alone.

Matters are otherwise, however, when it comes to Hoppe’s moral thesis and to his argument for it. This thesis—viz. that pure capitalism is morally superior to all forms of socialism—depends crucially upon his natural theory of property offering a morally correct account of property rights. In other words, the truth of Hoppe’s moral thesis depends upon its being true that whoever first uses a scarce resource acquires rights to exclusive use and control of it. Capitalism would not violate property rights, whereas all forms of socialism would violate property rights, if the natural theory were morally sound. Hoppe attempts to demonstrate the moral soundness of the natural theory of property in chapter 7. His argument is somewhat complex and not altogether easy to follow. A convenient summary is offered in the first paragraph of chapter 8. He writes “[Socialism] cannot be defended as a fair or just social order from a moral point of view because to argue so ... necessarily presupposes the validity of the first-use-first-own rule of the natural theory of property and capitalism, as otherwise no one could survive and then say, or possibly agree on, anything as an independent physical unit” (p. 145).

Put more fully, the argument seems to be this: in order to be able to engage in argument, it is necessary for a person first to have control over his body. Therefore, whoever wishes to be able to justify anything by means of argument must subscribe to the following principle (which Hoppe calls *the principle of non-aggression*): nobody has the right to uninvitedly aggress against the body of any other person and thus delimit or restrict anyone’s control over his own body. Now, if no one had the right to acquire anything except his own body, no one would be able to live. Therefore, anyone who engages in any argument must accept that people have a right to acquire property rights in scarce goods besides their own bodies. Since everyone who engages in argument must subscribe to the principle of non-aggression, it follows that everyone who acknowledges that people have a right to acquire scarce goods besides their own bodies must also accept that, in order to be valid, the norm which specifies how a person may acquire a scarce good besides his own body must be consistent with the principle of non-aggression. The only norm which specifies how someone may acquire some scarce good besides his own body that is compatible with the principle of non-aggression is the first-use-first-own principle of the natural theory. Therefore, it has to be accepted by whoever wishes to engage in any argument that whoever first works on an unused nature-given thing becomes its owner.

The crucial premise of this argument is the last: namely, that the only norm that specifies how someone may acquire scarce goods besides his own body that is compatible with the principle of non-aggression is the norm which assigns first ownership of a hitherto unused nature-given thing to whoever first uses that thing. What Hoppe wants to contend here is that individuals are owners of their own physical bodies. According to Hoppe, all other norms specifying how individuals may acquire scarce goods involve assigning scarce goods to individuals simply by verbal means, i. e., by decree. However, being able to acquire ownership of something simply by decree is inconsistent with everyone's owning their own body. For everyone else in addition to any given person is equally well able as that given person to decree that they own that person's body. So, if one accepts that the only person who owns a person's body is that person himself, then one must reject all norms which state how persons may acquire scarce goods besides their body other than the first-use-first-own principle.

Ingenious though the argument is, it is flawed. This is because it is false that wherever ownership of some unused nature-given thing is assigned by means other than reference to first use of that thing, ownership is being assigned merely by verbal means. In order to live, individuals need means of



A Theory of Capitalism and Socialism is published by Kluwer Academic Publishers as the first in a joint series with the Mises Institute called "Studies in Austrian Economics." The book is presently being translated into Portuguese, Korean, and Spanish.

subsistence. This fact establishes a relation between an individual and some scarce goods every bit as objective as that which mixing one's labor with those goods does. Thus, a norm that states that individuals have a right to what they need in order to live (i. e., to means of subsistence) is at least as non-arbitrary as the first-use-first-own principle as applied to scarce goods besides human bodies. More to the point, the norm specifying a right to means of subsistence

is significantly less arbitrary than Hoppe's natural theory for the following reason. A world which applied Hoppe's favored theory of property to scarce goods besides people's own bodies would be a world which permitted only a minority of the people existing within it to appropriate through first use the entire stock of scarce natural resources, and to deny access to means of subsistence to the remainder of the world's population who lacked any scarce resources of their own besides their own bodies. A rule which permits such a state of affairs would clearly permit some people to be denied the necessary preconditions for their being able to engage in argument. Consequently, no one who wishes to argue for their views should be willing to accept such a rule. Consequently, the first-use-first-own rule is not truly a precondition of argument and cannot be allowed to stand in an unqualified form by all who would be governed by reasoned argument in their moral views.

