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Globalization and Global Governance: Four Paradigmatic Views

Kavous Ardalan

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Abstract

Any adequate analysis of global governance necessarily requires fundamental understanding of the worldviews underlying the views expressed with respect to the nature and role of global governance. This paper starts with the premise that any worldview can be associated with one of the four basic paradigms: functionalist, interpretive, radical humanist, and radical structuralist. It argues that any view expressed with respect to global governance is based on one of the four paradigms or worldviews. It, therefore, discusses four views expressed with respect to the nature and role of global governance. The paper emphasizes that the four views expressed are equally scientific and informative; they look at the nature and role of global governance from a certain paradigmatic viewpoint. Emphasizing this example in the area of global governance, the paper concludes that there are opportunities for each paradigm to benefit from contributions coming from the other three paradigms if they respect paradigm diversity.

Keywords: global governance, functionalist, interpretive, radical humanist, radical structuralist

JEL Classification Codes: B40, F02

I. INTRODUCTION

An analysis of global governance necessarily requires a fundamental understanding of worldviews underlying views expressed with respect to the nature and role of global governance. Four general views, corresponding to four broad worldviews, are discussed. These four views are equally scientific and informative; each looks at the nature of global governance and its role from a certain paradigmatic viewpoint.

The paper takes the case of global governance as an example and emphasizes that, in general, any phenomenon may be seen and analyzed from different viewpoints and that each viewpoint exposes a certain aspect of the phenomenon under consideration. Collectively, they provide a much broader and deeper understanding of the phenomenon. Therefore, each academic field can benefit much from contributions coming from other paradigms if it respects paradigm diversity.

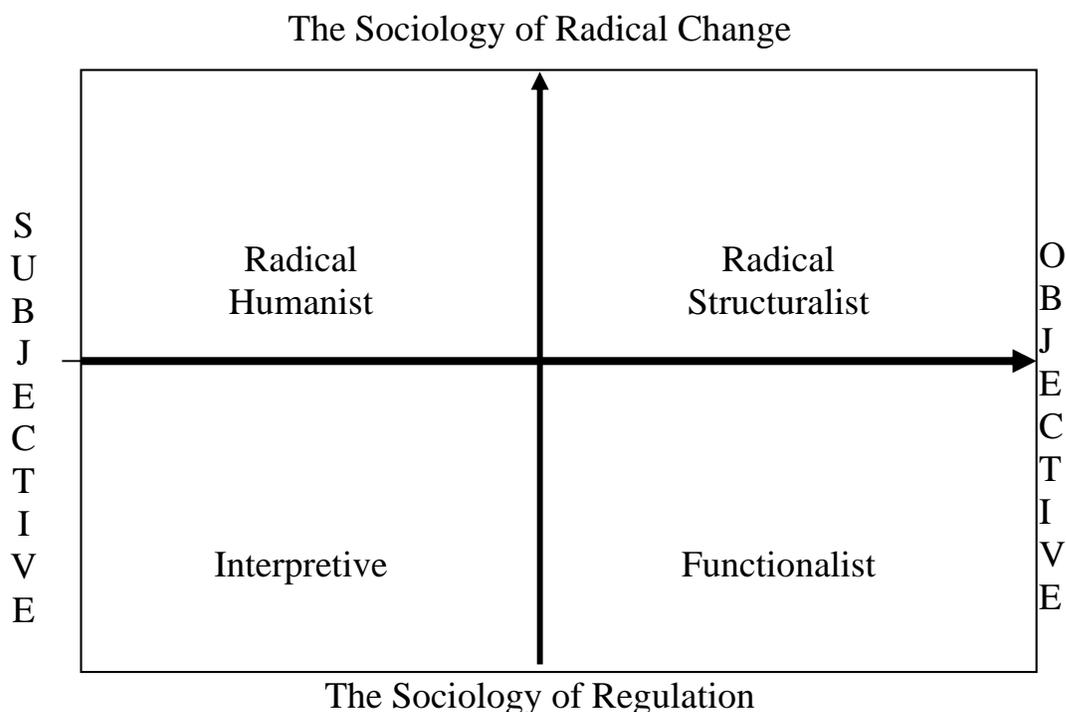
Ardalan (2007a, 2007b) respectively show how each of the four paradigms views and analyzes corporate governance and markets differently and therefore how each

one of them can benefit from the insights of the other three paradigms. For instance, as a sub-discipline of economics, mainstream finance does not concern itself with social structure. This paper proposes that the consideration of social structure is one way to improve the insight into the multi-faceted issues in finance.

Any adequate analysis of the role of paradigms in social theory must recognize the assumptions that underwrite that paradigm or worldview. Social theory can usefully be conceived in terms of four key paradigms: functionalist, interpretive, radical humanist, and radical structuralist. The four paradigms are founded upon different views of the social world. Each generates theories, concepts, and analytical tools which are different from those of other paradigms. The four paradigms are based on different assumptions about the nature of social science (i.e., the subjective-objective dimension), and the nature of society (i.e., the dimension of regulation-radical change), as in Exhibit 1.¹ This can be used as both a classificatory device, or more importantly, as an analytical tool.

Exhibit 1: The Four Paradigms

Each paradigm adheres to a set of fundamental assumptions about the nature of science (i.e., the subjective-objective dimension), and the nature of society (i.e., the dimension of regulation-radical change).



The paper is organized as follows. Sections II to V, first, each lays down the foundation by discussing one of the four paradigms. Subsequently, each section presents the nature and role of global governance from the point of view of the respective paradigm. Section VI discusses the benefits of paradigm diversity. Section VII concludes the paper.

II. THE FUNCTIONALIST PARADIGM

In Exhibit 1, the functionalist paradigm occupies the lower right quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From right to left they are: Objectivism, Social System Theory, Integrative Theory, Interactionism, and Social Action Theory.

The functionalist paradigm assumes that society has a concrete existence and follows certain order. These assumptions lead to the existence of an objective and value-free social science which can produce true explanatory and predictive knowledge of the reality out there. It assumes that scientific theories can be assessed objectively by reference to empirical evidence. Scientists do not see any roles for themselves within the phenomenon which they analyze through the rigor and technique of the scientific method. It attributes independence to the observer from the observed. That is, an ability to observe “what is” without affecting it. It assumes there are universal standards of science, which determine what constitutes an adequate explanation of what is observed. It assumes there are external rules and regulations governing the external world. The goal of scientists is to find the orders that prevail within that phenomenon.

The functionalist paradigm seeks rational explanations of social affairs and generates regulative sociology. It emphasizes understanding order, equilibrium and stability in society and the way in which these can be maintained. Science provides the basis for structuring and ordering the social world, similar to the structure and order in

the natural world. The methods of natural science are used to generate explanations of the social world. Their approach to social science is rooted in the tradition of positivism.

Functionalists are individualists. The properties of the aggregate are determined by the properties of its units. The functionalist paradigm has become dominant in academic sociology and mainstream academic finance. The world of finance is treated as a place of concrete reality, the individual is regarded as taking on a passive role; his or her behavior is being determined by the economic environment. Functionalist paradigm's views with respect to the nature and role of global governance are presented next.²

Democracy is a system of government in which the people choose their leaders at regular intervals through free, fair, and competitive elections. Democratization has expanded dramatically in the world. It promotes political transformation, freedom, the rule of law, and good government. The full global triumph of democracy is not yet attained, but it has never been more attainable. Democracy will continue its worldwide expansion if the process of global economic integration and growth is sustained and if freedom is made a priority in international diplomacy, aid, and other engagements.

Can every country become a democracy? The answer is a cautiously optimistic one. The current world order is in many respects without historical precedent. This is due to the unparalleled superiority of military and economic power of the United States to any conceivable combination of competitors or adversaries. Additional facts are as follows:

1. This superior global power is held by a liberal democracy.
2. The next highest global power is held by a loose union of countries that are also all liberal democracies.
3. The majority of states in the world fall in the category of democracy.
4. The only model of governance in the world with broad normative appeal and legitimacy is democracy.
5. There is a worldwide legal and moral recognition of democracy as a basic human right of all peoples.

6. States and international organizations are ever more variously intruding on sovereignty in order to promote democracy and freedom.

In short, the international context has been playing an increasingly important and favorable role in the growth of democracy. At this historical epoch, the cooperation among powerful democracies combined with a visionary and resourceful strategy can essentially eliminate authoritarian rule over the next generation or two.

The third wave of global democratization began in April 1974, when the Portuguese dictatorship was overthrown in a military coup and half a century of quasi-fascist rule was ended. The triumph of democracy in Portugal marked the beginning of a long wave of worldwide democratic expansion that continues to this day.

There is great depth and breadth of the third wave of democratization. In 1974, there were 41 democracies out of 150 states. Of the remaining 109 states, 56 states (i.e., more than half of them) subsequently made a transition to democracy; and of the 56 states, only Pakistan, Sudan, and Russia are not democracies today. Moreover, 26 states since 1974 have gained independence of colonial rule; 15 of them became democracies upon independence and have remained democracies since; and another 6 have become democracies after a period of authoritarian rule. Of the 19 new post-communist states, 11 states (i.e., 58 percent of them) are democracies. Of the 45 new states created after the start of the third wave, almost three-quarters (more specifically, 71 percent) are democracies, though in the case of the states in former Soviet Union, some of them (e.g., Ukraine, Georgia, and Armenia) are not clearly democratic.

After democracy spread to Eastern Europe, to a few states in the former Soviet Union, to some states in Africa, and to several states in Asia and Latin America, it became a global phenomenon during the 1990s. Now, it is the predominant form of government, and the only broadly legitimate form of government in the world. Today, about three-fifths of all states (121 of 193, according to Freedom House) are democracies. Democracy has no global rivals. Communism is dead. Military rule lacks appeal and normative justification. Most one-party states have disappeared. In the age of democracy, single-party states cannot credibly claim the ultimate wisdom and moral

righteousness to rule indefinitely, without facing criticism or challenge. Islamic states have provided only a vague model with some moral and ideological appeal as an alternative form of government. However, it is only for a small portion of the world's societies. Moreover, the only actual example of such an Islamic state is the Islamic Republic in Iran, which is increasingly corrupt, discredited, and illegitimate, and its people overwhelmingly desire a more truly democratic form of government.

It is now easier for states to become democratic because most states already are. Almost all states that became democratic during the third wave have remained so, including countries that lack some of the "required" conditions for democracy. Excepting pre-1990 Africa, only four democracies have been overthrown by military coups. Two of them (Turkey and Thailand) returned to democracy fairly quickly; and the other two (Pakistan and the Gambia) have been forced to institute civilian multiparty elections. Although several democracies have been suspended by elected civilian leaders, only 14 of the 125 democracies that have existed during the third wave have become authoritarian, and in 9 of these, democracy has since been restored.

Democracy has emerged and persisted in an extremely poor, landlocked, Muslim country like Mali, in which the majority of adults are illiterate, live in absolute poverty, and where life expectancy is 44 years. There can be no reason why democracy cannot develop in most other very poor countries as well. Indeed, out of the 36 countries the United Nations Development Program (UNDP) classifies as having "Low Human Development," 11 are democracies. If the scope of comparison is widened to include the bottom third of states classified by the UNDP, democracies rise from nearly a third to 41 percent. About a dozen have been democracies for at least one decade. It is important to note there are so many democracies among the world's least developed countries and that there is an overall predominance of democracy in the world.

Democracy has not covered all regions of the whole world. Except for one region, in all the regions of the world at least a third of the states are democracies. In Latin

America and the Caribbean, 30 of the 33 states are democracies, and almost half of them are now fairly liberal in terms of their levels of freedom. In the former communist countries, two-thirds are democracies. In Asia, half of the states are democracies. In Africa, about two-fifths of states are democracies. Only in the Middle East democracy is absent. None of the 16 Arab countries is a democracy, and, with the exception of Lebanon, they have never been.

In terms of the trends in freedom, every region of the world has experienced a fairly significant improvement in the level of freedom – except for one. Even regions that had been under the long-term rule of authoritarian regimes have seen improvement. Only in the Middle East the average level of freedom has declined. This situation is not related to Islam. There are 43 countries in the world with a clear Muslim majority. A quarter (i.e., seven of the 27) of non-Arab, Muslim-majority states is democracies. Moreover, non-Arab Muslim countries have a considerable cumulative experience with political freedom over the last 30 years.

Democracy exists in all types of states. It significantly prevails in almost every region of the world. It is present in countries with every major religious or philosophical tradition: Christian, Jewish, Hindu, Buddhist, Confucian, and Muslim. It is much well-received by developed countries (the top 20 countries in human development are all liberal democracies). It is also significantly present among very poor countries. It is much more common – and much more liberal – in small states with a population of less 1 million. Most of the biggest countries are democracies – i.e., 8 of the 11 countries with populations over 100 million. Only the Arab countries are undemocratic.

Democracy as a universal value prevails in every major region of the world and therefore it is almost a universal phenomenon. The richer a country the greater is its chance to sustain democracy. There is a striking monotonic relationship between the development level of a country and the probability that it sustains democracy. For the poor countries, democracy is not a luxury but a necessity. Democracies do not experience famines. People in economic need ought to have a political voice. Democracy is not a luxury that should be postponed until the arrival of general

prosperity. Poor people favor democracy. There have been many cases where poor people have mobilized passionately for democratic change and its defense.

Data from public opinion surveys show that democracy is understood and valued widely across cultures. Surveys show that Muslims prefer democracy as much as non-Muslims do. It seems that Islam has less influence on political attitudes than is frequently thought. In fact, individuals with the strongest Islamic beliefs are not necessarily less supportive of democracy than others. Significantly, Arab thinkers, scholars, and civil society activists are challenging lack of democracy and freedom in the Arab world. They realize that it undermines human development and it is one of the results of slow political development.

There is growing evidence that democracy is becoming a truly universal value. This is not because democracy has the consent of everyone, but because people everywhere see it as valuable. Democratizing the entire world is too bold an endeavor. Major democracies need to work with and through international partners and institutions in order to energize, transform, and democratize global structures.

The fully global triumph of democracy has not been attained. However, it has never been more attainable. Democracy will continue its worldwide expansion if the process of global economic integration and growth is sustained and in addition freedom is made an important priority in international diplomacy, aid, and other engagements. History has proven that democracy is the best form of government. Over time, more and more countries will become democratic while fewer go back to dictatorship. If major democracies retain their power, reshape their strategy, and sustain their commitment, eventually – certainly by mid-century – every country in the world can be democratic.

III. THE INTERPRETIVE PARADIGM

In Exhibit 1, the interpretive paradigm occupies the lower left quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum.

From left to right they are: Solipsism, Phenomenology, Phenomenological Sociology, and Hermeneutics.

The interpretive paradigm sees the social world as a process created by individuals. Social reality, insofar as it exists outside the consciousness of any individual, is regarded as being a network of assumptions and intersubjectively shared meanings. This assumption leads to the belief that there are shared multiple realities which are sustained and changed. Researchers recognize their role within the phenomenon under investigation. The goal of interpretive researchers is to find the orders that prevail within the phenomenon under consideration; however, they are not objective.

The interpretive paradigm believes that in cultural sciences, the subject matter is spiritual in nature. In the cultural sphere, human beings are perceived as free. An understanding of their lives and actions can be obtained by the intuition of the total wholes. Cultural phenomena are seen as the external manifestations of inner experience. The cultural sciences, therefore, need to apply analytical methods based on “understanding;” through which the scientist can seek to understand human beings, their minds, and their feelings, and the way these are expressed in their outward actions.

The interpretive paradigm believes that scientific knowledge is socially constructed and socially sustained; its significance and meaning can only be understood within its immediate social context. Interpretive finance research enables scientists to examine aggregate market behavior together with ethical, cultural, political, and social issues. The interpretive paradigm believes that there are no universally valid rules of finance and financial management. Interpretive paradigm’s views with respect to the nature and role of global governance are presented next.³

The interdependence of states has increased, but only to about what it was in the year 1910 if measured by the amount of trade or capital flows as a percentage of GNP; and it would be lower if measured by the mobility of labor; and yet lower still if measured by the mutual military dependence of states. Money markets may be the only truly global economic sector. However, international movement of financial assets is very

similar to international movement of commodities, i.e., the present situation is similar to what it was in the past. Despite today's high speed communication, financial markets at the turn of the previous century were at least as integrated as today. Closer interdependence has effects on the conduct of internal and external affairs of nations.

Globalization is the fad of the recent decades and it is made in America. This is because much of the world has been left unnoticed: most of Africa and Latin America, Russia, all of the Middle East except Israel, and large parts of Asia. Moreover, various regions of many countries participate in the global economy to varying degrees. For instance, northern Italy is involved in global activities much more than southern Italy. In general, globalization is not global because it is mainly limited to the north.

The world is not homogeneous. Unfortunately, there are wide disparities between the North and the South. There are considerable and persistent differences even among countries which are claimed to be in the zone of globalization. For example, financial patterns are quite different across countries. The United States needs to import capital, but Western Europe does not, and Japan exports capital. The more closely countries are compared the more variations are found. This is not surprising. What seems smooth, uniform, and simple from a distance, upon closer scrutiny proves to be pock marked, variegated, and complex. In a competitive system the losers imitate the winners, otherwise they continue to lose. In political as in economic development, newly-independent countries imitate the practices and the institutions of the countries that they consider advanced. Every once in a while, a country invents a new way, or modifies an old way to gain an advantage over other countries; and then the process of imitation begins anew. In general, in a competitive system there are winners and losers: A few do exceptionally well, some just make it, and many fall behind. In the past 75 years a variety of impressive political-economic systems were admired in their day.

Economic processes do not direct or determine a nation's policies. For instance, within the European community, which consists of advanced countries at similar levels

of development that are closely interrelated, forms of corporate governance fall within a spectrum of approaches and are expected to persist for the foreseeable future. Germany and France have economically grown more closely together as they have become each other's principal trading partners since the 1950s. Yet, France has copied German policies but has been unwilling or unable to copy its institutions.

Economies remain local to a large extent. Countries with large economies continue to do most of their business internally. Developed countries do most of their non-oil external business with each other, which means their dependence on developing countries is further reduced. The world is less interdependent than is usually thought.

Major corporations are firmly anchored in their home country. None of the world's 100 largest corporations could be called truly "global" or "footloose." The importance of a corporation's home base is evident on all important respects: location of most assets, site of research and development, ownership, and management. And the technological expertise of corporations closely corresponds to that of their base countries.

States' adaptability is the key to their success in the world economy. Those states have considerable advantage that adapt easily to the current rapid technological and economic changes. International politics remains inter-national. Global or world politics has not dominated national politics. The twentieth century was the century of the nation-state. The twenty-first century will remain so. Trade and technology do not determine how best to organize a polity and its economy. National systems are highly resilient. States continue to have a wide range of choices. Over time, the qualities of the state that define success vary. One wonders what qualities define the next successful state.

States also protect themselves. Different nations, having distinct institutions and traditions, protect themselves differently. Japan fosters industries, defends them, and manages its trade. Alternatively, the United States uses its political, economic, and military leverage to protect itself, and manipulates international events to promote its interests.

A state's internal monopoly control over society and economy has never been complete, but it seems to be at its highest currently, especially in well-established

states. The range of governmental activities has rarely been longer than it is now. In many countries, the concern has been not with the state's diminished internal powers but with their increase, although state's control has decreased somewhat recently.

Economic markets and economic interests cannot play the role of government. For integration, there is a need for a government to protect, direct, and control. In contrast to integration, interdependence is the mere mutualism of states. The most important events in international politics are due to differences in the capabilities of states, rather than being due to economic forces that are operating either across states or transcending them. The world-shaking events of 1989-91 were due to a political event: the failure of one of the world's two great powers. If the configuration of international politics had not fundamentally changed, neither the unification of Germany nor the war against Saddam Hussein would have been possible.

National politics play a major role in international-political events. National politics, not international markets, underlie many international economic developments. Internationally, blocs have increasingly become more common. Economic interests and market forces do not create blocs, but governments do. Decisions and acts of a state or decisions and acts of a group of states arriving at political agreements shape international political and economic institutions. Governments regulate international economic matters much more than they did in the earlier era of interdependence. Before World War I, foreign-ministry officials were known for their lack of knowledge of, or interest in, economic affairs. As a result of governments' increased activities in economic affairs both at home and abroad, interdependence has become less of an autonomous force in international politics.

States are differentiated from one another primarily by capability. The major larger states have been growing more rapidly and have been getting richer while poor countries have remained poor. In a system with no central governance, the states with greater capability enjoy disproportionately larger influence due to lack of constraining

laws and institutions. These states are able to manipulate the system to their advantage. Those states succeed that use their capacity to adjust to external conditions and use their ability to take advantage of their economic leverage for political advantage. The United States, for the past several decades has remained highly important in the international economy – serving both as a major importer and exporter of goods and services – yet it has maintained a low degree of dependency on others. Due to its low dependency on others, the United States has a wide variety of policy options; and has the ability both to place pressure on others and to assist them.

The international economy, similarly to national economies, operates within a framework of rules and institutions. Rules and institutions are made, sustained, and perpetuated. Britain, to a large extent, played this role prior to World War I; no one took this role between the two world wars, and the United States has played such a role since World War II. That is, more than any other state, the United States both makes and maintains the set of rules and institutions that shape international political economy.

The United States is the world's most important country economically; and the most important and decisive militarily. The world is sustained by American power and America's use of that power against those who threaten its worldwide interests. The "invisible" hand of the market never works without an effective fist. The United States' military expenditures are greater than the next six or seven big spenders combined. When force is needed, only the leadership of the United States settles the matter. The Cold War militarized international politics. International relations were defined in terms of military. National security decision making in some democracies was penetrated by the United States.

Ironically, the end of the Cold War has further raised the importance of the American military. Other countries have reduced their military budgets more than the United States. This has heightened the military dominance of the United States. The stronger states have many more choices in coping with their adversities than the weak have, and the latter depend on the former much more than the other way around. The United States is the only country that can manage and lead a military coalition. Some states

participate, partly under pressure from the strong and partly under pressure from their needs to the strong. For instance, Western European countries and Japan are more dependent on Middle Eastern oil than the United States, and Western European countries are more affected by events in Eastern Europe than the United States is.

American foreign policy increasingly relies on military means. America continues to maintain its military presence in much of the world, and to look for ways to expand its troops in foreign countries, rather than ways to withdraw them because the Cold War has ended. In America, the Treasury Department and the Defense Department make as much or more foreign policy than the State Department does.

IV. THE RADICAL HUMANIST PARADIGM

In Exhibit 1, the radical humanist paradigm occupies the northwest quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From left to right they are: Solipsism, French Existentialism, Anarchistic Individualism, and Critical Theory.

