THE NEW ECONOMICS

By A. Seldon

The 'new' economics is fundamentally not new in methodology but in application and in terminology. All knowledge is derived from previous knowledge; if the development and advance in thinking is very large, it is excusable to describe the new knowledge as 'different' from the old, and therefore 'new.' The 'new' economics is essentially a rediscovery, refinement and development of British classical economic thinking and policy, in particular its core of markets and pricing systems. This is now called 'micro-economics.' And it was the dominance of economic thinking and policy by macro-economics, as developed not so much by Keynes as by the economists who for 30 years from 1936 to the 1960s claimed to be interpreting him, that provoked the micro-economic counterrevolution in economic analysis largely in the USA, although the counterrevolution in policy began in 1979 in Britain.

Governments inspired by the old economics, as in France and Greece, and more recently in Spain, will find they cannot apply its macro-policies except by massive coercion, alienation from the world economy, and shrivelling living standards.

I write as the Editorial Director for nearly 25 years to 1981 of the British Institute of Economic Affairs (IEA) which mobilized the counterrevolution in Britain, and since 1980 as Founder-Editor of *The Journal of Economic Affairs* which expounds the new economics and has an Academic Council of new economists, Max Hartwell, S.C. Littlechild, Patrick Minford, C.K. Rowley and B.S. Yamey. After a short youthful attraction to socialism, chance led me to the London School of Economics where from 1934 I was taught by Professor F.A. Hayek, born in Austria, but who carried the mantle of Austrian market-micro-economics, and who directly or indirectly is intellectually the most powerful inspirer of the new economics. I must add three other teachers who anticipated the counterrevolution: Professor L.C. Robbins, who brought Hayek to Britain, Arnold Plant, who although less known was a tower of strength in the intellectual advance of the market as a concept and a precept for policy, and Ronald H. Coase, who later emerged as a pioneer of the new economics at the University of Chicago but whose seminal analysis of the nature of the firm as a unit of non-market activity was written at the London School of Economics in 1936. After the war, further chance led to a partnership with Ralph Harris, a product of Cambridge. Together we built the IEA over 25 years as the world's largest generator of micro-economic analysis by 300 economists who, whether or not they realized it at the time, were taking part in the counterrevolution.

The Classic Foundation

The roots of the new economics lie in three streams of classical economics – market analysis, political economy, and the tradition, strong among the classical economists, of thinking and acting as social reformers.

First, the central emphasis of the new economics is on the power of *price,* or cost at the margin, to influence decisions on both supply and demand in what may seem the most unlikely of activities. This *methodology* is not new. Economists for over 200 years since David Hume and Adam Smith have known about markets and their unique power to create choice for demanders between alternative suppliers at the optimum rate of exchange at which both sides gain at a voluntarily bargained price. The 'marginal' notion, in distinction to the irrelevant (macro-economic) *average* or *total,* was evolved, miraculously almost simultaneously, in the early 1870s by three European economists: Stanley Jevons in England, Carl Menger in Austria and Léon Walras in France. Since then the importance of the market mechanism has been refined by the Austrian school of economists as a procedure of discovery by choosing and learning, by trial and error, between new alternatives made possible by technological innovation and social advance. These processes are today called 'market forces' which the ignorant foolishly used almost as a bogeyman term of abuse but which merely describe ordinary men and women reacting to changing opportunities in the everyday business of earning and choosing. In one of the most illuminating pieces of economic analysis ever written, an Austrian economist, Eugene von Böhm-Bawerk (Minister of Finance of Austro-Hungary in 1913) explained (in *Macht oder Ökonomisches Gesetz*) how market forces, or 'economic law' as he called them, would prevail over government, or 'power,' that tried to suppress them. The "Austrian school" has continued with Ludwig von Mises (1881-1973) and F.A. Hayek, and with Ludwig Lachmann, Israel Kirzner, Murray Rothbard, and a growing school of younger men in the USA and, more recently, in Britain.