At the outset of the book, Hoppe introduces the idea that property rights are claims to exclusive ownership of scarce resources the purpose of which is to prevent conflicts between persons over the use of scarce resources. Such conflicts are surely not prevented by rules which permit some people to die of starvation through lack of opportunity to acquire means of subsistence. Consequently, any morally valid theory of property has to consist of rules which acknowledge people's rights to acquire their means of subsistence. A person who is destitute through no fault of his or her own in a society which contains enough resources to maintain that destitute person without taking away from anyone any resources that are necessary for the survival of someone else, has a right, against all those who own more than they need in order to survive, to be provided with the opportunity to acquire goods at least sufficient to live on. This does not imply that those with more than they need to survive are obliged to maintain the destitute in idleness. The granting of means of subsistence to the destitute can be made conditional on the destitute engaging in work for these means of subsistence.

Where does this leave the issue of capitalism versus socialism? What it means is that whoever first uses a scarce resource can at most acquire ownership of it subject to the qualification that this owner, or whoever that owner passes on that resource to, if he has more than he needs for subsistence, must be willing to provide those lacking means of subsistence of their own, through no fault of their own, the opportunity to acquire means of subsistence. This means that, in a world in which all natural resources have become privately owned, property owners must ensure either opportunities for gainful employment or welfare for those who are without means of subsistence of their own. The rights of the destitute are consequently being denied by

property owners in such a world if the latter deny the former both job opportunities and welfare.

Hoppe has presented a powerful economic case for making us prefer capitalism to socialism. However, society's enjoying the highest possible average standard of living per member is little consolation to a member who through no fault of his or her own neither has anything nor can acquire anything. Surely, no form of society which tolerates such states or unameliorated property within its midst can be morally superior to a form of society in which owners have an enforceable obligation to non-owners to provide them with enumerated work or welfare. Full-blooded socialism may not be required by justice, but some small departure from pure capitalism may well be.

On the Indefensibility of Welfare Rights: A Comment on Conway

by Hans-Hermann Hoppe

David Conway claims that my argument intending to show the unrestricted validity of the homesteading principle, i.e., the first-use-first-own rule regarding unowned, nature-given resources, is flawed, and that he can demonstrate the defensibility of welfare rights. I remain unconvinced and contend that it is his counter-argument which is faulty.

While I have no quarrel with his presentation of my argument, I will first briefly restate my proof. Second, I will point out the central errors in his reply. And third, offer an explanation for Conway's rejection of my argument as resulting from a rather common misconception regarding the logic of ethical reasoning.

Whether or not one has any rights, and, if any, which ones, can only be decided in the course of an argumentation. It is impossible to deny the truth of this without falling into a contradiction. Arguing requires a person's exclusive control (ownership) over scarce resources (one's brain, vocal cords, etc.) Trying to deny this would again merely prove the point. And a person must have acquired this ownership simply by virtue of the fact that he began using these resources before anyone else had done so, otherwise he could never say or argue anything to begin with. Thus, anyone denying the validity of the homesteading principle at least with respect to *some* resources would contradict the content of his proposition through his very act of proposition making.

So far, it appears, Conway would agree. But he wants to impose limitations on the range of objects that may legitimately be homesteaded. Unfortunately, (for Conway's case) once exclusive control over some homesteaded means is admitted as

justified, it becomes impossible to justify any restrictions in the homesteading process—except for a self-imposed, voluntary one—without thereby running into contradictions. For if the proponent of such a restriction were consistent, he could have justified control only over some, however limited, scarce resources which he would not be allowed to employ for additional homesteading. Yet, he could not then interfere with another's extended homesteading, simply because of his own lack of means to do anything about this. And if he *did* interfere, *he* would thereby inconsistently extend his ownership claims beyond his own justly homesteaded resources.

Moreover, in order to justify his interference he would have to invoke a principle of property acquisition *incompatible* with the homesteading principle: he would have to claim, inconsistently, that a person who extends his homesteading, and who does so in accordance with a principle that no one can argue to be generally invalid, is, or at least can be, an aggressor (even though in doing so this person could not possibly be said to have taken anything away from anyone, because he would have merely appropriated *previously unowned resources*.) Furthermore, a person who interferes with such an action, and who does so in accordance with a principle that no one could possibly argue to be generally valid, is, or at least can be, acting legitimately (even though he would always take something away from someone whose appropriations had occurred at no one's expense).