The radical humanist paradigm assumes that reality is socially created and sustained. It provides critiques of the status quo. It tends to view society as anti-human. It views the process of reality creation as feeding back on itself; such that individuals and society are prevented from reaching their highest possible potential. That is, the consciousness of human beings is dominated by the ideological superstructures of the social system, which results in their alienation or false consciousness. This, in turn, prevents true human fulfillment. The social theorist regards the orders that prevail in the society as instruments of ideological domination. The major concern for theorists is with the way such ideological domination occurs and finding ways in which human beings can release themselves. They seek to change the social world through a change in consciousness.

Radical humanists believe that everything must be grasped as a whole, because the whole dominates the parts in an all-embracing sense. Moreover, truth is historically specific, relative to a given set of circumstances, so that one should not search for generalizations for the laws of motion of societies.

The focus of the radical humanists upon the “superstructural” aspects of society reflects their attempt to emphasize the Hegelian dialectics. It is through the dialectic that the objective and subjective aspects of social life interact. The superstructure of society is believed to be the medium through which the consciousness of human beings is controlled and molded to fit the requirements of the social formation as a whole. The radical humanists emphasize the political and repressive nature of purposive rationality, logic of science, positive functions of technology, and neutrality of language. The radical humanist paradigm’s views regarding the nature and role of global governance are presented next.⁴

Since the 1960s, rapid technological progress has accelerated global flows of capital, labor, information, and knowledge. These shifts not only internationalize but also integrate economic activities. Major developments include a drastic increase in capital mobility, a changing hierarchy of national units, and the emergence of major regional powers – most importantly the Asia Pacific zone, the European Union, and the North American Free Trade Agreement (NAFTA) – as sources of political strength and economic vitality. Globalizing patterns add new complexity to international relations, because they transcend, blur, and even redefine territorial boundaries.

However, the compression of time and space has a limit because flows of capital and technology eventually reach distinct places. The combination of globalizing trends, national initiatives, and informal networks, has made new places – such as a few world cities (New York, London, Tokyo, etc.) and newly industrializing countries – important nodes in the present global political economy. People in some of these places tend to demand democratization as a means to gain control of the unaccountable forces of economic globalization. In general, there have been diverse responses to globalization: at one extreme, some have unconditionally accommodated globalization and planned

strategies for managing its currents; and at the other extreme, some have outright resisted globalization, often in the form of the invention and assertion of particularistic identities. States, international organizations, corporations, and social forces, have been trying to regain control and convert the threats of globalization into unparalleled opportunities.

Globalization is both an objective and a subjective phenomenon. It is not an entirely novel process, and may be regarded as a stage in the history of the development of capital, which has gathered many different societies in one system. This single configuration was developed based on some pre-conditions that included the long-distance trade and the emergence of nation-states. One of the characteristics of this Westphalian interstate system has been the rise and decline of periodic hegemonic orders. The last hegemonic order was the *Pax Americana*, which prevailed from the end of World War II to the early 1970s, which is marked by the breakdown of the Bretton Woods system. The weaker U.S. position in the world economy, made it subject to the challenges of Europe and Japan. The United States was the largest debtor nation. Since no military power can be infinitely financed by external credit, the U.S. lost a substantial measure of its strength.

With the emergence of a post-hegemonic order, a series of structural changes began to take place in the global political economy in a period known as globalization. These changes include not only an intensification of the existing patterns – e.g., from cross-national lending to the hyper-mobility of finance capital – but also a fundamental transformation to a system that lacks a stable power with effective means of regulation. That is, globalization constitutes dialectic of continuities and discontinuities.

Globalization is also a movement of capital with deeper commodified forms of political and social integration. Globalization not only involves a large number of globalizing firms, but also the centralizing tendencies of the most powerful corporations based in select cities equipped with the social and economic infrastructure to enhance

global control, and connected to a spatially dispersed economic activity. Globalization involves economic concentrations and the denationalization of economic activities.

In the current era of globalization, production can be transferred overseas to defeat competitors, and reduce impediments to free movement of people and ideas. To counter the forces of nationalism and localism, globalization is equipped with the ideology of neo-liberalism. Globalization embodies values of economic liberalism: the inevitability of market utopia. It portrays ideal conditions that have never existed and certainly not without state regulation of the economy. Globalization as an ideology extols efficiency of free markets; and offers an open world economy in which participants compete in a positive-sum game, i.e., all participants gain. In this competitive model, the appropriate corporate strategy is crafted to maximize profits and market share to meet the requirements of globalization. However, the liberal-economic restructuring of globalization had led to the widening of social and economic disparities which is apparent both within countries and between them.

In general, ideologies not only involve myths to justify a social and political order, but also form social consensus and thereby lessen the state's use of coercion. One myth about globalization is that it is teleological – i.e., it has a predetermined logic with a final state of affairs: a global village, a worldwide economy, a world government, etc. However, even if globalization involves a set of deep historical structures, since history has no end, its course must be taken by intervention of human agency. A closely-related myth is to reify globalization as an inevitable trend: a juggernaut moving into the future. This is clearly in contrast to the multiplicity of forms encountered in diverse contexts, i.e., the way that the centralizing elements of globalization interact with distinctive local and regional conditions.

With the growing concentration of unaccountable economic power at the world level, regulatory frameworks are only partly able to control global flows, and the state is engaged in internal restructuring, realigning the scope of and hierarchy among economic ministries, enhancing outward-oriented agencies active in trade or finance, and diminishing welfare activities. The state is adopting policies to adjust to and

manage the globalization process in diverse ways. Old-fashioned national development planning – based on the assumptions that states are autonomous and leaders can determine their destinies – has been replaced by globalization projects. Globalization also involves a changing hierarchy among states.

The global restructuring of production and power is a crucial piece of globalization. The global restructuring of production has accentuated the imports of labor to the advanced capitalist countries. Although the transfers of population are mostly from the South to the North, movements within either area are significant.

The free global economy has increased trade in harmful substances with limited regulation. Ecological problems become more challenging when barriers fall in the globalized economy. With expansion of markets and the fall of socialist regimes, a new stratum of crime bosses, often with the approval of government officials, is developing. Transnational criminal groups are heavily involved in car theft, trade in nuclear materials, smuggling of migrants, arms deals, money laundering, and sales of human organs. To counter them, the interstate system seeks new means of coordination and cooperation, but the distrust among rival actors, variations in criminal codes, and insistence on protecting national sovereignty form the obstacles to their fight against the global organized crime.

Globalization is mostly about opportunities arising from reorganizing governance, the economy, and culture in the world. It threatens, but does not dissolve, the Westphalian interstate system, and opens up possibilities for political participation at non-state levels. It can liberate people (e.g., women drawn out from seclusion in the home and into the industrial workforce) as well as displace the constraining values in their lives. The technological patterns can release people from repetitive jobs and provide opportunities for new career paths and cultural discovery.

Globalization tries to resolve conflict between different operative logics, generating two major contradictions. First, centralizing activities grow in a territorially-based

context. A globalizing economy coexists with a territorial mode of political organization. There is incompatibility between a horizontal system of economic relations – speeded by technological advancements that escape regulatory regimes – and vertical units of the Westphalian framework, i.e., nation-states. Second, there is the mounting pressure for increased democratization at the national level that regards civic power as a means to limit state power, curbing abuses and corruption, and ensuring accountability. Yet global concentrations of economic power are remote and difficult to control.

There are four reactions to these problems. One is acceptance of globalization. Some very poor states have adopted this policy on the ground there is no alternative. Many other developing countries have embraced liberal-economic globalization, seeking to take advantage of opportunities it provides to the national advantage.

The second reaction is to arrange a multilateral response to challenges globalization poses on their sovereignty by cross-border flows. The UN provides a solution because it preserves the principle of sovereignty; and it constitutionalizes, harmonizes, and stabilizes the international system, although imperfectly. The UN also reflects the notion a world of states is desirable and its affiliates, international financial institutions, manage the global market. Proposals for institutional reform seek smooth execution of the neoliberal project.

The third reaction is for corporations to define niches, shift to new production methods, upgrade their technologies, use state initiatives, and create competitive advantage. Some of the business strategies have succeeded brilliantly and turned a threat into an advantage.

The fourth response is to contest the logic of the globalization process. Two alternative approaches are as follows. The right proposes fascism or hyper-nationalism. Some other movements promote autonomous and strong civil societies. They aim to construct an identity which is denied to them in a globalizing world.

The first three responses accommodate globalization, whereas the fourth one mounts counter-movements and plans for its eventual downfall. The first three advocate neo-liberal globalization, whereas the fourth one advocates democratic globalization.

V. THE RADICAL STRUCTURALIST PARADIGM

In Exhibit 1, the radical structuralist paradigm occupies the northeast quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From right to left they are: Russian Social Theory, Conflict Theory, and Contemporary Mediterranean Marxism.

The radical structuralist paradigm assumes that reality is objective and concrete. It uses scientific methods to find the order that prevails in the phenomenon. It views society as a potentially dominating force. This paradigm is based on four central notions. First, there is the notion of totality, i.e., the phenomenon as a whole. This notion emphasizes that the totality shapes and is present in all its constituent parts. Second, there is the notion of structure. The focus is upon the configurations of social relationships, called structures. The third notion is that of contradiction. Structures, or social formations, contain contradictory and antagonistic relationships within them which act as seeds of their own decay. The fourth notion is that of crisis. Contradictions within a given totality reach a point at which they can no longer be contained. The resulting political and economic crises indicate the point of transformation from one totality to another, in which one set of structures is replaced by another of a fundamentally different nature.

To survive and reproduce themselves, human beings transform reality, where material reality is the most important. This transformation takes place through the social division of labor. This division implies social groups enter into relations with each other to produce, while using means of production, that is, they enter into production relations. These groups, formed in terms of production relations, are called social classes. A complete definition of a social class encompasses economic, political, and ideological elements, with dialectical relationships. Production relations, under capitalism, are

antagonistic, since they unite two antagonistic poles, defined as owner and non-owner. Therefore, social classes, who are the carriers of contradictory aspects of social relations, are antagonistic too.

Transforming material requires knowledge of doing it. Gaining knowledge of doing it requires dealing with it, i.e., transforming it. This is the materialist basis of epistemology, i.e., science has a materialist nature. Therefore, only classes, identifiable in terms of production relations, have the objective possibility of an independent knowledge of reality. Furthermore, the class which deals with a larger portion of reality, has the greater objective possibility of gaining a correct knowledge of it. Under capitalism, the proletariat,⁵ which deals with an increasing portion of social reality, has the objective possibility of knowing it correctly. In the context of the constant attempt that classes make to dominate each other, it can only realize itself through ideological class struggle. Knowledge is, thus, in the most fundamental sense, ideological, since it formulates views of reality and solves problems from a class point of view. Radical structuralist paradigm's views with respect to the nature and role of global governance are presented next.⁶

In recent decades the liberal cosmopolitan ideological current has gained prominence in the Anglo-American world. It runs parallel to the process of globalization and not only complements it, but also plays the more insistent role. Liberal cosmopolitanism is a radicalization of the Anglo-American tradition known as liberal internationalism, which believes in a single human race, peacefully united by free trade and common legal norms, and run by states that advocate civic liberties and representative institutions. Such liberal internationalism aimed at creating a global order with a code of conduct among states within the Westphalian system, i.e., states have jurisdiction in their own territories.

Liberal cosmopolitanism aims at creating a global order that governs important political and economic aspects of internal and external behavior of states. It does not advocate world government to decide on vital international issues. Rather, it proposes a set of disciplinary regimes, i.e., global governance, that penetrate deep into the

economic, social, and political life of nation-states, and safeguards international flows of trade and finance. The state sovereignty is granted by the “international community”, and is partial and conditional, which can be withdrawn if a state fails to meet the domestic or foreign standards of behavior set by the requirements of liberal governance.

Major shifts in ideologies are always responses to changes in the real world. The new liberal cosmopolitanism is a case in point. It has arisen in response to a host of new pressures on the internal affairs of weaker states, and new relationships among stronger ones. After the Cold War, Western powers have found it easier to end client dictatorships, and constitute liberal democracy as a common value, which is to be upheld in all parts of the world. Accordingly, domestic economic relations and property rights have been slowly realigned in terms of the directives of the IMF, WTO, or regional powers. Peripheral states, which fall outside the rich core, have been enthusiastically ready to make such internal changes. The collapse of the USSR has reinforced the cooperation among western countries, which is referred to as the “Pacific Union”. For instance, it has led to the military alliance in the Gulf War, and in the attack on Yugoslavia. Alternatively, it has led to the substantial increase in the UN military missions involving the major western powers.

The new liberal cosmopolitanism claims members of the “Pacific Union” have broken with power politics as their governing principle. In contrast, the central fact of contemporary international relations is that for the first time in history one country, i.e., the United States, has gained absolute military dominance over every other state or combination of states on the planet. Moreover, the US government has shown no sign of retreat in its global dominance. American defense spending is increasing. Pacific Union involves a set of bilateral, hub-and-spokes military alliances under US leadership. Although liberalism and democracy are now said to be prevailing norms, and the Warsaw Pact has disappeared, the US has worked vigorously to reorganize and expand these “defensive” alliances.

New liberal cosmopolitanism claims that the United States is no longer following egoistic national interest as its strategic guideline. In contrast, the actual policy guidelines for the US diplomacy show that they are wholly dedicated to the race for power politics. Moreover, wherever such documents refer to free trade and liberal democracy, they are conditions for the advancement of US power and prosperity.

The US geopolitical preponderance prevails in the whole of Western Europe, Japan, South Korea, Australia, New Zealand, parts of the Middle East, and Canada. The US is most firmly established in those areas that have the resource capacities to challenge US hegemony. These same areas have greater priority as the most important centers of capital accumulation or natural resources (most importantly petroleum). The rest of the planet is of little strategic interest to the US.

Although the United States and other Pacific Union governments publicly advocate the global spread of liberal rights and regimes, their policies are based on double standards. In those states that the US does not have any strategic interests, even real genocide is covered or sanctioned. However, in those other states that are pivotal to the US strategic interests, they are protected from human rights pressures.

The liberal cosmopolitan project for a new world order requires all states to conform to a supra-state planetary authority. The new liberal cosmopolitanism misrepresents the relationship between the US and various institutions of global governance that are either in place or are being formed, such as the IMF, the UN, and the WTO. Evidence suggests these institutions function effectively only to the extent their policies correspond to the priorities of the United States. These institutions should be viewed as disguised instruments of US policy.

There has been an asymmetrical pattern in state sovereignty. There has been a strong tendency towards erosion of sovereignty in most states in the international system, coupled with an accumulation of exceptional power for one state: the United States. There is a sharp distinction between members of the Pacific Union: the United States has not shown any tendency towards either abandoning power politics or subordinating itself to supra-state global authorities. Although norm-based

cosmopolitanism as an institutionalized order is not wanted in the US, it is enthusiastically wanted in Europe. However, under current world order, the EU propagates the US ideology of new liberal cosmopolitanism when dealing with other states by emphasizing on the free market, the rule of law, and democratic government; and by posing as guardian of universal liberal principles. On major issues, the EU has been acting as a regional subordinate of the US.

The new liberal cosmopolitanism claims the companies of Pacific Union states initiated economic globalization by escaping the control of their states. States continue to shape the patterns of international economic exchange by establishing the legal and institutional framework for the operation of markets.

The new liberal cosmopolitanism assumes that the regulatory and market-shaping efforts of states have been directed towards liberal free-trade regimes. In contrast, the evidence suggests that this is not the case. For instance, in the 1980s, the international economic policy of core countries deviated from the free-trade principles in sectors that were of crucial importance to economies outside the core – such as agricultural products, steel, textiles, and apparel – and in a number of other cases they moved towards managed trade and “reciprocity.” It exacerbates the existing huge debts, and makes peripheral governments increasingly desperate to access compensating inflows of capital from the core states. This pattern makes them vulnerable and unstable, and consequently incapable of providing sustained improvement in the well-being of their populations.

The majority of economic changes, described as “trade regimes” or “trade negotiations,” have been in relation to the property rights of foreign capitals in other states. As a consequence, they raised national public-policy concerns such as: the costs and benefits of allowing global oligopolies to obtain ownership of domestic assets and integrate them into their production and profit streams; of ending controls on the free movement of private finance; of privatizing (mainly into foreign ownership) domestic

social-service provisions and utilities; and of making domestic financial systems, and thereby entire national economies, highly vulnerable to sudden and massive moves in global monetary relations and in international financial markets.

Current changes in international trade and in the internal affairs of non-core political economies are very far from what new liberal cosmopolitanism has hoped for in terms of economic and social gains for the world's populations. The evidence points to an overwhelming huge and growing polarization of wealth between the majority of humanity and extremely wealthy small social groups within the core countries. The evidence also indicates there is almost no chance, if US allies within the Pacific Union were able to subordinate the US to a more collegial system, the existing pattern of economic relations would alter in any way. The US and its allies share a fundamental cause: their joint interest in perpetuating the drive for the control of new profit streams from non-core economies.

The new liberal cosmopolitanism confuses juridical forms with social substance. It views the world as a system of sovereign states on the one hand, and a proliferating number of regional, international, and global regimes and institutions on the other. Among these institutional patterns, it perceives a growing group of individuals who are becoming increasingly free to maximize their welfare in markets. Based on this juridical perspective, it hopes global regimes and institutions can embrace state sovereignties in a legally egalitarian, cosmopolitan rule of law in which all individuals in the world can unite in free exchange. When this same international order is viewed from the vantage point of social power, the reality is a highly centralized hierarchical pyramid of capitalist market forces which is dominated by the Pacific Union states and strongly supported by their state officials. There is substantial unity among market forces and the states of the core countries, rather than the antagonism suggested by new liberal cosmopolitanism. There is also substantial unity among societies of the Pacific Union, whose empire is guarded not by any supra-state institutions, but by a single hegemon, i.e., the USA.

The present international system is organized around American hegemony, not around a balance of power. International institutions serve American interests.

International security arrangements are mainly a collection of American-led alliances. What Americans call international “norms” are mere reflections of American and West European principles: Since the current benevolent circumstances are the product of our hegemony, reduction in hegemony will let others play a larger part in shaping the world to suit their needs, therefore, American hegemony must be actively maintained, just as it was actively obtained. US power will not come to an end unless it is actively detained. No system for universal harmony, however long-term, is credible if it sidesteps it.

VI. PARADIGM DIVERSITY

We briefly discussed four paradigms (as is summarized in Exhibit 2) and their views with respect to the nature and role of global governance (as is summarized in Exhibit 3).

Exhibit 2: Comparisons of the Four Paradigms

		Functionalist	Interpretive	Radical Humanist	Radical Structuralist
Nature of Science	Ontology	Phenomena are objective and external to the individual	Phenomena are subjective and are the product of individual's mind	Phenomena are subjective and are the product of individual's mind	Phenomena are objective and external to the individual
	Epistemology	Knowledge has to be acquired and science is value-free	Knowledge has to be personally experienced and science is value-laden	Knowledge has to be personally experienced and science is historical	Knowledge has to be acquired and science is class-specific
	Human Nature	Humans are the product of their environment and are viewed as individuals	Humans are the creators of their environment and are viewed in their socially-determined relationships with other humans	Humans are the creators of their environment and are viewed as dominating other humans through society's ideological superstructure	Humans are the product of their environment and are viewed as members of antagonistic classes
	Methodology	The social world is real hard and external to the individual. One needs to find the universal relationships among elements of the phenomenon	The social world is soft, personal, and subjective. One needs to understand the way the individual creates, modifies, and interprets the situation experienced	The social world is soft, personal, and subjective. One needs to understand the way the individual creates, modifies, and interprets the situation experienced	The social world is real hard and external to the individual. One needs to find the universal relationships among elements of the phenomenon
Nature of Society		Society has unity and cohesiveness	Society has unity and cohesiveness	Society has deep-seated conflicts and modes of domination	Society has deep-seated structural contradictions

Exhibit 3: Comparisons of the Implications of the Four Paradigms for Global Governance

		Functionalist	Interpretive	Radical Humanist	Radical Structuralist
Global Governance	Its Driving Force	Advances in technology, communication, and transportation	States and multinational corporations	Advances in technology, communication, and transportation; States and multinational corporations; and Ideology	Exploitative logic of capital accumulation
	Its Operation	Based on free markets, where states act as independent entities to enhance smooth functioning of markets	States structure international economic relations, i.e., whether globalization should occur and to what extent	International economic relations are negotiated among states, multinational corporations, transnational capital, non-governmental institutions, and international institutions	Based on capitalism, where states and international institutions act as the agents of the corporations
	Its Role	Globalization of markets benefits everyone	Current internationalization of economic activity is limited to certain national economies such that the gap between the North and the South has been growing	Economic globalization has benefitted some people and harmed others	Globalization of capitalism is the globalization of exploitation and has created global inequalities

The diversity of theories presented in this paper is vast. While each paradigm advocates a research strategy that is logically coherent, in terms of underlying

assumptions, these vary from paradigm to paradigm. The phenomenon to be researched is conceptualized and studied in many different ways, each generating distinctive kinds of insight and understanding. There are many different ways of studying the same social phenomenon, and given the insights generated by any one approach are at best partial and incomplete,⁷ the social researcher can gain much by reflecting on the nature and merits of different approaches before engaging in a particular mode of research practice.

The ancient parable of six blind scholars with the elephant illustrates the benefits of paradigm diversity. There were six blind scholars who did not know what the elephant looked like and had never even heard its name. They decided to obtain a mental picture, i.e., knowledge, by touching the animal. The first blind scholar felt the elephant's trunk and argued the elephant was like a lively snake. The second blind scholar rubbed along one of the elephant's enormous legs and likened the animal to a rough column of massive proportions. The third blind scholar took hold of the elephant's tail and insisted the elephant resembled a large, flexible brush. The fourth blind scholar felt the elephant's sharp tusk and declared it to be like a great spear. The fifth blind scholar examined the elephant's waving ear and was convinced the animal was some sort of a fan. The sixth blind scholar, who was between the elephant's front and hind legs, could not touch any parts of the elephant and consequently asserted that there were no such beasts as elephant at all and accused his colleagues of making up fantastic stories about non-existing things. Each of the six blind scholars held firmly to their understanding of an elephant and argued and fought about which story contained the correct understanding of the elephant. Their entire community was torn apart, and suspicion and distrust became the order of the day.