Second, an emphasis of the new economics is on scepticism of the ability of government to know how, or to wish, to do public good. J.M. Buchanan and Gordon Tullock, main Founding Fathers of 'public choice' economics, have long demonstrated the unrealism of policies resting on the assumption that government comprises benevolent despots. For almost a century economists had earnestly worked on technical solutions to problems for implementation by government as though politicians and bureaucrats were neutral, disinterested servants of the public. The new economics of government, democracy, politics and bureaucracy has destroyed that illusion. But long before the era of 'neutral,' 'behaviorist' or 'positive' economics, the early classical economists were wise in the nature of man and the ways of the world and, in devising their remedies for social ills, made allowance for the short-sightedness, self-interestedness, incompetence, fallibility, corruption and venality of men (or women) with power. Hence the classical economists favored free trade between nations not only because it maximized the international division of labor but also because politicians would be restrained from abusing the power to levy tariffs. And they grasped the nettle of assistance to the poor by evolving the principle of 'less eligibility' by which people who shirked were less comfortable than those who worked. The neglect of that principle in the 20th century welfare state developed by welfare economists has produced widespread demoralisation, voluntary unemployment, tax evasion, growing disrespect for law, and contempt for democratic representative politics. At a seminar organized by the IEA in 1978, J.M. Buchanan said:

> "In one sense, public choice – the economic theory of politics – is not new at all. It represents rediscovery and elaboration of a part of the conventional wisdom of the 18th and 19th centuries, and notably the conventional wisdom that informed classical political economy. Adam Smith, David Hume, and the American Founding Fathers would have considered the central principles of public choice theory to be so elementary as scarcely to warrant attention. A mistrust of governmental processes, along with the implied necessity to impose severe constraints on

> the exercise of governmental authority, was part and parcel of the philosophical heritage they all shared."

And he quoted John Stuart Mill in support.

Third, the new economics shows the way to effective reform. It fired the classical economists with the feeling that their ideas could contribute to public well-being, and they took their thinking to the public and its spokesmen in parliament. For half a century or more, economists have been content to speak to one another in the learned journals through abstract theorizing decked out in abstruse mathematics. The new economics, reinforced in Britain by belated cuts in government grants for fashionable but questionable subjects like sociology, has induced economists to resume the long-neglected task of justifying their comfortable lives at public expense by showing they could produce solutions for public problems. Again, the new economics is a long-delayed reassertion of the classical tradition and should now transform public policy in Europe.

The New Economics and Public Policy

The effect of the microeconomic counterrevolution on thinking in Britain was put in the January/February 1983 issue of the British journal, *New Socialist,* which woefully discussed the end of the

> "post-war consensus on the balance between public and private sectors, on the priority to be given to full employment, on universal welfare provision, on free state education, on trade union rights . . ."

The new economics is replacing the 'old' economics of Keynesian and etatisme in industry, welfare and local government.

The dominance of economics by macro-economics and the general neglect of micro-economics were widespread. In France, Henri Lepage, author of the admirable synthesis of the American streams in the new economics (*Demain le Capitalisme,* 1978), had studied economics but found the market meant nothing to him, and he first heard of the classical French economist Frederic Bastiat (1801-50) in 1976! In Britain, where a professor of economics confessed he had rarely mentioned entrepreneurship until recently, micro-economics was unfashionable for 20 years after the war, and still is in Cambridge, the home of Keynes, and other universities. No doubt in Spain students of economics for decades did not have their attention drawn to classical economics. It is not surprising the new economics developed strongly in the USA where the very size of the national economy has repeatedly demonstrated the massive benefits of liberal economic institutions in facilitating the exchange of goods, services and capital in a huge internal market. The Mont Pelerin Society, founded in 1947 by Hayek and a handful of economic liberals in Britian, the USA and mainland Europe, had few Frenchmen and no Spaniards until recently. It was left to a young French writer to introduce his countrymen to the new economics in 1978. In Britain the IEA began 20 years earlier, in 1957, to mobilize the new economists.

The importance of the new economics is that, in the words of the Englishman Bulwer-Lytton, "the pen is mightier than the sword." Keynes said ideas are mightier than vested interests. Ideas influence men with power more than they know. The 'practical man' who dismisses a hypothesis as 'mere theory' is himself reflecting ideas he absorbed as a young man. A member of a recent British Cabinet asked a group of economists at lunch, after explaining the policies he was trying to pursue, "Do you really think we have a good academic case?" Mitterrand, Papandreou, and Gonzales are the slaves of the old macroeconomics and its etatiste policies that have been tried for 35 years in collectivism, Keynesianism and corporativism but have repeatedly failed.