The central error in Conway's rejection of this argument is his refusal to acknowledge the logical incompatibility of his idea of welfare rights on the one hand—the notion that one can have enforceable claims against homesteaders—and of the homesteading principle on the other. Either the first idea is right or the second. Yet the first cannot be said to be right, because in order for anyone to say so, the second one must be presupposed as valid. There can be no such thing as a right to life, then, in Conway's sense of a right to having one's life sustained by others. There can only be each person's right to own his physical body, everything that is homesteaded with its help, and to engage in mutually beneficial exchanges with others.

Suppose, for instance, that I am terminally ill and the only way for me to survive is to have my brain short-circuited with Conway's. Does he have the right to refuse? I think so, and I am sure that he thinks so, too. But he cannot have this right on welfare grounds (assuming that his life would not be threatened by such an operation), but only on the basis of the homestead principle as the precondition of one's existence as an independently reasoning and arguing physical being.

Further, his claim that welfare rights "are every bit as objective" as those implied by mixing one's labor with scarce resources (contrary to my thesis that the former are subjective, arbitrary, verbal, derived out

of thin air) is fallacious. Through homesteading an objective link between a *particular person* and *particular resource* is created. But how can one say that my need can give rise to a claim regarding any specific resource or resource owner *x*, rather than *y*, or *z*, if I had not homesteaded or produced either one? Not only is neediness incapable of objective identification or measurement: who determines who is or is not needy? Everyone for himself? And what if I happened to disagree with someone's self-assessment?

People have died from love-sickness—do they have a right to a lover-conscript? People have survived by eating grass, bark, rats, roaches, or other's garbage—are there no needy people then so long as there is enough grass or garbage to eat? If not, why not? For how long would the support for the needy have to last? Forever? And what about the rights of the supporters who would thereby become permanently enslaved to the needy? Or what if my support for the needy caused me to become needy myself, or somehow increased my own future needs? Would I still have to continue to support them? And how much work can I expect the destitute to perform in return for my support—given the fact that one is not dealing here with a mutually beneficial employment relation or voluntary charity to begin with? As much as the needy feel is appropriate?

Moreover, even if all these difficulties were overcome, more are lying in the wings because need does not connect the needy with any resource or resource owner in particular, and yet it must invariably be particular resources that provide relief. The needy may be needy without any fault of their own; but the non-needy may be non-needy without any fault of theirs, too. So how can the needy claim support from me, rather than you? Surely that would be utterly unfair toward me in particular. In fact, either the needy can have a claim against no one in particular, which is to say they have no claim whatsoever; or else their claim would have to be directed equally against each one of the world's non-needy.

How can the needy possibly enforce such a claim? After all, they lack resources. For this to be possible, an all-resourceful, world-wide operating agency would be required. The owners of such an agency obviously would have to be classified as among the non-needy, and could hence have no direct claim against anyone. Supposedly, only need creates such claims. In fact, this agency would have to be considered one of the foremost debtors to the needy; and it could only legitimately act against other non-needy then, if it had previously paid *its* share of welfare debts *and* the needy had contractually entrusted it with such an enforcement task. And hence the welfare problem would have to wait for a solution until this institution arrived. So far it has not arrived, and there is nothing to indicate that it will arrive in the near future. And even if it did, welfare rights would still be incompatible with the

homesteading rule as an indisputably valid, axiomatic principle.

The explanation for Conway's refusal to accept the homesteading ethic lies in a misconception regarding the nature of ethical theory. Instead of recognizing ethics as a logical theory, deductively derived from incontestable axioms (akin to praxeology), Conway implicitly shares a popular, empiricist-intuitionist (or gut-feeling) approach toward ethics. Accordingly, an ethical theory is *tested* against moral experience, such that if the theory yields conclusions at variance with one's moral intuitions it should be regarded as *falsified*. However, this view is entirely mistaken and,



Hans-Hermann Hoppe

much like in economics, the role of theory and experience in ethics is almost precisely the opposite: it is the very function of ethical theory to provide a rational justification for our moral intuitions, or to show why they have no such basis and make us reconsider and revise our intuitive reactions. This is not to say that intuitions can never play a role in the building of ethical theory. In fact, counterintuitive theoretical conclusions may well *indicate* a theoretical error. But if after one's theoretical reexamination, errors are neither found in one's axioms nor in one's deductions, then it is one's intuitions that must go, not one's theory.