This parable contains many valuable lessons. First, probably reality is too complex to be fully grasped by imperfect human beings. Second, although each person might correctly identify one aspect of reality, each may incorrectly attempt to reduce the entire phenomenon to their own partial and narrow experience. Third, the maintenance of communal peace and harmony might be worth much more than stubbornly clinging to

one's understanding of the world. Fourth, it might be wise for each person to return to reality and exchange positions with others to better appreciate the whole of the reality.⁸

All theories are based on a philosophy of science and a theory of society. Many theorists appear to be unaware of, or ignore, the assumptions underlying these philosophies. They emphasize only some aspects of the phenomenon and ignore others. Unless they bring out the basic philosophical assumptions of the theories, their analysis can be misleading; since by emphasizing differences between theories, they imply diversity in approach. While there appear to be different kinds of theory, they are founded on a certain philosophy, worldview, or paradigm. This becomes evident when these theories are related to the wider background of social theory.

In order to understand a new paradigm, theorists should explore it from within, since the concepts in one paradigm cannot easily be interpreted in terms of those of another. The four paradigms are of paramount importance to any scientist, because the process of learning about a favored paradigm is also the process of learning what that paradigm is not. The knowledge of paradigms makes scientists aware of the boundaries within which they approach their subject.

Scientists often approach their subject from a frame of reference based upon assumptions that are taken-for-granted. Since these assumptions are continually affirmed and reinforced, they remain not only unquestioned, but also beyond conscious awareness. The partial nature of this view only becomes apparent when the researcher exposes basic assumptions to the challenge of alternative ways of seeing, and starts to appreciate these alternatives in their own terms.

Researchers can gain much by exploiting the new perspectives coming from the other paradigms. An understanding of different paradigms leads to a better understanding of the multi-faceted nature of the phenomenon researched. Although a researcher may decide to conduct research from the point of view of a certain paradigm,

an understanding of the nature of other paradigms leads to a better understanding of what one is doing.

The plea for paradigm diversity is based on the idea that more than one theoretical construction can be placed upon a given collection of data. In other words, any single theory, research method, or particular empirical study is incapable of explaining the nature of reality in all of its complexities.

It is possible to establish exact solutions to problems, i.e., truth, if one defines the boundary and domain of reality, i.e., reductionism. For instance, functionalist research, through its research approach, defines an area in which objectivity and truth can be found. Any change in the research approach, or any change in the area of applicability, would tend to result in the break-down of such objectivity and truth. The knowledge generated through functionalist research relates to certain aspects of the phenomenon under consideration. Recognition of the existence of the phenomenon beyond that dictated by the research approach, results in the recognition of the limitations of the knowledge generated within the confines of that approach.

There is no unique evaluative perspective for assessing knowledge generated by different research approaches. Therefore, it becomes necessary to get beyond the idea that knowledge is foundational and can be evaluated in an absolute way. Researchers are encouraged to explore what is possible by identifying untapped possibilities. By comparing a favored research approach in relation to others, the nature, strengths, and limitations of the favored approach become evident. By understanding what others do, researchers are able to understand what they are not doing. This leads to the development and refinement of the favored research approach. The concern is not about deciding which research approach is best, or with substituting one for another. The concern is about the merits of diversity, which seeks to enrich research rather than constrain it, through a search for an optimum way of doing diverse research. The number of ways of generating new knowledge is bounded only by the ingenuity of researchers in inventing new approaches.

Different research approaches provide different interpretations of a phenomenon, and understand the phenomenon in a particular way. Some may be supporting a traditional view, others saying something new. In this way, knowledge is treated as being tentative rather than absolute.

All research approaches have something to contribute. Interaction among them may lead to synthesis, compromise, consensus, transformation, polarization, completion, or simply clarification and improved understanding of differences. Such interaction, based on differences of viewpoints, is not concerned with reaching consensus or an end point establishing a foundational truth. On the contrary, it is concerned with learning from the process itself, and encouraging the interaction to continue so long as disagreement lasts. Likewise, it is not concerned with producing uniformity, but promoting improved diversity.

The functionalist paradigm regards research as a technical activity and depersonalizes the research process. It removes responsibility from the researcher and reduces him or her to an agent engaged in what the institutionalized research demands. Paradigm diversity reorients the role of the researchers and places responsibility for the conduct and consequences of research directly with them. Researchers examine the nature of their activity to choose an appropriate approach and develop a capacity to observe and question what they are doing, and take responsibility for making intelligent choices which are open to realize the many potential types of knowledge.

It is interesting to note that this recommendation is consistent, in certain respects, with the four paradigms: (1) It increases efficiency in research: This is because, diversity in the research approach prevents or delays reaching the point of diminishing marginal return. Therefore, the recommendation is consistent with the functionalist paradigm, which emphasizes purposive rationality and the benefit of diversification. (2) It advocates diversity in research approach: This is consistent with the interpretive paradigm, which emphasizes shared multiple realities. (3) It leads to the realization of

researchers' full potentials: This is consistent with the radical humanist paradigm, which emphasizes human beings' emancipation from the structures which limit their potential for development. (4) It enhances class awareness: This is consistent with the radical structuralist paradigm, which emphasizes class struggle.

VII. CONCLUSION

This paper briefly discussed four views expressed with respect to global governance. The functionalist paradigm views global governance as universal liberal democracy, the interpretive paradigm views global governance as historically specific, the radical humanist paradigm views global governance as multifaceted and multilayered, and the radical structuralist paradigm views global governance as class determined.

Knowledge of Economics and Finance, or any other field of the social sciences ultimately is a product of the researcher's paradigmatic approach to the multifaceted phenomena he studies. Viewed from this angle, the pursuit of social science is seen as much an ethical, moral, ideological, and political activity as a technical one. Since no single perspective can capture all, researchers should gain more from paradigm diversity.

NOTES

¹ See Burrell and Morgan (1979).

² For this literature see Diamond (1992, 1994, 1996, 1998, 2000, 2003, 2008), Doyle (1983, 1999), Frederick (1993), Fukuyama (1992), Haas (1958, 1964, 1990), Haas and Schumpeter (1964), Held and McGrew (2002c), Karatnycky (1999), Kindleberger (1969), Long (1995), Mitrany (1943), Ohmae (1990), Reinecke (1997), and Schumpeter (1976). This section is based on Diamond (2003).

³ For this literature see Brown (1995), Carr (1981), Gilpin (1981), Held and McGrew (2002c), Hirst (2001), Hirst and Thompson (1999), Huntington (1993), Keohane (1986, 1990, 1998), Keohane and Nye (1977), Krasner (1983, 1995), Low (1997), McNeill (1977), Morgenthau (1948), Spiro (1999), Waltz (1979, 1999), Weiss (1998), and Wolf (1999). This section is based on Waltz (1999).

⁴ For this literature see Archibugi (1995), Archibugi and Held (1995), Archibugi, Held, and Kohler (1998), Bobbio (1988), Burnheim (1985, 1986), Connolly (1991), Cox (1993, 1996b, 1997b, 1999), Deudney (1998), Dryzek (1990, 1995, 2000), Ekins (1992), Falk (1992, 1995a, 1995c, 1999), Gill (1995, 1996, 1997b, 1998), Held (1987, 1991, 1993b, 1995c, 1995d, 1999), Held and McGrew (2002c), Held et al (1999), Hobsbawm (1994), Kant (1795), Korten (1995), Linklater (1996), McGrew (1997, 2002), Mittelman (1996c), Murphy (2005b), Patomaki (2000), Robinson (1996a, 1996b), Rosenau (1997), Rosenberg (1994), Sakamoto (1997), Sandel (1996), Shaw (1994), Sklair (2001), Thompson, D. (1999), and Walker (1988, 1991). This section is based on Mittelman (1996c).

- ⁵ The proletariat is defined as all the individuals who participate in the transformation of material, i.e., in the transformation of the social product, while not owning the means necessary for this transformation.
- ⁶ For this literature see Brunheim (1985, 1986, 1995), Callinicos, Rees, Harman, and Haynes (1994), Dryzek (1995), Duffield (2001), Falk (1969, 1987), Gowan (2001), Held (1987), Held and McGrew (2002c), Scholte (2000), Walker (1988), and Wallerstein (1974b, 1979b, 1984, 1991a). This section is based on Gowan (2001).
- ⁷ For instance, the academic fields of Economics and Finance limit their perspective to the functionalist paradigm. On this matter see Ardalan (2008).
- ⁸ This parable is taken from Steger (2002).

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Sovereign Wealth Funds: An Examination of the Rationale

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Abstract

This paper describes trends in Sovereign Wealth Funds (SWFs) and examines the rationale of establishing such funds. State capitalist development rather than the pursuit of return appears to be the overriding objective of SWFs. These funds reflect the increasing recognition by the state of the power of finance and their chief attraction remains the balancing of globalization and national sovereignty.

JEL Classification Codes: G15, P16

Key Words: Sovereign Wealth Fund, State Capitalism

I. INTRODUCTION

There are 48 Sovereign Wealth Funds (SWFs) in the world owning assets nearing 3 trillion US dollars. SWFs are government investment vehicles funded by foreign exchange assets which are managed separately from monetary authorities' foreign exchange reserves. Johnson (2007) defined SWFs as "assets held by governments in another country's currency". Foreign exchange reserves are maintained by the Treasury or the Central Bank of a country for exigencies of imports, national emergencies, and maintenance of stability of national currency. Although state enterprises and public pension funds may own investments in foreign exchange, SWFs seek riskier investments that offer a higher rate of return in foreign debt and equity markets. SWFs are also different from sovereign holding companies that have a domestic orientation.

Although Funds such as those of Abu Dhabi and Singapore have been around since the 1950s, about half of the SWFs have come to existence in the last few years. Eleven new SWFs were established in 2009 alone. The *Morning Star* suggested SWFs are "fashion accessories" for emerging nations rather than actual money makers. In fact, the recent global financial crisis has seriously eroded the already modest performance of the SWFs. It is worthwhile to examine why many small economies rushed to establish SWFs. Section II of the paper provides an overview of selected SWFs. The case for SWFs is examined in Section III while the case against is presented in Section IV.

Section V offers a rudimentary discussion on management and performance of SWFs. State capitalist development rather than making money appears to be more overriding objective of SWFs. On this theme, an afterthought is presented in Section VI.

II. CHARACTERISTICS OF SOVEREIGN WEALTH FUNDS

Table 1 in the appendix shows data on selected sovereign funds. The seven largest SWFs have investments exceeding \$100 billion each. UAE's Abu Dhabi Investment authority, Singapore's GIC and Temasek Funds, Norway's Global Pension Fund, and SWFs from Kuwait, China, and Russia complete the top seven SWFs. The following features of SWFs are noteworthy:

1. Recently established funds are rather small with the exception of the funds of Russia, China, and Saudi Arabia. Some funds started with less than \$5 billion. Among the biggest 20 SWFs, the average size is over 10 billion USD (Zhang, Wei and Hou, 2008). Once SWFs are set up, they grow by returns they earn and also by subsequent addition of surpluses to the funds¹.
2. The valuation of SWFs is difficult because of volatile investment results as well as possible secrecy of investment holdings. To illustrate, Chile's ESSF (Economic and Social Stabilization Fund) was constituted with an initial deposit of \$6 billion in 2006, which according to the IMF, stood at \$9.83 billion in assets at the end of July 2007. The SWF Institute estimates the assets of ESSF at \$15.5 billion as of August 2008 and the *Morning Star* has yet another estimate.
3. Nearly two-thirds of the SWFs are funded by commodity exporting countries. UAE, Saudi Arabia, Kuwait, etc., have funded their SWFs by revenues from export of oil whereas funding of Chile's SWFs came from export of copper.

¹ Suppose foreign exchange reserves exceed a threshold level, such as a certain level of GDP, say 5%. The excess funds are used as an initial deposit for the SWF. Thereafter, reserves above 5% of GDP are added to the SWF.

Singapore, Korea, China, on the other hand, have funded their SWFs by export surpluses from a variety of manufacturing goods and services.

4. Non-oil exporting country's funds use a small portion of the country's foreign exchange reserves for SWFs. Oil exporting nations maintain small reserves and the funds used for SWFs are a large portion of their foreign exchange reserves.
5. Although most SWFs are from developing countries and they invest in developed financial markets in stocks and bonds, the SWFs can easily diversify into emerging economies, and into hedge funds and private equities. Such tendencies have recently become apparent.
6. SWF may emanate from both democratic and autocratic societies. The budgetary processes in democracies may provide public trust in government ownership and management of the funds.
7. Fund types vary by their main objective. Whereas stabilization and sterilization are the most common, some emphasize saving and development while others are preventive and strategic. Funds may have a mix of objectives as well.

III. THE CASE FOR SOVEREIGN WEALTH FUNDS

In this Section we discuss the rationale of setting up SWFs. The advantages of SWFs are many, although not all need apply for each country at any given time.

Increased Foreign Currency Reserves

The primary reason for SWFs comes from sustained increase in a country's foreign exchange reserves. China (\$2.4 trillion), Russia (\$447 billion), India (\$279 billion) and South Korea (273 billion) have substantial reserve accumulation in recent years. Singapore, Hong Kong, Malaysia, Brazil - all have reserves exceeding \$100 billion². The availability of large surpluses creates strong incentives to establish SWFs.

² Figures are as of March 2010, International Financial Statistics, International Monetary Fund, Washington DC.

Yield

Primary commodity exporters with trade surpluses used to passively invest funds in western banks that recycled the funds. Petrodollars in the 1970s were recycled when banks lent funds to developing countries. In the 1980s and 1990s, surpluses were invested in short term, low-risk US treasury bonds. When interest rates dropped on US treasuries in the 2000s, developing countries became anxious to augment foreign exchange reserve returns. One way they did this was by using SWFs to invest in foreign equity markets, thus reducing the opportunity cost of reserve holdings.

Stabilization

With volatile commodity prices, establishing SWFs for stabilization of revenues is appealing. Most commodity exporters have such an objective. Funds are removed from the state budget when revenues are high and are put back to the budget when revenues are down. These processes are not symmetric. The later may be complicated by liquidity and marketability of the SWF assets as well as the monetary authority's legal right to call upon the assets for meeting balance of payment needs.

Combating Inflation

Trade surpluses tend to increase domestic prices³. SWFs remove funds from the current budget and can soak up excess liquidity and reduce inflation. Facing inflationary

³ According to the classical *Specie-Flow-Mechanism*, trade surpluses induce inflow of gold. This increases the supply of money, which, in a gold standard system, is tied to the reserve of gold. The increase in the supply of money causes inflation, *a la* the quantity theory of money. Even in a fiat money system, trade surpluses work in a similar fashion, causing an inflow of currency into a country, thus raising both money supply and inflation.

pressure, governments may desire to remove foreign exchange from the hands of the public. The government issues bonds and uses bond proceeds to purchase foreign exchange from the central bank. To make bonds attractive they offer marginally higher interest on them, incurring sterilization costs. Higher interest, however, attracts hot money from abroad, further swelling foreign currency reserves and raising sterilization costs. Goldman Sachs estimated China's sterilization costs at \$500 million a year.

Development

Sovereign funds provide savings for economic development and facilitate savings and intergenerational transfer of surplus funds. Earmarking funds for specific developmental goals such as education, health, pension, infrastructure, and banking development is common. China's Investment Corporation (CIC) is committed to banking development and initially made investments in China Development Bank (\$20 Billion), Agricultural Bank of China (\$40 Billion), and smaller amounts in China Everbright Bank and China Construction Bank (Martin, 2008). Chile set up the Economic and Social Stabilization Fund (ESSF) to provide "funding for public education, health, and housing initiatives", and the Pension Reserve Fund (PRF) to fund the government's pension obligations (Kristian, 2007). Reform and long term investment in education or services can make an economy more competitive internationally.

Diversification

Depending on holdings, SWFs may bring diversification of a government's assets. The economies of primary commodity exporters are often dependent on the export of one or two products. SWFs permit the country to diversify its investment and risks.

Debt Management

SWFs allow alteration of debt structure. Excess funds can pay down debt, upgrading the country's debt profile. Brazil's SWF has this as its primary objective. Its SWF uses its proceeds to pay off Brazilian private sector debt, which, in turn, invests abroad.

Industrial Policy

SWF lending is an alternative to industrial incentives such as export financing or bond insurance. This bypasses World Trade Organization rules as such regulations do not extend to SWFs. Further, a country may try to keep its currency undervalued to boost exports and employment. Increasing reserves create pressure for foreign exchange rate to rise. Removal of reserves through SWFs reduces such pressure.

Covert Intervention in Foreign Exchange Markets

SWFs make it more difficult to trace central bank intervention in foreign exchange market. Conventional means of intervention are complex and small central banks will have small ability to intervene. However, interventions through SWFs and their subsidiaries would be immensely more complex.

Political Influence

Some developing nations flex their muscles in the international finance arena and use SWFs to enhance political influence abroad. SWFs may be used to acquire key foreign infrastructure and use ownership of such assets as a foreign policy tool. China, as the strongest emerging nation, draws political attention when it obtains infrastructure

and raw material sources in remote countries. The *Financial Times* (Sep 12, 2008) claimed China's state administration of foreign exchange "convinced" Costa Rica to switch ties from Taipei to Beijing.

Intangibles

Partnering with foreign companies may provide opportunities for gaining knowledge and developing expertise in unrelated areas tapping into networks where connections are the key to deal making. Even if China's \$3 billion investment in Blackstone does not make money, collaboration with Blackstone may bring opportunities to participate in the private equity market. Such opportunities may otherwise be expensive to achieve.

State Capitalism

The state acts as a capitalist when it uses government controlled funds to acquire strategic assets around the world. Developing countries have taken charge of capitalist development in the post-colonial era. Such development is often thwarted by public sector inefficiencies, center-periphery relationships, socioeconomic inequities, the neocolonial world order and other reasons. Globalization and liberalization in the 1990's restricted national autonomy. Empowered by the rise of a financier class within their economies and vast public sector holdings of foreign exchange reserves, some states find SWFs can influence capitalist development. Clark and Monk (2010) suggest SWFs provide an attractive middle path between globalization and autonomy of nation states. SWFs enable states to alleviate the adverse impact of globalization on their domestic economies without entirely giving up its benefits. State capitalism can work through many vehicles⁴, but SWFs are one of them.

⁴ The principal actors of state capitalism are: "national oil corporations, state-owned-enterprises, privately owned national champions, and sovereign wealth funds" (Bremmer, 2009).

IV. THE CASE AGAINST SOVEREIGN WEALTH FUNDS

Whereas many goals of SWFs are laudable, SWFs may not be the best vehicle to achieve those goals. SWFs have drawn criticisms from developed countries as well as domestically on several grounds. The main criticisms are:

Excessive Government Ownership and Management

SWFs give governments command over massive amount of wealth. Some believe the state may not be more efficient in utilizing such funds than the private sector and states should return surpluses to their people by national tax holidays. SWFs reduce government control and management of surplus funds when SWFs are managed by private entities. In practice, however, management of SWFs is entrusted to the country's central bank or entities whose independence from government is questionable.

Too Much Power to the States of the South

SWFs are largely investment vehicles of developing countries in the developed world's financial markets. There are concerns in both the United States and Europe on the potential influence on the Western financial system. SWFs are viewed as large, influential, and lacking in transparency. Their management objectives and investment strategies are often unknown. The US Congress held hearings on SWFs and the G-7 asked the IMF to develop guidelines to monitor SWF investment activities. SWFs, on the other hand, justify covertness for fear of protectionist response to their investment propositions.

Sovereign Wealth Funds are Unsuitable for Many

Criticisms of SWFs include claims that many countries are not prepared for SWFs. Countries with surplus funds should not rush to establish SWFs until urgent needs of the economy have been met first. For example, countries with poverty, unemployment, and current account deficits should not rush into SWFs just because they have foreign exchange surpluses. In many instances the foreign exchange reserves are not “earned” reserves but are “borrowed” reserves⁵. To the extent excess reserves are hot money inflows from abroad which can be withdrawn in short notice, SWF may not be sustainable. India is a case in point. India has large foreign exchange reserves but its trade balance shows a modest deficit, it has a high proportion of people below the poverty line, and much of its foreign exchange reserve is hot money from abroad. India’s central bank, the Reserve Bank of India, pursued and shelved the idea of establishing a SWF.

Creates Policy Conflicts

Concerns have been expressed that operations of the SWFs, when not integrated with other economic policies of the government, may undermine the later. The policies of a country’s SWF may interfere with the policies of the country’s central bank.

Despite repeated Congressional hearings in the United States on SWFs and protectionist alarmism, there is growing awareness SWFs do not threaten the western financial system. As a writer in *Foreign Policy* notes, “Worried about oil-rich foreigners taking over your economy? You shouldn’t be. In reality, it is citizens of unaccountable, paternalistic regimes who stand to lose most when rulers play games with their national wealth” (Ashlund, 2007).

⁵ One estimate puts as much as 37% of India’s foreign exchange reserves as “hot money”.

V. MANAGEMENT AND PERFORMANCE OF SOVEREIGN WEALTH FUNDS

Management responsibility of SWFs rests with the country's Ministry of Finance, or the central bank, or a state appointed board that hires private sector financial managers for fund management. Even when professional managers are utilized, government influence is evident. For example, Singapore's *Temasek* fund, although managed privately, was headed by the wife of the country's Prime Minister.

One consequence of employing professional money managers is SWFs tend to hold portfolios with different risk profiles, time horizon, and asset classes than central bankers who traditionally kept their holding in highly liquid government securities, agency debts, money market instruments and bank deposits. Although SWFs pursue higher return by bearing higher risk, many SWFs are managed quite conservatively. For example, Chile's initial investments had 30% in money market funds. This they intend to reduce, yet the new targets are 15% stock and 20% corporate bonds (Flyvholm, 2007). It may be noted Chile's SWFs are managed by the country's central bank. There seems to be a reluctance to hold cash by SWFs. Cash earns little yield, and defeats the purpose of SWFs which was, in part, to reduce the opportunity cost of holding reserves. Regarding the investment pattern of SWFs, it has been noted that very large share of SWF investment (half of the total investment) went into financial sector and the US financial market received half the funds (Bortolotti *et al*, 2010). China has shifted its emphasis from dollar denominated assets in financial firms to investment in commodities and real estate. Recently, CIC (China Investment Corporation) invested \$850 million in Singapore-based Nobel Group (Financial Times, Sep 21, 2009).