Until 1979 in Britain the Conservatives were content to manage socialism and largely ignored the battle of ideas. Mrs. Thatcher and her chief allies, Keith Joseph and Geoffrey Howe, are the first recent Conservatives to understand the power of ideas. And observers say they derived their intellectual inspiration and stimulus through the IEA. A more unexpected development is that the market is being understood by some leaders of the new British Social Democratic Party, who moreover go even further than the Conservatives on trade union and other reforms because they do not have a bad conscience about their wealth and do not fear alienating the working classes by liberalization of the economy. The most hopeful prospect for Britain, as perhaps for Spain and other countries in Europe, is the emergence of market-oriented coalitions alternating in government. Christian Democrats and other Conservative parties will not be able to ignore the truths of the new economics; and Social Democrats of various hues, who are generally more intellectually curious and excited by the battle of ideas, may take up the market with more enthusiasm once they understand its power to break down privilege and emancipate the masses. Soon a modern Ortega y Gasset may be writing of a new 'revolt of the masses' against over-government, bureaucracy and high taxation and in favor of private, family life as market forces accelerate the process of embourgeoisement.

Politicians and government that neglect the new economics will be left high and dry as the better macro-economists recognize that macro-economics is barren or dangerous if it neglects its micro-economic foundations in markets and market pricing. Professor Lawrence Klein, who won a Nobel Prize for his work in empirical macro-economics, has written a book to be published in May 1983 in which he argues for the reintegration of micro- and macro-economics. That is recognition of half of the truth: the whole truth is that micro-economics is more fundamental than macro-economics. Micro-economics may sometimes require to be complemented by macro-economics, because in some economic analysis the whole is more than, or different from, the sum of the parts; but without micro-economics, Keynesian macro-economics is a menace, as it has been in its teaching of full employment as the supreme aim of policy and the callous neglect of the consequence that it unleashed the power of politicians to unbalance budgets, borrow irresponsibly, and expand the money supply and so create inflation for which they would not suffer because they would have left office but from which many old people would suffer for the rest of their lives as their savings dwindled in real value. Such politicians led the 1970-74 British Conservative Government of Edward Heath. Not least, among its intellectual victories, the new economics, especially public choice theory, has shown macro-economics to be not only intellectually erroneous but politically unrealistic and naive.

So much for the origins and importance of the new economics.

The Main Components of the New Economics

I have classified the elements of the new economics into ten groups.

1. The Triumph of Micro-Economics

The most fundamental element is the reaction against 30 or

40 years of the dominance of macro-economics, the re-assertion of micro-economics, and the demonstration that it is the more seminal of the two. The supremacy of micro-economics is illustrated in the world's best text book for students, *University Economics,* the SA authors of which, Armen Alchian and William Allen, were never seduced by macro-economics. Unlike other text books which reflected the passing fashion for macro-economics dominance, it shows that macro-economic concepts like growth, unemployment, inflation are best explained by micro- economic analysis. It is a tribute to the German 'social market' economists, Eucken, Erhard, Müller-Armack and others, that they rejected or even ignored Keynesian macro-economics.

Macro-economics has separated into two main 'schools': the non-Ricardians (after David Ricardo, 1772-1823) led in Cambridge, England, by Jana Robinson, Piero Sraffa, and Nicholas Kaldor, and the neo-classicals led by Paul Samuelson and Robert Solow of Harvard in Cambridge, Massachusetts, USA. The Cambridge, USA, macro-economists claim they have inherited the micro-economic approach of the neo-classical Frenchman Leon Walras (1843-1910) and the Italian Vilfredo Pareto (1843-1923), but their thinking is defective because they also have not fully incorporated neo-classical micro-economics. The counterattack on the macro-economists of both schools has been spear-headed by the arch-exponents of micro-economics, the Austrian school, as demonstrated in a paper by L.M. Lachmann published in 1973 by the IEA.

Macro-economic analysis of (national) income, output, expenditure, investment, growth can be safely used only by micro-economists! Only they are constantly sensitive to the substructure of individual decisions (personal, family, households, firms, small groups) in buying and selling, borrowing and lending, saving and investment (and giving or taking). Macro-economics is not safe in the hands of macro-economists who think it replaces the substructure of individual decisions, or that it is enough to assume that individuals act in a way that conforms to the macro-economic laws, rules, tendencies or generalizations that apply to the behavior of large groups like a country or society as a whole.

Such macro-economists had produced fearful conclusions for four major policies: 'income policy' to control inflation, the management of economic growth, the means to ensure technological progress, and monetary policy for an open society.