In fact, what strikes Conway as a counterintuitive implication of the homesteading ethic, and then leads him to reject it, can easily be interpreted quite differently. It is true, as Conway says, that this ethic would allow for the possibility of the entire world's being homesteaded. What about newcomers in this situation, who own nothing but their physical bodies? Cannot the homesteaders restrict access to their property from these newcomers and would this not be intolerable? (Empirically, of course, the problem does

not exist: if it were not for governments' restricting access to unowned land, there would still be plenty of empty land around.) These newcomers come into existence somewhere—normally one would think as children born to parents who *are* owners or renters of land (if they came from Mars, and no one wanted them here, so what; they assumed a risk in coming, and if they now have to return, tough luck). If the parents do not provide for the newcomers, they are free to search the world over for employers, sellers, or charitable contributors—and a society ruled by the homesteading ethic would be, as Conway admits, the most prosperous one possible. If they still could not find *anyone* willing to employ, support, or trade with them, why not ask, "What's wrong with *them*?" instead of Conway's feeling sorry for them? Apparently *they* must be intolerably unpleasant fellows and had better shape up, or they deserve no other treatment. Such, in fact, would be my own intuitive reaction.

Notes and Transitions

Karen Vaughn has stepped down as chair of the Department of Economics at George Mason University. She returns to the Center for the Study of Market Process. Richard Wagner of the Center for the Study of Public Choice is the new chairman at George Mason University.

George Selgin, formerly of Hong Kong University, is now visiting assistant professor of economics at the University of Georgia.

Don Boudreaux, former editor of the *AEN*, is on leave from George Mason University and the Center for the Study of Market Process to attend the University of Virginia Law School.

John McCallie, former assistant editor of the *AEN*, is now visiting assistant professor of economics at the University of Alabama at Birmingham.

Mark Thornton, editor of the *AEN*, has been named O. P. Alford assistant professor of Austrian economics at Auburn University.

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Articles

Eugen Richter and Late German Manchester Liberalism: A Reevaluation, by *Ralph Raico*

Ludwig von Mises as Social Rationalist, by *Joseph T. Salerno*

Banking, Nation States and International Politics: A Sociological Reconstruction of the Present Economic Order, by *Hans-Hermann Hoppe*

National Goods versus Public Goods: Defense, Disarmament, and Free Riders, by *Jeffrey Rogers Hummel*

Karl Marx, Communist as Religious Eschatologist, by *Murray N. Rothbard*

The Subjectivist Roots of James Buchanan's Economics, by *Thomas J. DiLorenzo*

Notes and Comments

The DMVP-MVP Controversy: A Note, by *Walter Block*

Misconceptions about Austrian Business Cycle Theory: A Comment, by *James Clark* and *James Keeler*

Book Reviews

Understanding: A Phenomenological-Pragmatic Analysis, by Gary B. Madison; *A Conflict of Visions*, by Thomas Sowell; *A Farewell to Marx*, by David Conway; *The International Political Economy of Coffee*, by Richard L. Lucier; and *Man, Economy, and Liberty*, edited by W. Block and L. Rockwell, Jr.

Joseph T. Salerno, professor of economics at Pace University, has been granted tenure at the Lublin Business School of Pace University in New York City.

The Center for the Study of Public Choice has launched a new journal, *Constitutional Political Economy*. It will be edited by **Viktor Vanberg** and **Richard Wagner**. Nobel laureate James Buchanan will serve as advisory editor. The interdisciplinary journal will be published three times a year as "a forum for papers in the broad area of constitutional analysis."

The first issue of *Catallaxy* was published in October 1989. It is a four-page newsletter reporting on the activities of the East-West Outreach Program, a joint venture of the Carl Menger Institute (Austria) and the Institute for Humane Studies (USA). Contact either the Institute for Humane Studies or the Carl Menger Institute for more information.