There is very little published information on the SWF performance. Singapore's GIC claimed since its inception a long term rate of return of 6.49% through the end of 2007. The report was published before the recent financial crisis which inflicted heavy losses

on most SWFs. Temasek sold off, at a huge loss, its stake in Bank of America it had acquired through investment of \$4.4 billion in Merrill Lynch, the Abu Dhabi investment authority lost most of its \$7.5 billion investment in Citibank preferred shares, and China's CIC lost much of its \$3 billion in Blackstone. Some of these SWF stand at one-half to one-third their value estimated in 2007. Gamal (2009) reports that the Kuwait Investment Authority (KIA) lost \$30 billion in the last 9 months of 2008. Temasek lost 31% of its portfolio value during the same period (Wassener, 2009). The SWFs regained some of the losses as the markets turned around.

"Poor long-term stock performance" by SWFs is established by formal studies of SWFs performance. Bortolotti et al. (2010) found abnormal return of 802 acquisitions of stakes in publicly traded companies by 33 SWFs resulted in significant negative returns in the two year holding period following the investment. In the case of 355 acquisitions, they find SWFs acquired seats in the boards in 53 (14.9%) of the target firms. The authors concluded SWFs would be unable to exercise monitoring because they would be unwilling to antagonize local management.

VI. THE RATIONALE FOR SOVEREIGN WEALTH FUNDS - AN AFTERTHOUGHT

The rapid decline of SWF investments in the face of recent financial crisis raises doubt about the viability of the idea of developing countries participating profitably in developed world's financial markets for augmenting return and managing risks of their economies. With globalization and increasing financial market integration in the 1990s, companies from emerging nations raising funds in developed country financial markets, increasing commodity prices generating a modest surplus for some developing economies, hopes were high that participating further in the world financial markets would benefit the emerging nations. The recent global financial crisis has lowered such expectations. A financial crisis is not mere fluctuation of fortunes, but often a permanent destruction of value. The losses of SWFs suggest that developing country enterprises in the developed markets are sharecroppers who stand a chance to gain only when it rains

well in the developed markets. Evidently SWFs regained much of the losses they suffered during the financial crisis of 2008, as the stock markets turned around and especially the financial stocks rebounded. This led the NY Times to write that the SWF “reaped huge gains from bailing out financial institutions . . . even as ordinary investors have been pummeled by billions of dollars of losses” (Dash, Dec 07, 2009). This however cannot happen unless the financial institutions had special deals with SWFs which allow them to sell at high prices that ordinary investors can’t obtain. Notwithstanding populist cries in the developed country press, such recovery is modest and in line with stock market gains in general. The picture of SWFs recovering losses is quite mixed; Singapore’s GIC gained from the market rebound, but Tamasek did not.

SWFs are state enterprises which emulate the behavior of late nineteenth century private portfolio capital that moved around the globe in search of higher return. Such mobility of capital helped capitalist development worldwide. Emerging country states are trying to promote the same at home by acting as monopoly capitalists. For the purpose of capitalist development, aggressive pursuit of return should be the objective of SWFs. Instead, these funds are being promoted in the name of social goals of education, health and retirement while their financial performance has remained modest. Until SWFs are successful in reaping significant financial returns, emerging nations may be better off investing surplus funds in removing production bottlenecks at home. Internationally, the rise of SWFs would not indicate any shift of power from western financial establishments to the emerging nations. SWFs however reflect increasing acceptance of the power of finance by developing countries and the chief attraction of SWFs is to balance globalization and national sovereignty.

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APPENDIX

TABLE 1: Selected SWFs in the World

Fund (Country)	Inception	Assets (bn US \$)	Source of Fund	SWF-Forex Reserve Ratio
Abudhabi Inv Authority (UAE)	1976	875	Oil	29.5
Emirate Inv. Authority	2007	NA	Oil	
Pension Fund Global (NOR)	1990	396.5	Oil	7.1
Sama Foreign Holding (Saudi Arabia)	NA	365	Oil	NA
Singapore Inv. Corp	1981	330	Non-Commodity	1.9
Tamasek	1974	134	Non-Commodity	0.9
China Investment Corp.	2007	200	Non-Commodity	0.1
SAFE Inv. Company	X	311	Non-Commodity	0.2
National Social Security Fund	2000	74	Non-Commodity	n/a
Kuwait Inv. Authority	1963	264	Oil	12.7
Algeria Rev. Reguln. Fund	2000	47	Oil	3
US-Alaska Perma. Fund	1976	39	Oil	.5
Wyoming Mineral Trust	1974	3.9	Minerals	Nil
Alabama Trust Fund	1986	3.1	Gas	Nil
New Mex State Inv Office	1958	16	Non-Commodity	0.2
South Korea	2005	30	Non-Commodity	0.1
Chile ESSF	2006	15.5	Copper	0.9

Oil & Gas \$2381 billion

Others \$1448 billion

TOTAL \$3834 billion

Source: Morgan Stanley, April 2007.

Nature and Roles of Popular Discontent in Institutional Dynamics: from the *Early* to the *Later* Veblen

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Abstract

The present work sets out to re-read Veblen on the nature and effect of popular opinion in the process of institutional evolution. We mainly want to show – contrary to much of the interpretative literature – that machine discipline is just one way, and not even the main one, that Veblen uses to explain how popular discontent is generated, and that the economic grounds underlying the process of modification of institutions can work only if it is free from any counteracting force and modification therefore does not necessarily derive from machine discipline. In these terms the technocratic reading of the role of the population in the process of institutional change is only partially convincing. In order to achieve this general goal we will show how and where Veblen actually deals with the question of popular discontent in his works and what role it plays.

Keywords: institutional evolution, emulation, machine discipline, popular discontent, Veblen

JEL classification code: B10, B15, Z13

I. INTRODUCTION

Veblen's studies dealt with various phenomena: human behaviour, production, consumption, distribution, growth, development, cycle etc., and he was so innovative in his methodology and his theories that modern economists – such as Sweezy (1957, p.112) – recognize that: “[scholars of modern capitalism] will find more inspiration and guidance in [Veblen's ideas] than in all the rest of American social science put together” (see also Mitchell, 1936; Hobson, 1937).

The theory of institutions, and their evolution, is the main point investigated by Veblen, and it is studied in a great deal of historical, sociological and economic literature (see e.g., Edgell, 1975; 2001; Hodgson, 1994; Sanderson, 1994). Interpretative literature often relates the change of institutions to the discipline of the “material means of life,” which in the context of the “modern” machine era assumes the particular form of “machine discipline” (see e.g., Harris, 1953; Mayberry, 1969, Spengler, 1972; Walker, 1977; Stabile, 1987, 1988; Rutherford, 1984, 1992; Waller, 1988; Tilman, 1999; recently

Patsouras, 2004).¹ This line of interpretation is distinguished by at least two aspects: *a*) it always subordinates popular discontent to machine discipline, *b*) it overstates its effect of machine discipline in the process of institutional evolution. There are, on the other hand, clear arguments in Veblen showing popular discontent moves independently from machine discipline and that it may have little effect.

As Veblen was deeply bewitched by the nature and effect of popular opinion in the process of reforming the institutions, the present work intends to critically confront the interpretative literature which constantly presents a technocratic reading of the population's role in the process of institutional evolution. We mainly want to show that machine discipline is just one way, and not even the main one, that Veblen uses to explain how popular discontent is generated, and to show that the economic grounds underlying the process of modification of institutions can work only if they are free from any counteracting force and modification therefore does not necessarily derive from machine discipline. In these terms the technocratic reading of the population's role in the process of institutional change is only partially convincing. In order to achieve this general goal we will show how and where Veblen actually deals with the question of popular discontent in his works and what role it plays.

The paper is organized as follows. Section 2 briefly shows the essential features of Veblenian institutions and the general theoretical mechanism of their modification. In Section 3 we present brief considerations on the historical and cultural frame within which his theories of popular discontent are set. Section 4 and 5 show the nature and role of popular discontent in the process of institutional evolution, while in Section 6 we present those forces that are in conflict with the population's reformist attitude. Finally, Section 7 presents the conclusions.

II. INSTITUTIONS AND THEIR EVOLUTION: SOME BRIEF CONSIDERATIONS

Veblen defines institutions as "habitual methods of carrying on the life process of the community in contact with the material environment in which it lives" (Veblen, 1975 [1899a], p.190). More specifically, institutions are the outcome of minds – not

necessarily rational or reasonable² – that are embodied in tools, behaviours and styles (see Weed, 1972; Rutherford, 1992, p.126).³ Not all habits however become institutions, but only those able to discipline collective behaviour, whether by coercion or otherwise (see Harris, 1953; Edgell, 1975).

Institutional evolution is the result –*not foreseeable a priori* – of conflict between divergent institutions no longer compatible with the social and material environment (see Veblen, 1975 [1899a], p.213).⁴ According to him:

“[The] evolution of society is substantially a process of mental adaptation on the part of individuals under the stress of circumstances which will no longer tolerate habits of thought formed under and conforming to a different set of circumstances in the past” (Veblen, 1975 [1899a], p.192)⁵.

And also:

“[...] *The law of natural selection*, as applied to human institutions, gives the axiom: “*Whatever is, is wrong*”. Not that the institutions of to-day are wholly wrong for the purposes of the life of to-day, but they are, always and in the nature of things, wrong to some extent. They are the result of a more or less inadequate adjustment of the methods of living to a situation which prevailed at some point in the past development; and they are therefore wrong by something more than the interval which separates the present situation from that of the past” (Veblen, 1975 [1899a], p.207; italics added)⁶.

Although in the Veblenian perspective the outcome of institutional conflict is not foreseeable, it is clear in practice it depends on some mechanism for inducing change, and on some disciplining tool of thought and action. Below we will see such tools in detail and also look at the main reasons why institutional conflict is not foreseeable.

III. HISTORICAL AND CULTURAL FRAME OF POPULAR DISCONTENT

As we know, Veblen devoted much of his writings to the mechanisms underlying institutional dynamics without however labelling a particular social class as a pre-eminently reformist class. At the same time however the growth of the populist movements of his times pushed him to look deeply at the role of the population and on the nature and effectiveness of its discontent with the *status quo* in the process of

institutional evolution. In studying this, Veblen gets into a theoretical debate that we could define as *Marxist-Darwinist*, in a historical period characterized by deep economic changes (see also Vianello, 1961).

A) The historical-economic circumstances. Veblen lived in a time of great change in the United States. It was at the beginning of mass production and consumption (see Edgell, 2001). Economic historians (see e.g., Cameron, 1993, ch. 9-12) recognize the United States as an extraordinary example of rapid economic growth of the 1800s. The population, for example, was about forty million in 1870 and about a hundred million in 1915. Such an increase was both the result of internal development and also of European immigration. Elements that attracted immigrants were the increase in wages due to the scarcity of the labour force compared to other resources, and the availability of land. More specifically, there are two main reasons for the rapid growth of the United States: a) technological development, b) regional specialization where the use of industrial equipment was greatly stimulated by the high cost of labor. The huge area of the United States – combined with the variety of climate and of resources – meant the country had a marked regional differentiation of production. These combined aspects allowed both industry and agriculture to be constantly involved in technological innovations and always market-oriented. As a result, the nation saw the development and spread of industrial activities and of industrial employment on the one hand and the spread and development of business activities and of business employment on the other. The result of the parallel development of industrial and business employment was the expansion of two parallel classes: workers and businessmen, the very social categories to which Veblen devoted his main studies. Note also that, contrary to what might be thought, the continuous technological progress, and therefore the continuous growth of income, did not lead to its fair distribution (see Vianello, 1961, p. 23).

B) The technocratic debate on institutional development. Veblen developed his theories at a time of heated cultural debate on technological and institutional development. This fundamentally revolved around three points: a) technological progress theoretically belongs to the collectivity, b) there is no progress if technology does not concretely belong to the collectivity thus when it cannot remove the obstacles

preventing the collectivity from administering it directly and c) when technological progress is concretely spread throughout the community then it becomes the standard of thought for judging the existing situation.⁷ As Veblen was to remark in his works, technology is “an affair of the collectivity” (Veblen, 1922 [1914], p.103), “[it] is a joint stock of knowledge derived from past experience, and is held and passed on as an indivisible possession of the community at large” (Veblen 2001 [1921], p.19).⁸ In the Veblenian vision, technological development is dissociated from its control and the main obstacle to the concrete spread of technology is ownership, defined as the “conventional right or equitable claim [...] to extraneous things” (Veblen, 1975 [1899a], p.22-23; italics added; see also Veblen, 1898b).⁹

C) The extension of Marxian materialism and the move towards the non teleological dynamics of capitalism. It is well-known that Veblen fundamentally criticises Marx on three matters: a) the natural right of workers to receive the full outcome of production, b) the hedonistic nature of workers’ claims and c) the teleological dynamics of capitalism (see Veblen, 1906; 1907).¹⁰ Generally speaking, Veblen accepts the Marxian idea that the material conditions of life affect institutions and he tries to expand Marx’s arguments. For this purpose – also referring to the general statements of social Darwinism – he argues that human thought and behaviour are not only trained by necessities of subsistence, but also, and more in particular by “hereditary bent, occupation, tradition, education, climate [...] and the like” (Veblen, 1907, p.437-438).¹¹

IV. EARLY VEBLLEN: ECONOMIC EMULATION AS REASON FOR DISCONTENT

Veblen looks at the nature of popular discontent on two particular economic grounds: a) economic emulation and b) machine discipline. Veblen was first interested in economic emulation, in the last decade of the 1800s, and then in machine discipline, in the first twenty years of the 1900s. We identify the Veblen of economic emulation as the *early Veblen* and the Veblen of machine discipline as the *later Veblen*. This temporal watershed is useful for organizing his thought on the arguments more clearly even though it is not so clear-cut since both these economic grounds were analysed by him alternately or in parallel in the course of his works.

Veblen starts to develop his theory of economic emulation, the first economic reason for popular discontent, in his first essay on economics “Some Neglected Points in the Theory of Socialism” (1891). Here Veblen tries to explain the economic grounds for popular discontent by adapting his original idea to the political debate of the time.¹² As he highlights in the introduction:

“Socialist agitators urge that the existing system is necessarily *wasteful and industrially inefficient*. That may be granted, but *it does not serve to explain popular discontent*, because the popular opinion, in which the discontent resides, does notoriously not favour that view” (Veblen, 1891, p.389; italics added).¹³

In contrast to what he was to write afterwards (see Sections 5 and 6), the early Veblen talks about popular discontent as being separate from machine discipline. He in fact simply recognizes economic emulation as the main economic principle underlying popular discontent. His theory of a causal link between machine discipline and popular dissatisfaction is therefore preceded by a theory of a casual link between emulation and popular dissatisfaction. On the relation between emulation and popular discontent:

“The protest comes from those who do not [...] suffer physical privation. The qualification “of necessity,” is to be noticed. There is a not inconsiderable amount of physical privation [...] which is not physically necessary. *The cause is very often that what might be the means of comfort is diverted to the purpose of maintaining a decent appearance, or even a show of luxury* [...]. Regard for one’s reputation means, in the average of cases, *emulation*” (Veblen, 1891, p.392; italics added).¹⁴

To Veblen, the movement of popular discontent is thus prompted by psychological privations, namely the lack of esteem deriving from economic failure, rather than by the privation of the means of subsistence.¹⁵ The population’s material impoverishment is irrelevant – in spite of what he would say later (e. g., Veblen, 1894) – and he tries to explain why in these terms: the machine era causes a substantial increase in the amount produced so the population cannot, at least in absolute terms, suffer physical privation since it has more goods at its disposal than previous generations; at the same time it constantly shows a state of dissatisfaction towards the existing order, why then? Because the modern era is not only the machine era, but also the era of “private property under free competition” (Veblen, 1891, p. 391). Everyone is free to own and no

formal constraint limits this freedom except for the amount of income possessed. So the population shows dissatisfaction when it sees the inadequacy of the income possessed to cover the necessities of life, mainly psychological, imposed by the prevailing institutions. The test of incongruity here is not objective and absolute. It is subjective because it depends on the prevailing institutions, and therefore on the behaviour of the dominant class, and it is relative since it results from comparison between incomes and institutional necessities.¹⁶ Veblen constantly points out that the prevailing institutional necessity is esteem. Esteem is obtained through economic success which does not exist without emulation. A person obtains economic success when he is able to own more than the next man and when he ostentatiously displays this greater wealth.¹⁷ Note that the sense of economic success is always relative since it depends on the types, numbers and distribution of individuals with whom the economic comparison is made.¹⁸

While in this first work Veblen limits himself to generally applying the emulation factor to all social classes, in subsequent years he specifically labels the social class, namely the leisure class, which is the provider of canons of esteem, and therefore of the prevailing institutions, for the whole of society. Let us quote Veblen on this point:

“The leisure class stands at the head of the social structure in point of reputability; and its manner of life and its standards of worth therefore afford the norm of reputability for the community. The observance of these standards, in some degree of approximation, becomes incumbent upon all classes lower in the scale (Veblen, 1975 [1899a], p.84)”.

And then,

“The norm of reputation imposed by the upper class extends its coercive influence with but slight hindrance down through the social structure to the lowest strata. The result is that the members of each stratum accept as their ideal of decency the scheme of life in vogue in the next higher stratum, and bend their energies to live up to that ideal” (Veblen, 1975 [1899a], p.84).

As anticipated in Section 2, institutional evolution depends on disciplining tools and on mechanisms for inducing change. In this early Veblen, and in view of what has been said above, the disciplining tool that acts on the critical opinion of the institutions is that of emulation induced by ownership, which endogenizes the level of economic success reached, therefore the level of esteem obtained, therefore the level of psychological

privation suffered and consequently the state of popular dissatisfaction. Moreover, the main change-inducing mechanism is social “contact” – direct or indirect – of members of the collectivity with the leisure class.¹⁹ The institutional order not conforming to the habit of emulation is subject to critical evaluation and, if necessary, to modification.

With reference to this particular mechanism of critical evaluation of the existing order, the goal of the income “levelling policy” – emblematic of popular movements which interested the early Veblen – is not that of the fair allocation of the goods produced to members of the community, but that of the “fair” distribution of the possibilities of emulation among individuals. What is claimed by the population is the right to appropriate a part of the social income, as the upper classes do. As a result, the populace endogenizes the fairness of exploitation. They want this not for the purpose of reclaiming the product of their labour unduly taken from them by the upper classes, but simply to obtain the means of payment owned by the upper classes, indispensable if they are to act like them.²⁰ In this form of discontent Veblen does not link the reason underlying popular discontent to the people’s claim for a hypothetical and immutable natural right to own in full the product of labor. This is for two reasons, the first methodological and the second factual. On the methodological plane Veblen considers rights in institutional, not natural, terms. Since they are the product of institutions, and as institutions are in continuous evolution, the nature of a right claimed by the population is subject to modification in the course of time. Veblen himself modifies his theory of the nature of the rights claimed by the population in subsequent works, moving from emulation to machine discipline (see Section 5). On the factual plane, instead, Veblen observes that the contingent reason underlying popular discontent is simply the urge to emulate the upper classes, not the desire to reclaim something improperly removed by them. If the cultural weight of emulation is particularly felt by the collective, the population could be pushed towards the modification of those institutions that do not allow a concrete growth of the money available to them, which improves their level of economic success, and in turn their self-esteem, thus decreasing their discontent.²¹

Popular discontent, driven by economic emulation, takes the following logic chain: the higher the discrepancy between incomes, the lower the economic success of some

individuals compared to others, the lower the capacity to emulate, the lower the esteem that some can receive. This produces psychological privation and popular discontent. If popular discontent accumulates in the community, institutions will be subject to modification, but since Veblen does not envisage automatism of results – either in the case of popular discontent prompted by emulation or when prompted by machine discipline (see Section 5) – we can only say when popular discontent reaches a critical intensity and a wide distribution – not foreseeable, not measurable and above all free of counteracting forces (see Section 6) – only then can institutions change.²²

V. LATER VEBLLEN: MACHINE DISCIPLINE AS REASON FOR DISCONTENT

We saw Veblen, in his early works, was interested in describing the first economic grounds of popular discontent. In the course of his studies – particularly in 1904 with *The Theory of Business Enterprise*, in 1914 with *The Instinct of Workmanship and The State of Industrial Arts* and in 1919 with *The Vested Interests and The State of Industrial Arts* – his attention shifted to another disciplining tool of mental habits opposed to emulation, namely machine discipline. We call this the *later* Veblen. Machine discipline is manifested as a mental aptitude for problem-solving – as Bush (1987) and Samuels (1990) remark – oriented to efficiency, here intended by Veblen as the mental tendency towards the improvement of “human life on the whole” (Veblen, 1975 [1899a], p. 99). It has features of creativity and proficiency and facilitates the understanding of events in terms of evidence and “objective knowledge” (Veblen, 1922 [1914], pp. 55-56). Veblen depicts the internal structure of machine discipline:

“[machine discipline] furnishes the new terms in which the revised scheme of economic life takes form. The revision of the scheme [...] runs, not in terms of natural liberty, individual property rights, individual discretion, but in terms of standardized livelihood and mechanical necessity, - it is formulated, not in terms of business expediency, but in terms of industrial, technological standard units and standard relations (Veblen, 1904, p. 335).

The thought underlying machine discipline requires logic, a mental process that learns, evaluates and enhances facts in terms of measurable relations following a precise and standardized process (see Veblen, 1904, ch. 4). It calls for the existence of

a pre-established system of impersonal sequential rules of cause and effect whatever the goal. A rule working under the regime of machine discipline has an elementary structure based on the concatenation of dependent operations and “mechanical effects” (Veblen, 1905, p. 310) of the following kind: “given *A*, do *B* if, to get *C*.” The elementary instruction can be additionally divided into two sequential sub-instructions: check and then act. Instruction needs time, since instructions are sequential, and information, since it is necessary to know what must be checked, how to check it and how to act.

In view of the above, machine discipline calls for two essential categories of rules: a) checking rules and b) action rules (cf. Waller, 1988). A mindset that works on this plane – and is widespread in society – is able to generate a cultural heritage based on elements of realism, scepticism and materialism (see Veblen, 1904, ch. 9). These elements are useful in understanding facts for what they objectively are (*imputation*) or for what they will objectively become (*derivation*).

Machine discipline channels mental habits towards a reasoning based on evidence and facts. Everything has a cause and an effect; every process of derivation of consequences is known *a priori*. Since machine discipline trains the mind to efficiency, people objectively value the aptitude of each institution to comply with it and those institutions not in line with the criterion of efficiency are subject to modification. Contrary to what he writes on the question of economic emulation (see Section 4), he clearly ascribes the reforming role to machine discipline (see Veblen, 1904, ch. 9). This point is expounded by Veblen in his *The Vested Interests and The State of Industrial Arts*:

“It may well be that the frame of mind engendered by this training in matter-of-fact ways of thinking will presently so shape popular sentiment that all income from property, simply on the basis of ownership, will be disallowed, whether the property is tangible or intangible” (Veblen, 1919, p. 170).

The interpretative literature has tried to interpret how machine discipline changes institutions by referring to the hypothetical effects that a universal ‘contagion’ of this institution could produce on popular habits.²³ Following this line, the contagion manifests itself on two levels: a) a direct effect, generated by the contact of industrial

workers with technicians and b) the subsequent and indirect one generated by the contact of industrial workers with the rest of the population.²⁴

Accepting machine discipline as the basic Veblenian principle in institutional evolution, the automatic and hypothetical effect produced by machine discipline on the habits of people can be summed up in the following terms: technicians “naturally” interiorize the method of thought based on efficiency, and technology becomes the tangible expression of their attitude. The constant use of new technology *necessarily* modulates the habits of those that are in contact with it.²⁵ As a consequence, new institutions prevail over the older ones when the number of technology-users goes up, so a large part of the population absorbs the habits of technicians via technology first in the field of work and then by the use of its products. The universal “contagion” of machine discipline necessarily has just one outcome that is a new institution naturally conforming to efficiency and symmetrically contrary to any “economic and social enragements” opposed to it.²⁶

Note that the *later* Veblen shows a different nature and justification of the “levelling policy” of income distribution which can be explained as follows. People receive – directly or indirectly – training in machine discipline, which allows them to “rationalize” the unfairness of income distribution. This “rational” evaluation is formed in terms of relative comparison – as for emulation – of some form of “useful effort” supplied – unlike emulation – in exchange for the income received. In schematic terms *B* considers the income received by *A* unfair if

$$\frac{\text{income}_A}{\text{income}_B} - \frac{\text{product of labour}_A}{\text{product of labour}_B} > X$$

This shows the objective measure of popular discontent, since it is the comparison between gains obtained and efforts supplied, on the one hand, and objective limits of acceptability *X* – determined by the efficiency criterion – of the discrepancy between the relative level of income earned and the relative level of product supplied. In contrast to emulation, the goal of income “levelling policy” is the efficient allocation of the product within the community, whose members internalize the sense of useful effort to social development. Note that, as for emulation, the reason that popular discontent continues has nothing to do with the unfair appropriation of output that hypothetically belongs to

workers by nature. Here the discontent depends on the fact that some members of the collective obtain part of the social output without giving a useful contribution in exchange. As a result, but unlike emulation, the population internalizes the unfairness of being exploited; moreover it does not claim a right as in the case of emulation, but a duty, and in particular the duty of everyone to sustain the life and development of society, with all the others. Here Veblen does not regard *possible* social conflict as a struggle with foreseeable outcomes between the capitalist and the working class, but, with unforeseeable outcomes, between “vested interests” and “common men,” that is to say between those (the minority) who, on the one hand, have the right to obtain an income without supplying any useful effort and the right to control society and, on the other hand, those (the majority) who have to work for a living. However, as for emulation, it is only if the community has taken the goal of efficiency particularly to heart that the population could be pushed towards modifying the institutions not complying with it. Actually, as for emulation, and contrary to the prevailing interpretative literature, we are not able to say if machine discipline necessarily generates institutional changes. As for emulation, Veblen’s thought does not envisage automatism of results in the case of machine discipline.²⁷ So we can simply say that when popular discontent reaches a critical intensity and a wide distribution – not foreseeable, not measurable and above all free of counteracting forces (see Section 6) – only then will machine discipline produce changes in institutions.

VI. THE FORCES OPPOSING INSTITUTIONAL EVOLUTION AND THE TWO VEBLENS COMPARED

The later Veblen was not only interested in finding a different economic reason for popular discontent and the process of modification of institutions. He was also interested in highlighting the fact that neither emulation nor machine discipline may actually be strong enough to make real changes in institutions. Veblen thus starts to manifest a sceptical attitude to the idea of results automatically emerging from the evolution of mental habits (see Pluta and Leathers, 1978). This is present in several

parts of his works such as in *The Theory of the Leisure Class*, in *The Theory of Business Enterprise* and in *The Vested Interests and The State of Industrial Arts*. In particular as Veblen remarked in 1919:

“[Popular] sentiment has not yet reached that degree of emancipation from [...] ownership that [goes] to make up the modern [...] point of view in law and custom. The equity of income derived from the use of tangible property may presently become a moot question; but it is not so today” (Veblen, 1919, pp.170-71).²⁸

The later Veblen was thus particularly interested in studying the reasons why institutional *inertia* prevails, giving a detailed explanation of the circumstances in which the mere manifestation, spread and contact of mental habits fails to give rise to the iconoclastic effect of institutional discipline (see sections 4 and 5). Veblen’s arguments revolve around three particular factors mitigating popular discontent, namely a) unequal income distribution, b) the morality of the population and c) the indoctrination of a sense of acritical acceptance of the *status quo*. The early Veblen anticipates such arguments in *The Theory of the Leisure Class*, describing the economic mechanism leading to institutional inertia in the following way:

“The objectively poor and all those persons whose energies are entirely absorbed by the *struggle for daily sustenance* are *conservative* because they cannot afford the effort of taking thought for the day after to-morrow” (Veblen, 1975 [1899a], pp.203-204; italics added).

Here the population’s passivity has a *materialistic* nature as the effect of the scarcity of the population’s resources. It follows that the lower the population’s income, the less critical its attitude. If income is low people have to work hard to cover their needs; so they do not have sufficient resources, time or energy to spend in any form of conflict against the existing institutional order. While in 1899 Veblen offers a materialistic notion of institutional *inertia*, in 1904 he changes his vision offering a vague *metaphysical* conception of social *inertia*. In *The Theory of Business Enterprise* he in fact observes:

“There is a *naive, unquestioning* persuasion abroad among *the body of the people* to the effect that, *in some occult way*, the material interests of the populace coincide with the pecuniary interests of those business men [...]. This persuasion is an *article of popular metaphysics*, in that it rests on an *uncritically* assumed solidarity of interests” (Veblen, 1904, pp.286-287; italics added).

From this point Veblen aims at studying institutional inertia, going beyond the simple materialistic arguments of the popular status and investigating instead the ‘first principle’ that maintains the existing order despite popular displeasure, namely the persuasive power of conservative thought on reformist thought. The mitigation of reformist thought is in concrete terms the effect of the upper class aptitude for adequately stimulating and refreshing popular morality and docility. In order to clarify his arguments we refer to his *The Theory of Business Enterprise* (1904) where we find three particular institutional categories that can mitigate the intensity of reform, while generating a sort of inter-class solidarity. These are: a) politics (see Veblen, 1904, ch. 8), b) philanthropy (see Veblen, 1904, p. 377) and, in more general terms, c) culture (see Veblen, 1904, p. 391; see also Veblen, 1917, 1918). The intensity of reformist thought is mitigated by the “art of government” and by the juridical architecture of the State, in particular by the formal rules of social conduct, *laws*, and by a bureaucratic and normative structure aimed at the punishment of deviant behaviours, *justice*. Veblen points out both law and justice are naturally persuasive institutions of social conduct. The vast majority of the population is naturally inclined to respect laws because of innate docility and morality. So, when popular morality and docility are sufficiently stimulated, monitored and controlled, it becomes more difficult for conflict to exist with the existing order:

“The government commonly works in the interest of the business men [...] and [...] *in some occult way*, the material interests of the populace coincide with the pecuniary interests of [the same] business men. *This persuasion is an article of popular metaphysics*, in that it rests on an uncritically assumed *solidarity of interests*, rather than on an insight into the relation of business enterprise to the material welfare of those classes who are not primarily business men [...]. Since the conservative element comprises [...] the effective majority of law-abiding citizens, it follows that [...] constitutional government has, in the main, become a department of the business organization and is guided by the advice of the business men.” (Veblen, 1904, pp.286-287; italics added).

The same arguments derive also from the cultural dimension and cultural direction of patriotic values. As Veblen writes:

“The largest and most promising factor of cultural discipline [...] over which business principles rule is national politics [...]. Business interests urge an aggressive national policy and business

men direct it. Such a policy is warlike as well as patriotic. The direct cultural value of a warlike business policy is unequivocal. *It makes for a conservative animus on the part of the populace [that] learn[s] to think in warlike terms of rank, authority, and subordination, and so grow progressively more patient of encroachments upon their civil rights* (Veblen, 1904, pp. 391-92; italics added) [or upon] the *unequal distribution of wealth*" (Veblen, 1904, p.393; italics added).²⁹

The intensity of reformist thought is mitigated by those values designed to spread a feeling of pride and sense of belonging to the group. The population is trained to put the interests of the group before their own interests through the rules of *rank, authority and subordination*. It follows the solidarity of national interests serves the conservatism of the *status quo*. Rank, authority and subordination were institutional categories affecting organizational structure of industrial firms in the years Veblen was writing (see Alajlani *et al.* 2010) so the critical thought generated by ‘machine discipline’ – *via* the institutions of creativity, proficiency and efficiency (see section 5) – did not find fertile ground for its full development because it was naturally restrained by the intensity of the working class’s docile proclivity to being commanded. Reformist thought is also mitigated by the appropriation of humanitarian sentiment and charitable behaviour by the upper classes. In the eyes of the population, humanitarian gestures are noble, independent from which social class is taking action to deal with social ills, so the population “sympathizes” with the upper class when the latter is sympathetic towards the population:

“[If the humanitarian sentiments] traverse the course of business enterprise and of industrial exigencies, they are nugatory, being in the same class with the *labor of Sisyphus*; whereas if they coincide in effect with the line along which business and industrial exigencies move, they are a work of *supererogation* [..]” (Veblen, 1904, pp. 377-379; italics added).

From the above quotation it is clear Veblen does not find any form of incompatibility between philanthropy and predation, the natural proclivity of the upper class (see also section 2). So any temptation to refresh reformist thought by playing on a hypothetical asocial sentiment among the upper class has no effect since the upper classes can incorporate humanitarian sentiment in the same way as the populace, and since the population valorises all humanitarian gestures, the intensity of its conflictual spirit tends to decrease as the number of observations of upper class humanitarianism increases.

In conclusion, in order to sum up our line of interpretation of Veblen’s thought on the nature and role of population in the process of modification, or preservation, of

institutions we now present a table in which the two Veblens are compared, the Veblen of economic emulation and the Veblen of machine discipline, and in which we schematically present the forces – analysed in detail in the above sections – that may, or may not, change the institutions.

TABLE 1: The Two Veblen Compared

POPULATION AND INSTITUTIONS	THE EARLY VEBLLEN	THE LATER VEBLLEN
Time	1890-1900	1900-1920
Predominant institutions	Ownership	Industry
Forces of institutional change	Envy	Efficiency
Mechanism of “contagion” of popular thought	Contact with leisure class	Contact with technicians
Nature of institutional <i>inertia</i>	Materialistic	Metaphysical
Forces counteracting change	Unequal income distribution Training	Popular morality Docile proclivity Training
Effect on institutional change	Uncertain	Uncertain

VII. CONCLUSIONS

Contrary to much of the literature, we have shown that the technocratic reading of the role of the population in the process of institutional change is only partially convincing. More specifically, we have seen that Veblenian popular discontent is not necessarily subordinated to machine discipline and that the presence of counteracting forces limits the population’s reformist attitude, so the spread of a particular kind of institution amongst members of the collective does not necessarily lead to modification of the institutions. In brief, institutional evolution may not be the necessary consequence of machine discipline, or, if it is the necessary consequence of machine discipline it can encounter opposing forces that limit its reformist effectiveness.

NOTES

¹ However some authors recently seem to be interested in following a different line of interpretation. Forges Davanzati (2006), for example, relates the evolution of institutions to distribution dynamics while Hodgson (2007) relates it to morality.

² On the non ‘rational’ nature of institutions Veblen writes: “[.] Under the Darwinian norm it must be held that men’s reasoning is largely controlled by other than logical, intellectual forces; that the conclusion

reached by public or class opinion is as much, or more, a matter of sentiment than of logical inference; and that the sentiment which animates men, singly or collectively, is as much, or more, an outcome of habit and native propensity as of calculated material interest" (Veblen, 1907, p. 441).

³ Think for instance of the social habits of dressing, playing, drinking, praying or of economic habits of business, ownership, industry, income, credit and money. The methods of livelihood are those managed and affected by material, technological and economic matters (see Rutherford, 1984). Notice that on the nature of instincts Veblen writes: a genetic inquiry into institutions will address itself to the [cumulative] growth of habits and conventions, as conditioned [...] by the innate and persistent propensities of human nature; and for these propensities [...] no better designation than the time-worn "instinct" is available" (Veblen, 1922 [1914], pp. 2-3). On the other hand Veblen also argues that institutions are "habitual methods of carrying on the life process of the community in contact with the material environment in which it lives" (Veblen, 1975 [1899a], p. 193).

⁴ It is well-known that Veblen wrote his theories in a time characterized by a profound reflection on the nature and evolution of species. The evolution of species was a characteristic trait both of the natural sciences – think for instance of Jean-Baptiste Lamarck's *Histoire naturelle des Animaux sans vertèbres* (1815) and Charles Darwin's *On the origin of species* (1859) – and of social science, e. g. Herbert Spencer's *First Principles* (1862). For a long time naturalists thought that each species was immutable, being a divine creation. Lamarck started to present a different perception on the nature of species arguing that each present organism is the result of a continuous process of transformation that started in the past and is under the pressure of environmental conditions. Lamarck's ideas were further investigated by Darwin who stressed that populations of organisms, rather than the single organism, are subject to evolution by a process of natural selection. As we know, according to Darwin the environment 'chooses' the species that adapts itself to the environment so nature selects those genes that are best suited to its characteristics, erasing those that are useless for this purpose (cf. the Veblenian theory on "good" and "bad" instincts). Unlike Lamarck and Darwin, Spencer develops a theory of the evolution of social organisms arguing that – like other organisms – social organization increases its size and interrelation amongst its single components, changes its structure and survives the death of its components. Different aspects of the above theories interested Veblen in his studies. The Lamarckian interpretation of hereditary characters and their transmission from generation to generation was borrowed by Veblen in his theory of 'characters' such as the character of creativity, excellence and docility of individuals (see e. g., Veblen, 1922 [1914]). The fact that Darwin entrusted evolution to the group, rather than to the single organism, is borrowed by Veblen in his theory of instincts – predation, salesmanship, pugnacity, workmanship, idle curiosity, survival, parental bent, solidarity and sympathy – as traits of social classes – leisure class, undertakers, engineers, workers – rather than traits of individuals (think for instance of his *The Theory of the Leisure Class*) (see also Edgell and Tilman, 1989). At the same time Spencer's theory of the evolution of organizations is borrowed by Veblen in the *Theory of Business Enterprise* and in other works in which firms naturally tend to increase their size achieving "economies of production, superior management [and] economies of scale" (Veblen, 1905, p. 463).

⁵ On the interpretation of the Veblenian process of modification of institutions via conflict see, amongst others, Harris (1953) and Jennings and Waller (1994).

⁶ Cummings (1899, pp. 437-38) in his famous critique on the evolutionary theory of institutions, stresses that Veblen is wrong when he writes "whatever is, is wrong", stressing that it might be better to say "whatever is, is imperfect". Cummings remarks that whatever is, is not wrong, it is just imperfect because if it were wrong then the whole cumulative process of development would be wrong too. So what is now right as regards what has been until now, is wrong – or rather, imperfect – as regards what will be from now onwards. The imperfection of current institutions is connected to the imperfection of knowledge and experience as regards current conditions; in other words, in Cummings, knowledge and experience are aimed at improving the present condition not at destroying it. So the protected institutions existing at a given time are the best result of what the society has known from the beginning of evolution until now, but they are imperfect as regards what society will know from now onwards.

⁷ On the reconstruction of the cultural debate in Veblen's time see e.g. Vianello (1961).

⁸ The connection between technology and social knowledge in Veblen's thought is also pointed out by Hodgson (2004, p.183) who writes "The individual and the social aspects of knowledge are connected, because the social environment and its 'common stock' of experience provide the means and stimulus to individual learning" (see also Lawson, 2006).

- ⁹ As we know, Veblen's theory of ownership is the opposite of Locke's. Veblen constantly explains that ownership is the tangible expression of the predatory culture which manifests itself by "infliction of injury by force and stratagem" (Veblen, 1975 [1899a], p.8; see also Veblen 1898b, Veblen, 1904, ch.4). On a recent reconstruction of Veblenian theory of ownership see Prasch (2007).
- ¹⁰ See Hunt (1979), Edgell and Townshend (1993) O'Hara (2000) and recently Hodgson (2007) for a critical comparison of the two authors and for the clarifications of Veblen's mistakes in interpreting Marx. Since the specific goal of the present work is not to understand how Veblen reads Marx and what interpretative mistakes he makes, we will limit our considerations to his original interpretation.
- ¹¹ On the methodological impact of social Darwinism on Veblen's thought see e.g. Eisely (1958), Vianello (1961), Dugger (1979), Edgell and Tilman (1989), Edgell (2001).
- ¹² In this work the historical circumstances and the popular opinions of his times played an important role for the construction of his first theory of popular discontent (see Veblen, 1891, p.387). Note also that Veblen gave equal weight to economic and moral principles in expounding his theory of popular dissatisfaction both in the early and later works.
- ¹³ Note that Veblen does not want to analyse waste and efficiency in this work. These issues would be dealt with more extensively in the following years, particularly in 1898 when he published *The Instinct of Workmanship and the Irksomeness of Labor* and in 1899 when he published *The Theory of the Leisure Class*.
- ¹⁴ Veblen does not say that the 'modern era' is the only one in which emulation exists. As he remarks: "the modern system of industry has not invented emulation, nor has even this particular form of emulation originated under that system. But the system of free competition has accentuated this form of emulation, both by exalting the industrial activity of man [...] and by in great measure cutting off other forms of emulation from the chance of efficiently ministering to the craving for a good fame" (Veblen, 1891, p.395; italics added).
- ¹⁵ He constantly underlines this point, as the following quotations show: a) "the cause of discontent must be sought elsewhere than in any increased difficulty in obtaining the means of subsistence" (Veblen, 1891, p.393), b) "[the cause] is the craving of everybody to compare favourably with his neighbour (Veblen, 1891, p.397) c) [...] under modern conditions the struggle for existence has, in a very appreciable degree, been transformed into a struggle to keep up appearances" (Veblen, 1891, p. 399).
- ¹⁶ As Veblen argues: "the existing system has not made, and does not tend to make, the industrious poor poorer as measured absolutely in means of livelihood; but it does tend to make them relatively poorer, in their own eyes, as measured in terms of comparative economic importance, and, curious as it may seem at first sight, that is what seems to count" (Veblen, 1891, p. 392).
- ¹⁷ As he argues: "to sustain one's dignity – and to sustain one's self-respect – under the eyes of people who are not socially one's immediate neighbors, it is necessary to display the token of economic worth, which practically coincides pretty closely with economic success. A person may be well-born and virtuous, but those attributes will not bring respect to the bearer from people who are not aware of his possessing them, and these are ninety-nine out of every one hundred that one meets" (Veblen, 1891, p. 393).
- ¹⁸ On this point the Veblen writes: "the wider [...] the personal contact of each with his fellowmen, and the greater the opportunity of each to compare notes with his fellows, the greater will be the preponderance of economic success as a means of emulation and the greater the straining after economic respectability" (Veblen, 1891, p. 396). Note that Veblen constantly points out the relativity of social well-being in his works and this goes in opposition to the contemporary Spencerian arguments on the importance of an absolute standard of living (see Spencer, 1891).
- ¹⁹ Note that this particular mechanism of contact would be expounded clearly by Veblen only in *The Theory of the Leisure Class*.
- ²⁰ On a recent reconstruction of the impact of income distribution on the social well-being in the Veblenian perspective see Knoedler (2007).
- ²¹ On the working of emulation in Veblen's thought see amongst others Edgell (1992), Edgell and Tilman, 1991.
- ²² Veblen explains the sense of the continuous search for the esteem of others via economic emulation by using a well-known saying: "when we say that a man is 'worth' so many dollars, the expression does not

convey the idea that moral or other personal excellence is to be measured in terms of money, but it does very distinctly convey the idea that the fact of his possessing many dollars is very much to his credit" (Veblen, 1891, p. 394). Note also that the concrete possibility of giving the working classes the chance to emulate depends on the modality by which income is produced and distributed. In his point of view, income is divided into three parts (rent, profits and wages) whose level and attribution to social classes does not reflect their contribution to production. Such categories are opponents and they are distributed merely on an institutional basis. As Veblen remarks, "the principles and practice of the distribution of wealth vary with [...] the [...] cultural changes [...]; but it is probably safe to assume that [...] the consensus of habitual opinion as to what is right and good in the distribution of product [...] have always been such as to give one person or class something of a settled preference above another" (Veblen, 1908, p. 113). Then he adds "principles (habits of thought) countenancing some forms of class or personal preference in the distribution of income are to be found incorporated in the moral code of all known civilizations and embodied in some form of institution" (Veblen, 1908, pp. 112-13). Notice also that Veblen is particularly interested in the measurement of income categories in the following terms: a) income categories are in continuous evolution in terms of measurement and social awarding; b) the benchmark of each income category is measured in relative terms, comparing different categories at the time t , the same categories as regards different collectors, or variations of the same categories over time; finally and more importantly c) individuals quantify their target income on a moral basis.

²³ Recently this statement has been critically discussed by Knoedler (2007), who does not give much credence to Veblen's intent to give the population the power to change institutions. He mainly reappraises the role of technicians. On the same line before him was Spengler (1972), Diggins (1977), Stabile (1987, 1988), Waller (1988).

²⁴ Accordingly to Walker (1977, pp. 230-31) for example: "[...] participation of workers [in mechanical operations] induces them by occupational conditioning to think in the impersonal terms of causal sequences, and leads them to adopt scientific impersonality and mechanistic criteria in evaluating propositions. [Like technicians] workers begin to question the traditional metaphysical basis of justification of economics institutions. They become critical of specific economic and social arrangements, such as the distribution of income, the existence of privileged classes, the economic and legal domination of businessmen, thrift and even the family. [So] economic conflict in the modern era is therefore generated between the workers, who have new habits of thought, and owners and businessmen, who have older habits of thought".

²⁵ This argument has also been reconsidered by Bush (1987, p. 1087) who remarks: "the problem-solving processes of the community generate innovations in the ways of bringing material things to account, thereby changing the industrial environment in which the community works and this changed environment produces further changes in prevalent habits of thought about how to conduct the community's affairs".

²⁶ Notice that on the economic plane, technological development also has a positive effect on economic growth in Veblen's view. Accumulation of capital does not depend on the accumulation of saving nor on the variation of aggregate demand. Accumulation of capital is the accumulation of technical knowledge – "industrial art" (Veblen, 2001 [1921], p. 19) – and the full utilization of industrial capital which is the expression of the materialization of technical knowledge. Since accumulation of technical knowledge is an expression of the evolution of the instinct of workmanship, then economic growth in concrete terms depends on technicians' freedom to fully use industrial capital in production.

²⁷ In 1907 for example he remarks: "there is [...] no warrant [...] for asserting a priori that the class interest of the working class will bring them to take a stand against the propertied class. It may as well be that their training in subservience to their employers will bring them again to realize the equity and excellence of the established system of subjection and unequal distribution of wealth" (Veblen, 1907, p. 441).

²⁸ Even though it is impossible to know exactly *if* and *when* institutions change, in his studies Veblen also argues that a simple observation of the state of things could help a social scholar to understand whether a process of change of habits is in progress. Unfortunately according to Veblen, his times were still not ready for a possible institutional evolution. As he writes e.g. in *The Engineers and Price System* (1921): "this sentimental deference of the American people to the sagacity of its business men is massive, profound, and alert. So much so that it will take harsh and protracted experience to remove it, or to divert it sufficiently for the purpose of any revolutionary diversion" (Veblen, 2001 [1921], ch.VI).

²⁹ See also Veblen, 1917, ch. 7.

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Competing Catholic Views on Private Property and Free Enterprise

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Abstract

The present paper demonstrates that there was a sea change of opinion amongst Catholic theologians, in general, and Jesuits in particular, on the issues of private property, economic regulation of the economy and free enterprise. The earlier members of this Order, stemming from the School of Salamanca in the 16th century at the time of the founding of the Society of Jesus, in the main favored economic freedom; their modern successors, with some minor exceptions, take the opposite point of view. Several hypotheses to account for this phenomenon are then raised and discussed.

Key words: Jesuits, Catholic theology, laissez faire capitalism, economic freedom

JEL categories: Z12

I. INTRODUCTION

The Catholic clergy's perception of the economy has changed radically since the Middle Ages. In the 16th and 17th centuries, theologians of several Orders¹ at the School of Salamanca developed innovative ideas. They were inspired by economic and societal changes caused by the discovery of the Americas. These now neglected theologians primarily promoted free enterprise. Today, however, the teachings of the Catholic Church are largely filled with anti-market, leftist sentiment. This ideological change is evidenced perhaps most dramatically within the Jesuit society.² For example, the Society of Jesus has largely changed its definition of what constitutes a just wage. This alteration in thought can be attributed to several factors, particularly the clergy's changing role in society.

Although a comprehensive statement of opinion from the Jesuits does not exist on this issue, the general sentiment can be observed in the writings and teachings of individual members of this Order throughout history. Have the modern Jesuits high-jacked the institution passed on to them by the founders of this organization?

In section II we discuss the early period of philosophical development of these theories. Section III is devoted to an analysis of these views in their more modern

emanations. In section IV we explore the contribution of natural law and private property rights to our considerations; in V we compare perspectives on property rights between the early and later church leaders. The burden of section VI is to try to explain these changes. Under this rubric we consider A. societal changes; B. education and C. Socialism. Section VII is the most ambitious of them all; here we attempt to rectify the crisis of lack of economic education on the part of the priesthood. We conclude in section VIII.

II. THE EARLY PERIOD: 1540-1640 A.D.

The Salamancans used reason and logic to develop their ideas. They made deductions based on observations of inflationary pressures caused by inflow of specie in Europe during the discovery of the New World. The Jesuit Scholastics of the School of Salamanca, as well as other Catholic theologians of the time, correctly concluded that free markets were essential to justice and the economic well being of individuals.

As noted by Gordon (1975, p. 244), “scholastic economics was brought to a new pitch in the writings of the Belgian Jesuit, Leonard Lessius (de Leys) (1554-1623).”³ Using the bustling commercial area of Antwerp for reference, Lessius asserted a just price is determined by a consensus of market participants. Gordon labeled this as “the popular or natural price” (1975, 258). In *De Justitia et Jure* (1605), Lessius also acknowledged it is permissible for prices to be “determined by the public authority.”⁴ However, prices set by law should not be used when “in change of circumstances of increasing or diminishing supply and similar factors, the authorities were notably negligent in changing the legal price...” (Lessius, as quoted in Gordon, 1975, p. 259). Thus, Lessius suggested a free, competitive market is the superior mechanism for price determination.⁵ Here, the views of Lessius are congruent with beliefs of the founder of the School of Salamanca, Francisco de Vitoria, a Dominican professor at the University of Salamanca (Rothbard, 1995, p. 102).

Salamanca Lessius distinguished himself from the other Scholastics by applying his theory of just pricing to wage determination; labor, as he observed, is also subject to

market forces of supply and demand. He was the first Jesuit to proclaim the free market is an effective and efficient means to determine wages. Lessius stated that a fair wage is that which is “customarily paid in a given place over a given period” (Gordon, 1975, p. 263). He added that the minimum wage does not need to be and should not be determined by the government, as a wage “can be established that it is not below the minimum from the fact that there are others who are willing to perform such work or office or service for the remuneration in question” (Gordon, 1975, p. 263). As Rothbard (1978, p. 64) observed, Lessius was in agreement with the Franciscan Scholastics, Pierre de Jean Olivi and San Bernardino, on the treatment of wages as ordinary prices found in the marketplace.

Lessius believed that workers should be paid according to their productivity.⁶ He stated that if an employee’s “work brings an advantage to the employer far outweighing the value to him of the employee’s sustenance he would be bound to compensation, at least at the level of the minimum just wage ... when the work is of notably more value to the employer than what it costs him to provide sustenance for life, he must pay something more for it” (Gordon, 1975, p. 264). The value of this productivity is subjective. People who satisfy others’ demands effectively and efficiently will be compensated accordingly in the marketplace. Thus, wages depend on the perception of consumers, not the needs of the workers. Lessius said: “It is not surprising if an industrious agent does make a good income in a short time” (Gordon, 1975, p. 266).⁷

However, it must be acknowledged Lessius was not a radical exponent of the free enterprise system (De Roover, 1951, pp. 499-500). He did allow exceptions. De Roover (1958, p. 427, citing *De justitia et jure*, lib. 2, cap. 2i, dub. 20, para. 148) explains:

Perhaps the best treatment on the subject is found in the writings of the Belgian Jesuit Leonardus Lessius (1554-1623). He admits that not all monopolies are iniquitous and that a prince, if he has good reasons, may grant exclusive privileges. He must then, however, fix a fair price giving due consideration to all attending circumstances (*spectatio circumstantiis omnibus*), such as cost, risk, and market conditions, presumably by striking a compromise between conflicting criteria, as public utility commissions do today.

It is tempting to account for this “deviation” on the part of Lessius on the ground that, as a “mere” Salamancan, he is only an “impure,” or “proto” Austrian; and modern Austrians themselves would be precluded from making any such compromises with

price fixing, whether directly, as in this bygone era, or via anti trust legislation (which allows for, in addition to direct price fixing as in the case of so called utilities, also nationalization and the breaking up a large firm into smaller entities). And there is a great deal of truth in this first approximation. There are very few modern Austrian economists, indeed, who would accept the notion of monopoly as market failure, and thus be open to government regulation via anti trust or price fixing. Most modern Austrians follow Rothbard's (1993) analysis of monopoly and anti trust. However, there are at least two significant exceptions to this first approximation: Mises (1996) and Kirzner (1973).⁸

According to Rothbard, the Society of Jesus did the most to spread the ideas of the School of Salamanca. As evidence, a manual on moral theology promoting free markets was written by Father Antonio de Escobar y Mendoza, translated into four languages, and accrued 37 editions (Rothbard, 1995, p. 131). The treatise of Cardinal Juan de Lugo, another Jesuit, was also widely published (Rothbard, 1976, p. 65).⁹

III. THE MODERN PERIOD: 1890-2004 A.D.

Rerum Novarum (On Capital and Labor), written in 1891 by Pope Leo XIII, was the first social encyclical; it focused on the plight of workers and concern for their morality.^{10,11} A series of writings by bishops and other Catholic theologians following the encyclical ultimately led to the creation of Catholic labor schools, of which the Jesuits were significant contributors, to educate and promote the union movement among American workers. As a result, the early to mid-1900s marked a radical shift in focus for the Catholic Church. It became uncharacteristically involved in emotionally-charged, secular activities. "Until this initiative, the energies of the Church were almost totally devoted to sacramental worship, corporal works of mercy and parochial school education" (Boyle, 2000). These Jesuit institutes lasted the longest – many until the 1980s.

Several papal encyclicals focusing on social issues followed *Rerum Novarum* with similar messages on wage determination. In 1931, Pope Pius XI issued *Quadragesimo*

Anno (On the Reconstruction of the Social Order). Pope Pius XI did not at all, like his predecessors, maintain just wages could be determined by market processes. Rather, in section 70 of *Quadragesimo Anno*, he stated “wages ought to be regulated and established.” In section 71, the Pope said, “the worker must be paid a wage sufficient to support him and his family.” The concept of a family wage became pervasive throughout Catholic social teaching, especially in the writings of popes and bishops.

Pope John XXIII apparently used a very different definition of justice than was understood by the Salamancan theologians. In his 1961 encyclical letter, *Mater et Magistra* (Mother and Teacher; On Christianity and Social Progress), he stated “In determining wages, therefore, justice demands that account be taken...of the individual workers and their families” (section 33). He made the family wage a requirement for justice. In section 71 of *Mater et Magistra*, the pope spoke for church leaders when he said, “We therefore consider it our duty to reaffirm that the remuneration of work is not something that can be left to the laws of the marketplace... It must be determined in accordance with justice and equity; which means that workers must be paid a wage which allows them to live a truly human life and to fulfill their family obligations in a worthy manner.” He was proclaiming that the market, the interaction of supply and demand, could not provide a just wage. Concurrently, Pope John XXIII dismissed the ability of workers to increase their incomes through their own volition – by discovering better ways to satisfy others’ needs and wants. He did not realize the market could have been used to reach a family wage in such a way.

Pope John Paul II composed *Laborem Exercens* (On Human Work). He provided a very detailed critique of the market. In section 90, he wrote:

Just remuneration for the work of an adult who is responsible for a family means remuneration which will suffice for establishing and properly maintaining a family and for providing security for its future. Such remuneration can be given...through what is called a family wage – that is, a single salary given to the head of the family for his work, sufficient for the needs of the family without the other spouse having to take up gainful employment outside the home...

Pope John Paul II’s view, like other modern Catholic theologians, is contrary to Lessius’. The latter, but not the former, believed it is possible, by increasing productivity, for an individual to attain a higher wage entirely without government help, that is,

through the market. This could conceivably be done to the point that the family could be sustained by a single income. Mandated minimum wages prohibit employers from paying employees, whose productivity level is below the minimum wage level, according to productivity. In fact, these workers may not be paid at all. Minimum wages cause unemployment by making it illegal to pay workers according to their productivity. They are priced out of the market as only those whose productivities meet or exceed the minimum wage level are retained.¹²

Finally, Pope John Paul II wrote *Centesimus Annus* in 1991 to commemorate the hundredth year anniversary of Pope Leo XIII's *Rerum Novarum*. Again, the Pope spoke of the family wage that "should be sufficient to enable him [the worker] to support himself, his wife and his children" (section 8). This concept of a legislated family wage was absent from Pope Leo XIII's encyclical, however.¹³ In section 15, Pope John Paul II called for coercion and legislation when he said "society and the State must ensure wage levels adequate for the maintenance of the worker and his family, including a certain amount for savings."

The above encyclicals, the words of the pope, are indicative and representative of the Church as a whole. A widespread change in thought among Jesuits to distrust free markets as a source of economic justice is also noticeable in writings following the release of Pope Leo XIII's *Rerum Novarum* in 1891. Edward Arroyo, S.J. (2000) recalls the *Instruction on the Social Apostolate* (1949) that led to the creation of Jesuit foundations specifically dedicated to social justice and social ministry.¹⁴ Denying free markets could provide justice, the Jesuits promoted ways (such as legislated wage minima) to fill that supposed void.

Documentation became even more significant following the Second Vatican Council. The Jesuit Superior General Peter-Hans Kolvenbach, S.J. wrote a letter addressing his fellow Jesuits in 2000. This letter denounces free markets and specifies that globalization and "the excesses of the market economy" inhibit the social apostolate (Arroyo, 2000, section 5).¹⁵ He failed to recognize that the very wealth created by this market economy enables the Society of Jesus to do works of charity and promote the causes of its choice.

Thomas Massaro, S.J. questions whether globalization, essentially world-wide trade, will be fair. He indicates this phenomenon needs to be restrained. Massaro (2002) stated globalization may even be a threat to “proper human development.” This is in stark contrast to Jesuits of the School of Salamanca, as they promoted freedom in trade and recognized inefficiencies caused by coercive effects of government intervention. Thus, modern Jesuits, with this belief advocate coercion, have the effect of hurting those they seek to help.

The change in thought among the majority of Catholic theologians is demonstrated in actions taken in response to their writings. There is even a political action organization, established in 1971, whose sole purpose is “to influence the formation of federal legislation to promote economic and social justice” (Network, 2004).¹⁶ They consider only government intervention as a means to help the poor. They do not recognize the superior benefits of economic freedom in the marketplace derived by allowing individuals’ incentives to remain unscathed (Gwartney et al., 1996). Network seeks to have the legislated minimum wage raised so that a worker can sustain a standard of living above the poverty line for his family. The organization wants further government interference into markets. Although it concedes, wages have lost their purchasing power due to inflation (which is caused by government interference in the money supply).¹⁷

The Society of Jesus started a similar organization despite the obvious problems caused by government intervention. The Centre for Social Justice, a Jesuit initiative, is an advocacy and educational organization located in Canada. This organization campaigns and publishes works on social justice issues, such as increasing the minimum wage (Centre for Social Justice, 2004).

IV. NATURAL LAW AND PRIVATE PROPERTY RIGHTS

This divergence is also due to the fact that the Salamancans, unlike their modern counterparts, had a deep understanding of private property¹⁸ was in agreement with natural law. Natural law theory was the key and foundation of Salamancan economic thought (Benson, 1993; Block, 2004D; Chafuen, 2003; van Dun, 2001; Hulsman, 1998;

Madison, 1986; Meng, 2002; Rothbard, 1980). Thus, in order to understand the School of Salamanca it is essential to further explore the principles behind natural law theory. This theory refers to a set of self-evident principles and the conclusions that follow these principles. Natural law theory is a collection of rules by which to govern one's life. Saint Thomas Aquinas (1225-1274), a Catholic philosopher and theologian in the scholastic tradition, launched the idea of natural law, and the view discussed here is one proposed and supported by Domingo de Banez and the Dominican theologians.¹⁹ Natural law theory is broken down into two main categories, both of which are critical to economics: analytical and normative natural law.

The Salamancan branch of the Scholastic school felt it was imperative that individuals follow both branches of natural law in order to gain success in worldly affairs. The first of the two, analytical natural law, consists of universal and objective laws that lie beyond human control; thus their effects are inescapable. On the other hand, normative natural law concerns proper behavior embedded in moral human conduct. Whereas it is impossible to violate an analytical natural law, it is possible to do so with a normative one, and the consequences are severe. The Salamancans used normative natural law to formulate their economic principles; therefore, any institution (e.g., private property) that they advocated had a sound moral foundation in economic thought because it had to be in accordance with proper behavior embedded in moral conduct.

Analytical natural theory is helpful in developing the concept of natural order, which gives way to economic order. There is an objective natural order that affects human behavior, and humans react to this natural order in a reasonable way. Based on this, "whatever is contrary to the order of reason is contrary to the nature of human beings as such; and what is reasonable is in accordance with human nature as such" (Chafuen, 2003, p. 21). The key for them was to determine what was reasonable, because that which was reasonable was necessarily good. There was an emphasis on what was reasonable and making sure that human conduct was in accord with reason. In terms of private property, as with any other economic issue, the Salamancans determined if it was good or bad and for what reasons.²⁰ Thus, they had to address the nature of private property. Their "primary intent was to study human action from an ethical

standpoint. Since their thought was rooted in natural law framework, they produced an approach to economics borne on that framework” (Chafuen, 2003, p. 22).

These scholars were concerned not only with what man does, but also with those things he does that are good. By examining the Scholastic method, it becomes apparent why their ideas are so economically sophisticated. They studied the fundamental subject matter of economics: human action.²¹ Economics is the study of human action, and human action is a major concern of natural law theory, and natural law theory promotes private property.

On the opposite end of the economic spectrum are modern Catholic theologians who do not fully support private property rights. They support government welfare and legislation transferring property from those with ability to those with need, and claim this upholds justice and love, hence bettering the conditions of human life (Paul VI, 1965, p. 30). From an economic standpoint, their outlook is problematic. It is difficult to find their arguments compelling because they do not support their beliefs on economic grounds. They speak from a different platform: a moral stage where individuals are pressured to submit to moral convictions.²² However, the Scholastics too have moral and ethical reasons in favor of private property. In economic terms, the main concern of most modern Catholic theologians is to eliminate worldwide poverty, and though their intentions are noble, their approach is ineffective and even counterproductive (Bauer, 1954, 1972, 1981, 1982, 1984, 1987; Bauer and Yamey, 1957; Smith, 1776).

The modern Church, as articulated in several of the papal encyclicals, opposes economic freedom.²³ However, it has been proven that less economic freedom means greater inequality.²⁴ Their beliefs mirror a socialist system, in which property (money, resources, etc.) changes ownership from each according to his ability to each according to his need. For example “if a family finds itself in exceeding distress, utterly deprived of the counsel of friends, and without any prospect of extricating itself, it is right that extreme necessity be met by public aid” (Leo XIII, 1891, p. 14). This is a coercive system that has proven to be unable to generate wealth. In sharp contrast, millions of otherwise poor people owe their enviable standards of living to economic freedom, which guarantees private property.²⁵ Furthermore, most modern Catholic theologians advocate for a system of public aid/government welfare where possession of resources

shifts from the rich to the poor. This is theft.²⁶ The modern Church is anti-market, but its leaders are unaware of the consequences of their beliefs. They are promoting an economic system that is destructive to economic growth and development. Their intent is not malicious; instead they are simply economically ignorant.

V. PROPERTY RIGHTS: A COMPARISON

Let us examine the implications of both groups' beliefs, and discuss how they are different with regards to private property. First and foremost, for the Scholastics, violating private property rights is the most evil sin: "And the devil answered that having goods that belong to someone else is a sin worse than homicide because it is this sin which sends more people to hell than any other."²⁷ Meanwhile, many modern Catholic theologians hold true to Jesus' view that those with property are not heaven-bound: "Yes, it is easier for a camel to pass through the eye of a needle than for a rich man to enter the kingdom of God."²⁸ The Salamancan Scholastics argue the mere ownership of property is not evil, and thus not an impediment in achieving salvation. Only when one values property (a created thing) over God (the creator) does a problem arise, because this would violate the natural order (Chafuen, 2003, p. 32). Despite this economically sound view, modern Catholic thought can be interpreted as resisting such an argument, as "the right to private property is not absolute and unconditional" (Paul VI, 1967, p. 23). One implication of this is that ownership should be held in common.

Many modern Catholic theologians favor common ownership arguing – using scriptural references (Acts 2:44-47) – at one time all people lived together and owned everything in common. Furthermore, they claim people shared gladly and generously the profits of their goods and possessions, ensuring everyone had adequate amounts of food, clothing, shelter and whatever else they needed (Chafuen, 2003, p. 32).

The Salamancans inveighed against common ownership. They employed logic and reasoning, primarily utilitarian arguments, to show privately owned goods are put to better use than commonly owned goods: "This explanation offers a budding theory of economic development: The division of goods and their ultimate possession by private

individuals facilitates increased production, and increased production often contribute to the common good” (Chafuen, 2003, p. 33). They claimed goods which are owned in common are often abused and not cared for, while privately owned items are better maintained, leading to increased productivity. The Salamancans also explained under any other form of ownership other than private property (e.g. land that is privately owned while its produce is commonly shared, or commonly owned land whose produce is privately enjoyed, or common possession of both the land and its fruits) problems would surface, such as resentment of others due to unequal rewards, envy, laziness, greed, and a general attack on the peace and prosperity of society (Chafuen, 2003, pp. 33-34). These Scholastics believed “when goods are commonly owned, the orderly society and a peaceful division of labor are impossible” (Chafuen, 2003, p. 34). According to Domingo De Soto, the best socioeconomic arrangement is one where goods are privately owned along with the produce of these goods (Chafuen, 2003, p. 34). Based on these points, the typical modern Catholic theologian has no real economic argument against private property. Never does he mention anything about increased productivity or the division and specialization of labor.

Modern Catholic theologians believe in a brotherhood of man, where each individual looks out for the well-being of his brother, ensuring he has adequate stock of whatever he needs. They go so far as to say that “The preservation of life is the bounded duty of one and all, and to be wanting therein is a crime” (Leo XIII, 1891, p. 44). People own their wealth, and by giving to the poor, engage in charity, which the modern Church advocates. Yet the church maintains owners of property have an obligation to give to the poor. This obligation undermines charity. The Scholastics of the School of Salamanca, with regards to the brotherhood of man, have a sound refutation against the modern Church – one that requires private property. Not only do these Scholastics have economic reasons for private property, they provide strong moral defenses.

According to de Soto, with commonly owned goods,²⁹ the virtues of liberality (the quality of being liberal or generous) and hospitality (pleasant or generous treatment of guests) would disappear because those who owned nothing could not be liberal, and those without a home could not be hospitable. This would hinder relationships among men. In addition, he argued that it is heresy to state that it is sinful to own property.

Tomas de Mercado noted the importance of self-interest and the greater care that humans generally exercise in relation to their own property (Chafuen, 2003, p. 34). Self-interest is a driving factor in human behavior. Individuals naturally love and care for what is their own. For example, a parent cares for his own child first.³⁰ Not only do people treat their own property with greater concern, they also put it to the best, most productive use.³¹ The fact that privately owned goods are more efficient than publicly owned goods is evident throughout history.³² Common goods, unlike private goods, are treated with indifference, which leads to unproductive and undesirable uses.³³ They are not respected and often mistreated. Modern Catholic theologians have neglected to take into consideration the effects of self-interest, which is a natural thing, inherent in all human beings. They also fail to recognize the implication of common ownership, but the members of the School of Salamanca did not make this error.

These Scholastics acknowledged common ownership leads to inefficient production and resource misallocation. Without private property, as there are not enough goods to go around due to scarcity, violence follows, the strong exploit the weak, nobody is interested in serving the public good, and nobody works in those jobs that require greater effort. In the natural condition, where man has no property rights there is a “constant fear and danger of violent death, and the life of man [is] solitary, poor, nasty, brutish, and short” (Hobbes, 1982, p. 112). The brotherhood of man is and always will be destroyed without private property. Natural rights, namely the right to private property, allow man to escape this self-destructiveness. Charity and generosity would also become impossible in a world without private property. One can only donate what one owns. These latter two virtues are essential to modern Catholic economic thought.

Catholic theologians nowadays are strict believers in charity and generosity, but do not recognize private property makes these virtues possible. They strongly advocate a society in which those who are better off contribute to those who are worse off. On a larger scale, they maintain wealthier countries should transfer their superfluous goods to poorer nations (Paul VI, 1967, p. 49). However, not many nations have superfluous wealth: even the United States, the richest nation in history, has an outstanding public debt of \$9,141,973,745,570.17, which is growing at a rate of \$1.41 billion a day since

September 29, 2006. With an estimated population of the United States at 303,892,344, each citizen's share of this debt is \$30,082.94. (Brillig.com, December 27, 2007).

Modern Catholic thinkers are so rabid about transferring wealth that charity and generosity become in effect an obligation, which is a downright logical contradiction. In addition, they claim, because present generations benefited from past ones, we are “under obligation” to contribute to the welfare of those future generations who come after us (p. 17). But this is problematic on their own grounds, since our grandchildren will likely be richer than us. Also, by giving to the poor, “You are not making a gift of what is yours to the poor man, but you are giving him back what is his” (p. 23). However, charity is voluntary, and once you make it an obligation to give to the poor, it becomes coercion, which is incompatible with the entire logic of giving. Also, obligation undermines charity, making it logically impossible to be charitable. This is clearly a violation of private property, and distorts the incentive to work.

Despite this, the modern Catholic Church also claims that “every man has the right to glean what he needs from the earth,” and “under the leadership of justice and in the company of charity, created goods should flow fairly to all.” The Pope goes on to say that private property rights should “be subordinated to this principle” (Paul VI, 1967, p. 22). First of all, people do have the rights to get what they need from the earth, but not by any means necessary, for example theft. Stealing violates private property and is not conducive to economic growth; rather the very opposite policy is the best and indeed only way to achieve economic progress. It is obvious that modern Catholic theologians, although their intentions may be noble, have no economic platform from which to speak, thus making their arguments weak and inferior to those of these Scholastics.

Private property allows people to reap the fruits of their own labor.³⁴ “Any person has the natural right to donate or transfer the things he legally owns in any way he wants” (Chafuen, 2003, p. 41). As private property is in agreement with natural law, man has free will to do with his property what he chooses, whether it be transfer, abandon, destroy, or hoard it. This is a fundamental difference between early and modern Catholic theologians. Violating private property rights distorts the structure of incentives and hinders production and savings, since at any time your property can be taken away.

VI. EXPLANATORY HYPOTHESES

Having demonstrated that a vast gulf divides early and later Catholic theologians, we now attempt to explain how and why this bifurcation developed.

A. Changes in Society

As secularization and urbanization increases and feudal societies disappear in the modern period, Catholic priests are no longer among the wealthiest and most educated in society. Perhaps they denounce free markets because it seems to them capitalism destroyed their positions in society. They may think it unjust for businessmen to earn more than clergy.³⁵ One can tell, by their flimsy explanations as to why markets are insufficient, that modern theologians either do not care for or do not understand market processes. They turn to politics as the laity becomes less dependent upon them.

Pope Pius XI clearly called for the establishment of a family wage in *Quadragesimo Anno*. In very sharp contrast, the Salamancans were concerned with determining whether market wages were just. In 1931, this pope saw a need to be more specific. A family wage would allow women to remain out of the workforce. The roles of men and women could remain static in the family (at least in the most observable, financial sense). In fact, he explained unambiguously a woman's role is to be a homemaker and rear children. It is one possible explanation this pope was desperate to restrain society from moving down this path.

Joseph Husslein, S. J., a modern Jesuit social theorist, longed for the return of the medieval patriarchal family structure. He felt the working women would usher in the downfall of society: "if woman loses her domestic affection . . . then paganism has returned and the deluge is upon us" (quoted in McDonough, 1990, p. 337).

Peter McDonough (1990) found membership in the Society of Jesus has significantly declined in recent years. His study showed a 30 percent drop between 1965 and 1988 (from 36,000 to 25,000); he predicted the downward trend to continue. Since Vatican Council II, their agenda has shifted as they have become less conservative and more

involved in politics (McDonough, 1990, p. 325). Advocacy for the poor has replaced education as their primary goal. Neophytes in the order are no longer taught to restrain emotion. As immigration increased in the United States in the 1940s, the American Jesuits' departments of social work were added to Jesuit Universities to fight both capitalism and communism and to promote Christianity. Some Jesuits received training in the social sciences. Soon members of this Order were making policy recommendations, possibly trying to find a new niche due to their changing role in an increasingly secularized world. Following the 1960s, social hierarchy changed. New recruits were older, more educated, and rejected the customary structure of the Order. Training was altered. During this time the teachings of the Catholic Church emphasized collective rather than individual spirituality and further promoted leftist ideology (McDonough, 1990, pp. 326-33). Existing clergy, of course, recruited like-minded individuals who provided continuity and enforcement for this change in thought.

Regardless of the cause, many modern Catholic social thinkers sharply diverge from the thought of their Scholastic predecessors who founded the Society of Jesus. The fact remains a government mandate cannot be relied upon to adequately provide a just price or wage.³⁶ As (Woods, 2005) eloquently stated, "real wages are reliably increased across the board not by intrusive legislation but by an economic order that leaves capital accumulation unhampered, thereby increasing the productivity of labor."³⁷

Private property is defined as the right to use something, and to exclude others from its use. Not only is the enforcement of private property absolutely critical for a peaceful and prosperous society, it is the cornerstone of a thriving civilization. As Saint Thomas Aquinas put it, "It is lawful for a man to hold private property; and it is also necessary for the carrying on of human existence" (<http://www.vulgatamagazine.org/neil07.html>). The Scholastics (800 to 1500 A.D.) were a group of Catholic moralists and philosophers who affirmed this statement. However, most modern Catholic theologians - namely from the late 19th century to the present - deny it. The reason for this divergence in thought is early Catholic theologians were economically sophisticated, while modern ones are not.

Although both early and late Catholic theologians have the same end – a peaceful and prosperous society – the means they espouse are different. While the early scholars concentrated on economic growth and development, and favored private

property, the moderns are more interested in equal distribution of wealth and welfare, and favor legislation to that end. These Scholastics, who were economists, favored a system that is compatible with free society and laissez-faire economics. Alternatively, modern Catholic theologians, who are not economists, hold beliefs that appear to be more in line with socialism. Therefore, their economic principles are shaky and not conducive to greater opulence for the masses.

B. Education

Another answer to our puzzle is education. Even in the 1500s, priests were well educated. These late scholastics were no exception. According to Murray Rothbard (1976, p. 53), they were well versed in Aristotle and the classics, and were fully aware of the writings of St. Thomas Aquinas. In fact, they used all of these sources to help formulate their economic theories. In addition, many of these men studied economics at the School of Salamanca. Most of these late scholastics later went on to teach economics in different universities around Spain, including the School of Salamanca.

These men were very well educated, particularly in the field of economics. There is no doubt they had a firm grasp on what makes the market work. These men made some very astute observations that would take others hundreds of years to rediscover. Dominican Martin de Azpilcueta Navarrus was a respected canon lawyer and an advisor to the pope, as well as an economist. "Azpilcueta used his great influence to advance economic liberalism farther than it had ever gone before, among the scholastics or anywhere else. Azpilcueta was the first economic thinker to state clearly and boldly that government price-fixing was imprudent and unwise" (Rothbard 1976, p. 105).

On the other hand, priests today can rarely claim that type of knowledge on the subject of economics, which is part of the reason why Catholic Social Thought is so economically illiterate today. Priests in the modern era rarely have an economic background, nor any familiarity with the subject. Like most people, they may have had a class or two on the subject as undergraduates, or they may have discussed some topics related to economics in the seminary, but the fact is, they do not have the training, and

they rarely possess a thorough understanding of the subject. What little economic teaching they receive in the seminary is biased toward modern leftist Catholic Church doctrine. Yet, as Placher states, “Preaching and pastoring in contemporary society surely requires knowing something about the natural sciences, economics and world politics, to say nothing of the range of ways of understanding human beings and how to help them, from Freud to pharmacology” (2003, p. 37). It is necessary for priests to have a grasp of politics, economics, and current events if they are to be able to respond rationally to students or parishioners in matters of business, profits, employment, etc.

Why do seminaries offer a less than thorough overview of economics to students? It seems reasonable the priests would be able to respond better to questions about Catholic Social Teaching if they knew more about other alternatives. The same could be said for all of Catholic Social Thought. One would be better equipped to defend his stance if he is aware of other options available to parishioners.

Of course, the situation is more complicated than that. The truth is that seminaries probably would teach economics if they could, but it would be very difficult to do so. First, they only have several years in which to prepare these future priests for the duties they will be undertaking. The theological knowledge these men are required to know these days is so extensive that it alone is difficult to fit just that into the time allotted.

It's not enough [for seminarians] to know how their denomination differs from others on the Eucharist. They need to understand how we Christians differ from Buddhists on just about everything. Even in our own society there are black, Hispanic, feminist, womanist, mujerista, gay, neoevangelical and many other voices. Where can one stop in listing the theological perspectives calling for our attention?(Placher, 2003, p. 36).

Priests today have to be able to answer questions regarding Catholicism, as well as all other religions. They must be well versed in Christian, Islamic, Jewish, Buddhist, and Hindu teachings, stances, and publications. In addition, the average age of seminarians is increasing. As men enter the seminary at an older age,³⁸ they are more likely to have other commitments while attending school. Many of them work while attending the seminary. It is so common now, that some institutions will only schedule classes from Tuesday to Thursday, allowing students to hold jobs to pay for their schooling (Placher, 2003, pp. 36-37). Seminarians spend less time in class, on campus, and in theological libraries. This shortened amount of time limits what can be taught about economics.

Further, the idea is while economics is important, and would be helpful to almost anyone, it is not a theological topic, and, it is not the duty or place of the seminary to teach it. It is best left to professors with PhD's in economics, who teach at universities, is the typical thinking. Also, since more and more seminarians are older than the average graduate student, one could assume they have had opportunities to educate themselves in necessary fields, or on topics that interest them, such as economics.

Of course, all of this merely explains why priests of today's society adhere to modern Catholic Social Thought. One still must ask why the Church supports such a doctrine, as opposed to a free market economy, as did these late scholastics.

C. Socialism

During the time of the Salamancans, there were no set theories or tenets of socialism circulating amongst the intelligencia. Many economists during these years believed that the price of a good was and should be decided by the cost of the inputs. These late scholastics were the first to demur; in their view the common estimation, or the market, should, and when free to do so did decide the price of a good. "By the High Middle Ages, the Scholastic philosophers had largely abandoned the cost-of-production theory to adopt the view that the market's reflection of consumer demand really sets the just price" (Rothbard, 1976, p. 54). The late scholastics formulated pro-market theories about the value of money and usury.³⁹ As they spread these theories, others read and further elaborated them over many years. Eventually, in the 1600s the School of Salamanca failed to produce any more great thinkers on the subject of markets, and the tradition of the late scholastics died out. These types of ideas continued to flourish in other countries, but Spain, the School of Salamanca, and the Catholic scholastics had reached the end of an era (Rothbard 1995, p. 128).

About 200 years later, in 1813, Robert Owen published a book called, *A New View of Society*. This man would eventually be known as the first socialist, a derogatory appellation at the time. He thought society should come together to help each other out. People should pool all their goods so that each man gets his fair share, and no one

would have to go hungry. After Owen came Pierre-Joseph Proudhon, author of the 1840 book, *What is Property?* Proudhon comes to the conclusion “Property is Theft,” which became the socialist slogan throughout the 19th century. Eight years later, another tome was published, called, *Manifesto of the Communist Party*. It was written by Karl Marx and Friedrich Engels (1848), and their view of socialism was it was “the stage of history and class structure immediately following the revolution, in which power would pass to the proletariat.” After this, communism would follow (*History of Socialism*, 1, 2).

These authors were the inspiration for the socialist groups and ideas that came later. What they said made sense to a lot of people: there arose in their wake many large socialist followings all over the world. Some were successful in taking over and implementing socialist governments, but at great cost and with minimal success.

In 1891, Pope Leo XIII decided it was time the Catholic Church spoke out against the way the world was heading, and he published the famous encyclical, “*Rerum Novarum*.” This encyclical spoke out against both socialists, who are “emphatically unjust, for they would rob the lawful possessor [of property], distort the functions of the State, and create utter confusion in the community,” and capitalists, who amass “enormous fortunes” and create “utter poverty of the masses” (1891, p. 1). Pope Leo XIII finds both capitalism and socialism to be unsatisfactory, so he takes points he likes from both schools of thought, and fashions them into his own statements about how society and the economy should work. Thus, Catholic Social Thought was born. For example, Pope Leo XIII states in “*Rerum Novarum*” that private property rights are good, and they are one of the only ways that a worker can get ahead in the world. However, he also maintains that it is man’s duty to help his fellow man (1891, p. 2, p. 4). If it is a duty to give to others, then he is robbed of his property rights.⁴⁰ But the Pope supposedly strongly favors private property rights, so this is a contradiction. He creates a school of thinking that is flawed, even if, superficially, it sounds like the best of both worlds.⁴¹ To the untrained eye, though, Catholic Social Thought looks like a good idea.

People with no background in economics took Pope Leo’s flawed thinking to heart. The fact the pope endorsed this “third way” form of economic thinking and berated both socialism and capitalism formed the basis of Catholic Social Thought; these ideas appealed to religious people, priests and lay people alike. This doctrine tells

parishioners they won't go to hell if they have a big house and nice cars, but they can help their souls along to heaven by tithing their ten percent. For priests, it is the perfect mix between capitalism and socialism; the best of both worlds. It avoids the "greed of unchecked competition" and the pitfalls of socialism (Pope Leo XIII, p. 1). If one cannot see the holes in the theory, it looks pretty good. Catholic Social Thought gives priests something to believe in, and something to impart to students or parishioners.

Most advocates of Catholic Social thought would disagree with this argument for several reasons. First, they would say this view is not so close to socialism. It is merely a way to live, a moral code by which to conduct one's daily life. They might also disagree these late scholastics were libertarians.⁴² Finally, they would undoubtedly reject the charge they are uneducated on economics. They would say that they understand how capitalism works, and that the free market creates greed and waste, making the rich richer and the poor poorer. But each of these arguments is erroneous.

First, Catholic Social Thought is very close to socialism. The main divergence is on private property rights. True socialism calls for a complete surrender of one's property so that all may have what they need to survive. As the Proudhonian socialist slogan has it, "Property is theft" (*History of Socialism*, p. 1). Socialists are always looking to close the gap between the rich and poor at the point of a gun, not merely through voluntary means, such as charity. Although they might deny it, this is what the Church also calls for, when it supports such programs as the welfare state, progressive taxation, etc.

As for the Salamancans, it is clear that these men were libertarians, or very close to it. They didn't all believe that the government was unnecessary, but nor do many present day. These scholastics believed in private property rights. They were against the fixing of prices by the government. They believed that the market, or common estimation, should decide prices of goods. They knew that the price of a good was separate from the cost of that good. They held that wages should not be decided by the government, but by mutual agreement between the employer and the employee. They "clearly identified the value of money as its power in terms of goods. For then, like other goods, the value of money varied inversely with its supply, or quantity available" (Rothbard 1995, p. 106). These scholastics even stated that "charging interest on a loan

is legitimate if in compensation to the lender for risk of non-payment” (Rothbard 1995, p. 108). The members of the School of Salamanca not only subscribed to many of the tenets that modern day libertarians do, they originated them.

Yes, there are some priests who are students of economics, and professors too. But these men are in the minority. Most are not specialized in this field. Many might well have a little training in the field, but “a little knowledge is a dangerous thing.”⁴³ To understand fully what is wrong with Catholic Social Thought, the alternatives must be understood. Furthermore, the market itself must be comprehended. True, this institution is very complex, but a person cannot make an educated decision about what is best for the well being of his family, state, or country without the proper knowledge.⁴⁴

VII. HOW TO EDUCATE PRIESTS IN THE FIELD OF ECONOMICS

There are several possible solutions. Seminaries could require a certain amount of core courses in the dismal science before acceptance,⁴⁵ which would mean all class time spent at the seminary could be devoted to theology. By setting requirements for entrance, they could ensure everyone coming in has had a similar amount of education in these matters. One problem Placher had with the seminary is it accepts men from all different backgrounds; some have an extensive understanding of the Bible, while others do not. This puts seminarians at different levels from the very beginning, which makes things even more difficult (Placher, 2003, p. 39). Setting minimal requirements would help solve the problem of heterogeneity. However, this might discourage people with less schooling to enter into the priesthood.⁴⁶

The seminaries could extend the number of years required to graduate and receive Holy Orders. If four years were required instead of three, education would not be stretched so thin. It would afford a more well-rounded education. However, this could discourage seminarians from entering if they must pay for an extra year of schooling. There are scholarships and endowments, though, for men willing to enter the priesthood. If these men are truly sincere about dedicating their lives to God, a few extra requirements either before or during seminary should not make too much of a difference.

The Church could acknowledge economics is as beyond their ken as is physics, mathematics or astronomy. Theologians make no pronunciamientos on any of these fields.⁴⁷ There is no reason they have to regarding economic matters. The shortcoming of this alternative is religion would be relevant to what occurs on, only, one day of the week, not for the entire seven days. However, better to ignore a field, one would think, rather than mislead the flock, and support erroneous and mischievous doctrines.

One last and perhaps best option: what little economic education now taking place in the seminaries of the nation is biased in an anti-market direction. Balance this with the writings and teachings of theologians who take the opposite stance. Include in the curriculum theologians such as Sirico, Woods and Chafuen. According to Mill (1947), the best way to educate is to offer students alternative viewpoints. This is true in all contexts, certainly including economic education for priests and ministers.

The Jesuits today differ from those priests at the School of Salamanca in the 1500s for many reasons, all of which are complicated and intertwined. However, there are solutions to this problem of perpetuating the flawed theory of Catholic Social Thought. The most important is education of priests, as well as the masses, which would call for changes within the Church. Without radically altering education, nothing much of substance can change. If we as a society are not educated, we will continue to make the same mistakes.

VIII. CONCLUSION

For anyone who has heard of or read about the School of Salamanca and the economic scholastics associated with it, it is easy to see there is quite a difference between those priests and the Jesuits of modern times. With respect to their economic beliefs, the two groups could not diverge more.

These late scholastics, those priests associated with the School of Salamanca and economic thinking in the 1500s, could be considered libertarians by today's standards. They formulated economic theories that supported markets, private property rights, and capitalism. These economists produced a value of money theory, spoke out against the

evils of price fixing, and even went so far as to oppose those who tried to ban usury. Many of the theories these men posited were way ahead of their time.

“In recent decades, the revisionist scholars have clearly altered our knowledge of the prehistory of the Austrian school of economics. We see emerging a long and mighty tradition of proto-Austrian Scholastic economics, founded on Aristotle, continuing through the Middle Ages and then later Italian and Spanish Scholastics, and then influencing the French and Italian economists before and up till the day of Adam Smith” (Rothbard, 1976, p. 71).

The amazing thing about the theories they put forth is they were able to reconcile them, now deemed greedy and evil by many religious persons, with their faith. Because they fully understood the free market economy, they saw everyone could benefit from economic freedom, not just the rich. This is a point many today still do not understand.

On the other hand, priests today espouse Catholic Social Thought. This idea began with Pope Leo XIII when he wrote his famous encyclical, “*Rerum Novarum*,” in 1891. In this encyclical, Pope Leo speaks out against the greed of capitalism, but he also criticizes the lack of private property rights afforded by socialism. He does not put the Catholic Church in either camp, but rather gives his own ideas on what the Catholic Church believes is best for human beings. He offers a mix of socialism and capitalism,⁴⁸ which has become Catholic Social Thought.

There is no doubt these late scholastics would wholeheartedly disagree with Pope Leo. For example, the Catholic Church believes in the preferential option for the poor. They believe it is man’s duty to provide for his brother if he is in need. Therefore, programs must be set up for him, because of this duty. The scholastics would agree no man should be in need when there are others with so much wealth who could help, but they would see the flaw in the Church’s teaching. Luis de Molina, the first Jesuit scholastic, wrote, “In the same way that a pauper has the [right] to beg alms, a merchant has the [right] to sell his wares” (Rothbard, 1995, p. 115). The pauper has the right to beg for alms, but he does not have the right to be given alms. If it is someone’s duty to provide for the man, then they are being forced to give up their private property. While this benefits the pauper, it is a violation of the richer man’s rights. Both the early priests of Salamanca and the Jesuits of today have the same goal when it come to the preferential option for the poor; they both want to see an end to poverty. Their means of

realizing that end, though, are different. The early priests would let the market solve the problem, while the modern Jesuits would rely on taking other people's private property.

NOTES

- ¹ Mainly Dominican and Jesuit: <http://cepa.newschool.edu/het/schools/salamanca.htm>
- ² Exceptions are the writings of Fr. James Sadowsky, S.J. (1983), and James Schall, S.J. (1982, 1990)
- ³ Lessius ascribed to the school of thought developed at the University of Salamanca in Spain, though he never studied there. He taught philosophy and theology at the University of Louvain in Belgium.
- ⁴ Lessius, as quoted in Gordon (p. 258). The Salamancans were innovative regarding a free market, liberty, autonomy, and self-government.
- ⁵ Friend of Lessius and fellow Jesuit, Luis de Molina (1535-1601), was the first Scholastic to use the word "competition" in the determination of prices. Molina, quoted in De Roover (1958, p. 425), proclaimed that "competition among buyers...and their greater avidity will cause prices to go up, whereas paucity of purchasers will bring them down." States Rockwell (1995): "Vitoria, Navarrus, Covarrubias, and Molina were four of the most important among more than a dozen extraordinary thinkers who had solved difficult economic problems long before the classical period." Also, see Chafuen, 1986; Rockwell, 1995; Rothbard, 1995; Watner, 1987; Woods, 2002, 2004, 2005.
- ⁶ Lessius also developed the idea that monetary compensation does not constitute the total wage of the worker; working conditions, such as environment and status, are also part of the worker's compensation. See for further details (Chafuen, 2003, p. 108).
- ⁷ In many ways Martin de Azpilcueta (Navarrus) was an even more radical proponent of the free enterprise philosophy, and more of a precursor to the Austrian School, begin in the 19th century. In the very wise words of an exceedingly helpful referee of this journal: "It is Navarrus ...who not only explicitly rejects government price controls of any kind but also gives an impassioned *defense* of usury on the grounds that since everyone takes or receives interest to condemn all forms of interest is nonsensical and antithetical to God's grace." Continues this referee: "In addition, there is the work of Diego de Covarrubias y Leiva, who, if Adam Smith had known of him, might have helped economics escape the whole value in use vs. value in exchange debate, when he stated in his *Vararium* (1554), 'The value of an article does not depend on its essential nature but on the estimation of men, even if that estimation is foolish.'"
- ⁸ For a Rothbardian-Austrian critique of Mises and Kirzner on monopoly and anti trust, see Block, 1977.
- ⁹ Despite this proliferation of exemplary intellectual work, the Scholastics lost credibility during the height of the usury debate due to apparent inconsistency. They continuously found justifications for charging interest, yet denounced usury as a sin. This conflict resulted in the demise of this school of thought (Rothbard, 1995, p. 128).
- ¹⁰ An earlier encyclical, on economics, was *Vix Pervenit* by Pope Benedict XIV, in 1745
- ¹¹ A referee of this Journal urges us to note this encyclical also contains some important support for economic freedom and private property rights. Consider these quotes: "The fact that God has given the earth for the use and enjoyment of the whole human race can in no way be a bar to the owning of private property. . . Here, again, we have further proof that private ownership is in accordance with the law of nature. . . . So strong and convincing are these arguments that it seems amazing that some should now be setting up anew certain obsolete opinions in opposition to what is here laid down. They assert that it is right for private persons to have the use of the soil and its various fruits, but that it is unjust for any one to possess outright either the land on which he has built or the estate which he has brought under cultivation. But those who deny these rights do not perceive that they are defrauding man of what his own labor has produced" (8); and this one: "Men always work harder and more readily when

they work on that which belongs to them; nay, they learn to love the very soil that yields in response to the labor of their hands, not only food to eat, but an abundance of good things for themselves and those that are dear to them.” (p. 47)

¹² For further explanation on the effects of minimum wage laws, see Hazlitt (1979, pp. 134-39).

¹³ *Rerum Novarum* primarily made recommendations on working conditions and the proper morals of both employer and employee. It states that both parties are free to engage in negotiation of wages without restriction (sections 43 and 44).

¹⁴ The abbreviation for the Society of Jesus, S.J., could suitably stand for “social justice” during the current, modern period. For a critique of this doctrine, see Block, 2000, 2003, 2004A, 2004B, 2004C, 2007; Flew, 1995; Hayek, 1976; de Jasay, 2003; Kilchrist and Block, 2006; Mueller, 2003; Sowell, 1999; Vogelgesang, 2004; Woods, 2002, 2005.

¹⁵ Full text of the letter by General Peter-Hans Kolvenbach, S.J. is included in Arroyo’s *Blueprint* article.

¹⁶ Block (2004C) referred to both this organization and the Centre for Social Justice in his response to Fr. Hendry on the appropriateness of labeling a university as an institution promoting social justice.

¹⁷ The National Conference of Catholic Bishops (June 4, 1986) also recognized that inflation decreases purchasing power and asked Congress to increase the minimum wage to ameliorate the situation. In section 194 of *Economic Justice for All: Catholic Social Teaching and the U.S. Economy* (third draft), the bishops stated that the minimum wage’s “real value has declined by 24% since 1981.”

¹⁸ For a Catholic view on this institution, see <http://www.newadvent.org/cathen/12462a.htm>

¹⁹ According to Banez, natural law consists of self-evident principles with moral conclusions that necessarily follow them. An example of this thinking, critical to our discussion, was Banez’s use of the “golden rule” and its application to private property. From this principle of natural law, “Do unto others as you would have them do unto you,” Banez arrived at the conclusion, “you must not steal.” (Domingo de Banez, *De Iustitia at Iure Decisiones*, Salamanca, 1594, p. 57; Chafuen, 2003, p. 36).

²⁰ Oliver Cromwell, Henry Ireton, and the other men of property found private property to be so reasonable that a loss of private property would culminate in an all-consuming collapse into immorality. Therefore, they were against universal manhood suffrage, and felt that only property holders should have the right to vote because they are tied by their ownership to their country, and for that reason, have a permanent interest there. In short, private property ensured that men made good decisions, based on good judgment, which would benefit the state. (Herbert, 2003; pp. 101-102).

²¹ Ludwig von Mises and the Austrian school of economics, which abstains from any judgment of value and focuses on means for achieving desired ends, hold the view that economics is the study of human action. Mises believed that people act because they have a felt uneasiness and envision the world to be better off by their action than without it. It is interesting to note that the Austrian view on value is in sharp contrast to those of Karl Marx, who had an objective theory of value, in which he assigned to people the ends at which they should aim at (Mises, 1959).

²² It is very difficult to exert moral pressure in the market, which is an economic phenomenon (Brennan, 1985).

²³ One example: Pope Paul IV favors expropriation as a means of poverty relief, which discourages the free movement of property (resources and money). The state can take action to modify the property rights of an individual if it feels that the owner of the property is misusing them, or not using them at all; as a result hurting the state. (Paul, 1967; #24).

²⁴ This statement is based on a study, *Economic Freedom and Social Welfare*, which demonstrates that economic freedom and income equality are positively correlated. (Gwartney and Lawson, 2000, p. 17).

²⁵ Coercion is the most important distinction in a political economy. In societies that have coercive governments (socialism), the rich get rich by impoverishing others (Cuba). On the other, in societies that do not engage in coercion (free enterprise), the rich get rich by enriching others (Hong Kong, Switzerland).

²⁶ This is no better than putting two people, one of an IQ of 150 and the other of 50, into a machine that would transfer 50 IQ points from the person with 150 to the person with 50, thus making them even at 100. This is clearly theft, and nobody in their right mind would think it justified to force people to give up some of their IQ, so why should people make this assumption with regard to being forced to give away their wealth? Here is a story told by Saint Bernardino of Sienna in the Sermon XXVII of “De Amore Irratio,” Opera Omnia (Venice, 1591). A demon-possessed person asked Saint Francis what the worst sin in the world was. Saint Francis said homicide, but the demon told him that there was a sin worse than homicide: having others’ property (Chafuen, 2003, p. 31).

- ²⁷ This is Jesus' reply when asked how difficult it is for a rich man to enter heaven. It is a scriptural reference from the Jerusalem Bible (Chafuen, 2003, p. 32).
- ²⁸ Modern economists would characterize this phenomenon as the "tragedy of the commons." See on this Hardin (1968).
- ²⁹ What would the world be like if parents loved other children more than their own and put the needs of other children ahead of their own? His answer: something would be wrong; the structure of values in society would not be conducive to progress and prosperity.
In a free market, resources and goods end up in the hands of those who value them the most, thus there is no better use for the good or resource other than what the owner deems its best use. Prices are the tool used to determine value. In a truly free market without government intervention, the structure of values reflects the structure of prices, which in turn reflects the structure of production.
- ³⁰ One of John Kenneth Galbraith's (1958) main concerns was the huge disparity between the private and public sectors. The private sector was affluent, as it produced goods in abundance, but the public sector was terrible, as it struggled to provide adequate services. Galbraith felt the public sector was not given enough resources, and the answer was to transfer funds, via taxes, from the affluent private sector to the starved public sector (Skousen, 2001, pp. 255-57). But, as usual, Galbraith had it all wrong. The explanation for public poverty and private affluence is that the tragedy of the commons operated in the former context, but not the latter (Hayek, 1967). Our very perceptive referee correctly notes that for Galbraith, it was almost a matter of indifference whether the government actually carried out these tasks (for instance, public schools), or farmed them out to the private sector under its close control. We, too, are just about indifferent between these two options; we regard the former as akin to socialism, and the latter as akin to fascism, and reject both. However, we must note that ours is a minority position within the economics profession. Most practitioners hold the view that in some cases, markets are indubitably more efficient than government. But that in at least a few cases (and, for many economists, there are more than a few and these are important considerations), matters are the other way around. See as an example Wolf, 1988.
- ³¹ The tragedy of the commons occurs when public goods are mistreated and used unproductively. It is a metaphor that illustrates the sub-optimal use or even destruction of public resources (the "commons") by private interests when the best strategy for individuals conflicts with the common good. The metaphor is often used to argue in favor of private property and against theories such as libertarian socialism which aim at communal ownership of resources. The key to the tragedy of the commons is when individuals use a public good, they do not bear the entire cost of their several actions. Each seeks to maximize individual utility, and so ignores costs born by others. This is an example of an externality. The best (non-cooperative) strategy for an individual is to try to exploit more than his or her share of public resources. Since every rational individual will follow this strategy, the public resource gets overexploited.
- ³² This view, held by John Locke, is a labor theory of ownership. By mixing their labor with things in the natural world, Locke says, men originally acquire a right to property, transforming what was once common possession into the private property of the laboring individuals. Thus, people do have a right to possess and enjoy things exclusively (Block, 1990, 2002A, 2002B; Block and Yeatts, 1999-2000; Block vs Epstein, 2005; Herbert, 2003; 110; Hoppe, 1993; Kinsella, 2003, 2006; Locke, 1948; Paul, 1987; Rothbard, 1973, 32; Rozeff, 2005).
- ³³ Saliba (2004) used this rationale to explain the high numbers of socialists found in universities. Recognizing the common element of human jealousy, we can extrapolate this retaliatory reaction formation to the clergy as a whole. See also Schoeck (1966).
- ³⁴ In our view, the Just Price doctrine is an attack on private property; it limits how much the owner of the property can charge for it.
- ³⁵ See also Woods, 2002, 2004A, 2004B.
- ³⁶ Indeed, many of these older men that decide to become priests are men with business backgrounds that are tired of the cutthroat business world. They are already biased against capitalism and find Catholic Social Teaching to be more appealing (Dart, 2003, p. 34).
- ³⁷ For a more modern analysis of usury from a Catholic perspective, see Noonan, 1957.
- ³⁸ This holds true if the duty is a legal one. But, if it is a duty of Christian charity, for example, then there is no theft involved.

³⁹ It is important to remember that most Catholics do not think of Catholic Social Teaching as an economic system, but rather as a moral code. It is a way to live their lives on an ethical basis.

⁴⁰ For a contrary view, see Chafuen, 1986; Rockwell, 1995; Rothbard, 1995; Watner, 1987; Woods, 2002, 2004, 2005.

⁴¹ States Rothbard (1970, p. 4) in this regard: "It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a 'dismal science.' But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance." We owe this quote to Tom Woods and B. K. Marcus.

⁴² In the article "Catholicism's Developing Social Teaching," it is stated that, "Pope John Paul II declared 1991 a Year of Church Social Teaching and issued a groundbreaking new encyclical, *Centesimus Annus*, which represents a dramatic development in the encyclical tradition in favor of the free economy" (Sirico, p. 1). Pope John Paul II leans more toward the free market than toward socialism in this most recent encyclical, which is an excellent start on reeducating the masses. However, there is still a long way to go.

⁴³ Medical schools typically require undergraduate courses in biology and chemistry before admittance.

⁴⁴ This problem is much more complex than it seems. The financial stress that most seminaries suffer from these days keeps them from putting too many constraints on their students. With a shortage of priests, these seminaries cannot afford to scare away too many potential candidates.

⁴⁵ At least not on the latter for many years.

⁴⁶ Synonyms for this system might include "regulated capitalism," "crony capitalism," "state monopoly capitalism," "corporate capitalism," or "fascism." See on this Block (2010).

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BOOK REVIEW ESSAY*On the Morality of the Market and Government*

Chang, Ha-Joon (2010). *23 Things They Don't Tell You About Capitalism* (New York: Penguin Books).

Roth, Timothy P. (2010). *Politicians, Economists and the Supreme Court at Work: The Founders Betrayed* (Cheltenham, UK and Northampton, MA: Edward Elgar).

For the dismal science, the academy of economists certainly does have its share of jokes. Two of my favorites revolve around the awarding of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel in 1974 and 2002. Gunnar Myrdal and Friedrich Hayek shared the Nobel Prize in 1974 for “their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the interdependence of economic, social and institutional phenomena” despite the fact that the analyses really were at opposite ends of the political spectrum, thus spawning the stab that economics is the only discipline where you can win a share of a Nobel Prize (even though it technically is not a Nobel Prize but rather a prize named in memory of Alfred Nobel) for saying the opposite of what the person with whom you are sharing the prize is saying. Similarly, in 2002, when Vernon Smith won “for having established laboratory experiments as a tool in empirical economic analysis, especially in the study of alternative market mechanisms,” his research showed how economic theory could be confirmed by experiment. Yet, the person with whom he shared the prize was Daniel Kahneman “for having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty.” The joke is Kahneman, along with longtime co-author Amos Tversky (who died in 1996), basically showed using experiments that economic theory doesn't work the way the books tell us it should.

I only hope the juxtaposition of these two books in the same essay does not provoke a similar laugh because although the authors come at the material from two entirely different perspectives (Roth is for a limited government perspective, while Chang sees much the government can do), their argument the current economic (and, by extension,

political) system is morally bankrupt is one that should be listened to by all sides of the current debate over the proper role (or lack thereof) of government in the economy.

Roth's book is the more narrowly focused (and slimmer) volume. Professor Roth, the A.B. Templeton Professor and Chairman of the Department of Economics and Finance at the University of Texas, El Paso, makes the argument the increasing girth and reach of the Federal Government is something the founders of this nation would not have recognized nor would they have approved. It is an intellectually dense book filled with citations and quotations from original source documents of those who were present and involved in the birth of this nation and its constitution. Roth notes both Democrats and Republicans have presided over what the founders would consider an unwarranted and unbridled expansion of federal government activity into a myriad of places.

Roth makes a compelling case the Commerce Clause, the General Welfare and Necessary and Proper Clauses and the Legislative Powers Clause have been stretched beyond belief and to the point their interpretations would not be recognizable by the Founders. Ironically, notes Roth, the Commerce Clause, allowing the US government to regulate *interstate* and *international* commerce is invoked by the Obama Administration to regulate a purely *intrastate* activity: the purchase of health insurance. Since each health insurer is licensed by the state in which it operates, the interstate commerce clause cannot be used. This would not have been the case had the ability to purchase health insurance across state lines been included in the legislation, but it was not.

Similarly, actions undertaken under the stimulus bill, which went to propping up individual companies could not be justified under the General Welfare and Necessary and Proper Clauses and, furthermore, violates the moral equivalency of persons so cherished by enlightenment thinkers such as the Founders. Indeed, by requiring the general taxpayer to pay for individual corporations, it is about as far from the Founders' intentions with regard to the conception of these clauses as can be.

Then there are the mini-fiefdoms created in *Executive Branch* agencies such as the Food and Drug Administration and the Environmental Protection Agency. These entities have gone so far as to usurp those powers specifically granted *exclusively* to Congress as to upset the delicate balance of powers between the various branches of

government. The recent pronouncement by the EPA it can regulate carbon emissions and other greenhouse gases as a type of pollutant under the Clean Air Act is arrogant in the least and more likely unconstitutional from the standpoint of being an illegal delegation of power that is “strictly and exclusively legislative” (Chief Justice Marshall in *Wayman v. Southard* as quoted by Roth, p. 109).

Roth’s most damning critique, however, is saved for his fellow economists. Roth notes a fundamental incompatibility between the Smithian/Kantian perspective embraced by the Founders and the Utilitarianism as practiced by economists. The means to the end are important according to the Founders’ doctrine. Whereas health care for all may be a noble goal, the means to undertake it through a federal government health care bill is constitutionally in doubt. On the other hand, utilitarianism follows a consequentialist argument: the end justifies the means under the “greatest happiness for the greatest number” principle. However, Roth practicing such a philosophy can lead to deep-seated resentment and eventual disrespect for government that would render it impotent in its most important mission, the maintenance of public order and national defense.

Where Roth’s argument fails is where he treads a little too far afield. He argues in favor of a balanced budget amendment by stating “political discrimination against future taxpayers by in-period majorities is clearly inconsistent with the Founders’ prior ethical commitment to the moral equivalence of persons” (*emphasis as in original*, p. 21) and that “the Founders would reject federal deficit spending on moral grounds” (*emphasis as in original*, p. 22). Yet, the Constitution of the United States, as approved by those same Founders provides in Article I, Section 8 that “The Congress shall have Power to lay and collect Taxes, Duties, Imports and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States” (*emphasis added*). Furthermore, the next enumerated power of Congress that is listed is to be able “[t]o borrow money on the credit of the United States.” The notion that debt was anathema to the Founders is actually a contradiction in analysis from an otherwise fine tome. To hammer home this point, the Founders’ actions belie Roth’s argument, for, from the very founding of the Republic, the new nation was in debt to the tune of \$75 million when it assumed the debts of the Continental Congress and the obligation to make payments on the national

debt was not extinguished for the first 40 years of the country's existence, by which point all but Charles Carroll (signer of the Declaration of Independence) and James Madison (who wrote most of the US Constitution) among the Founders had died.

Still, on balance, this is a very useful book in understanding the rather conservative nature of our Founding Fathers and the founding document, the US Constitution. Even as he disagrees with its actions, Roth does a good job of describing how the political economy of the country has been shaped by the Supreme Court, much in the same way as a book that he should have cited did 86 years before: that book being *The Legal Foundations of Capitalism* by John R. Commons.

Ha-Joon Chang, Reader in the Political Economy of Development at the University of Cambridge, takes a broader approach. It is written more for the lay person with fewer citations and the style is more conversational. Chang has little regard for legal questions encompassing Roth's tome but instead provides the neoclassical/neoliberal perspective and then demonstrates most economists are inconsistent in their application of theory. Among the *23 Things They Don't Tell You About Capitalism* is "there is no such things as a free market" (p. 1), "companies should *not* be run in the interest of their owners" (p. 11), "despite the fall of communism, we are still living in planned economies" (p. 199), "financial markets need to become less, not more, efficient" (p. 231), and "good economic policy does not require good economists" (p. 242).

His style is to begin with the "lie" economists tell the general public and then provide the "truth", all the while pointing out the inconsistencies in the positions of economists, oftentimes appealing to the history of economic thought and the history of the economy to buttress his position. His positions, while probably castigated by many as being on the "left" of the political spectrum, should appeal to the right as well if properly understood. The limited liability enterprise known as the corporation was skewered by the founder of economics, Adam Smith, for good reason: it tends to cause people to take more risk than they ought because you get all the upside with a limit on the downside. As Dr. Chang correctly points out, it was Karl Marx, hardly an apologist for capitalism, who recognized the ability of corporations to advance human progress precisely because of this tendency. People are always looking for a mechanism to do

this and the corporation provides that vehicle. *It gets worse.* Stockholders are easily the most fleet-footed of stakeholders, able to exit the investment virtually instantaneously by simply selling it to someone else (whether they will receive a price that they like is open to debate but anyone who instructs his or her stockbroker to sell “at market” can exit their ownership position in one company and enter into an ownership position in another company within minutes, if not seconds) and they can keep doing this every day of every year, multiple times per day. Others (such as workers in those companies) are not so mobile. This leads to myopic behavior of the worst sort. The solution from a right-wing stand-point would be to abolish corporations entirely since they are creations of the state, although Dr. Chang prefers to argue corporations need to be more inclined to respect interests of all stakeholders through broader corporate governance schemes.

Chang points out restrictions on labor mobility are standing in the way of neoclassical nirvana, yet few economists argue in favor of lifting immigration controls. A cynic could argue the reason so few examine this with any degree of intellectual honesty is because they personally benefit: economics is one field that is practiced no different in Bangalore than Boston and, if anything, is probably practiced *better* in Bangalore. Yet, having good economists is no substitute for good economic policy. Chang quotes John Kenneth Galbraith, although noting the case is overstated, that “economics is extremely useful as a form of employment for economists” (p. 245).

Indeed, perhaps Chang’s greatest contribution is the indictment of neoclassicals and neoliberals who run the profession:

Over the last three decades, economists played an important role in creating the conditions of the 2008 crisis (and dozens of smaller financial crises that came before it since the early 1980s, such as the 1982 Third World debt crisis, the 1995 Mexican peso crisis, the 1997 Asian crisis and the 1998 Russian crisis) by providing theoretical justifications for financial deregulation and the unrestrained pursuit of short term profits. More broadly, they advanced theories that justified the policies that have led to slower growth, higher inequality, heightened job insecurity and more frequent financial crises that have dogged the world in the last three decades. . . .
 . . . In other words, economists have been worse than irrelevant. Economics, as it has been practiced in the last three decades, has been positively harmful for most people. (pp. 247-48)

Therein lies the rub: economics as currently practiced is positively immoral and it encourages everyone to behave the same. As Chang notes, free-market economists state that “If people look as if they are behaving morally . . . it is only because the observers do not see the *hidden* rewards and sanctions that they are responding to” (p.

48). Thus, people are honest not because of an inherent belief in honesty but rather because they wish to develop a reputation for honesty, so as to be more successful. It is the seeking of success, not honesty, that captivates them. Chang notes, however, the inherent illogic of this line of argument since there are many things that we do each day that simply do not have such hidden rewards and sanctions (unless those rewards and sanctions are internal to the individuals, which would mean that people really were moral creatures in any case). Indeed, this is Thing 5, according to Dr. Chang, “Assume the worst about people and you get the worst” (p. 41).

Instead, Chang supports the heterodox economists as they exist in many folds “from the very right-wing [Friedrich] List to the very left-wing [Karl] Marx” (p. 249). These economists share one commonality: an inherent belief the conditions of “free market economics” can *and should* be altered by government action, whether it be reshaping institutional characteristics in which market flourish (a right-wing approach) or by direct government regulation and ownership of economic resources (a left-wing approach).

Getting back to why neoclassical economics has failed so miserably, it is as if the profession has completely forgotten the Lancaster and Lipsey general theory of the second best: if you cannot optimize in all spheres, sometimes it is better to deviate from optimality in those areas that you can control. This paper, published in 1957 and rooted in the general equilibrium theory that is (mis)used by many to justify free market policies, serves to showcase how far afield neoclassical economics really is even from its own roots. Indeed, that one paper probably ended up shaping my perspective on economics more than any other that I have ever read. Let’s hope that Chang’s book can do the same for a new generation of economists.

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