'Incomes policies' in Europe that have controlled wages, salaries and other payments for labor have done extensive damage to democratic societies because they are based on the characteristic error of macro-economics that it emphasizes the *income* effect and ignores the *price* (rationing, efficiency) effect of wages in redistribution labor. Incomes policies put the price mechanism out of action and deprive the market of its main function. Moreover they gradually spread to the control of more and more incomes and prices and in the end lead to the central direction of all economic activity.

Second, macro-economics has produced 'growth targets' and projected growth rates of GNP, such as in the short-lived British 'National Plan,' that are meaningless, since growth is the cumulative outcome of the micro-economic decisions and behavior of individuals. Growth 'targets' cannot be the aim of economic policy; they are instead a distraction from the task of facilitating entrepreneurial alertness to new opportunities for investment to satisfy unsatisfied demand that another originally British economist in the Austrian tradition, Israel Kirzner of New York University, has demonstrated to be the prime mover of progress. Economic growth in France has taken place not because of 'indicative planning' but in spite of it.

Third, macro-economics confuses the technical and the economic, as in accelerating the scrapping of old equipment. Technical change does not necessarily bring economic progress. When new techniques for new products are introduced, only the market can reveal whether they will be demanded and profitable, for how long, and how soon superior versions will be installed by other firms. Only the market, with its pricing mechanism reflecting individual (or small group) decisions, can tell us, by the process of trial and error, by learning from doing, whether *change* is *progress.* The notion of Nicholas Kaldor that industrial managers should be incited by a tax on old equipment to search for technical improvements is a characteristic, far-reaching error arising from macro-economic thinking.

Fourth, macro-economic policies, as in the Irish saying, are impartial between right and wrong. 'Reflation' has, in the short run at least, the same effect of boosting output in all industries: efficient and inefficient, new and old, growing and declining, capable or incapable of being self-financing and profitable. All macro-economic policies tend to be inefficient, clumsy, wasteful and damaging. Similarly, as Kayek has repeatedly emphasized, what is important for growth and efficiency, and for employment and inflation, is not the total, or average, or absolute size of wages and other pay but wages in individual industries, occupations and even single firms and jobs relative to pay in other industries, occupations, firms and jobs. But the neo-Ricardian macro-economists are not interested in *relative* wages or other prices. They are therefore not equipped to deal with the *divergent* expectations which (as Keynes, whose name and prestige they exploit, emphasized) are the basis of decisions on investment.

In all these ways the new economics has mounted a complete counterattack on the prevailing, contemporary, conventional macro-economics which neglectes the underlying jig-saw puzzle of supply and demand, activities and expectations characterized by one of the new economists, British professor G.L.S. Shackle, as able to change

> "as swiftly, as completely, and on as slight a provocation as the losse, ephemeral mosaic of the kaleidoscope. A twist of the hand, a piece of 'news,' can shatter one picture and replace it with a different one."

After all this, Lawrence Klein's forthcoming book is not surprising, but belated.

2. *The New Interpretation of Capitalist History*

A counterrevolution in the economic reading of history has restored, refined and reinforced the classical interpretation of capitalism as the source of increased productivity and rising living standards.

For long many British historians and economists, G.R. Porter, T.B. Macauley, famous for his Whig interpretation of history, John Stuart Mill, J.E. Cairnes, Alfred Marshall, Herbert Butterfield taught that the Industrial Revolution had improved the condition of the mass of the people from the late 18th century. For a century, beginning with Arnold Toynbee in 1884, a string of 'liberal' and socialist historians – the Webbs, the Hammonds, the Coles (three man and wife teams – is that a clue?) and more recently the Marxists, E.J. Hobsbawm and E.P. Thompson, have taught almost the opposite – that the condition of the people had worsened contrasted with the 'quality of life' in 18th century 'Merrie England' and that capitalism had produced 'immiseration.'

The counterrevolution, which is restoring the classical view, is largely the work of economists or historians trained in economics who are examining the evidence more closely than did the 'immiseration' (Karl Marx's word) school. In Britain, the original counterrevolutionaries in the 1920s and 1930s were John Clapham, Dorothy George, Dorothy Marshall, and Ivy Pinchbeck. Aspects of the immiserationist interpretation were challenged later by two British scholars, the economist W.H. Hutt and the historian T.S. Ashton. In recent years their work has been reinforced by British economist-historians, of whom the most combative is R.M. Hartwell, an Australian. Even the neo-classical macro-economist John Hicks has recognized that "without the increase in productive power due to industrialization, the rise in real wages could not possibly have occurred."

In 1954 Hayek and Hutt had collaborated with the Frenchman Bertrand de Jouvenal and the American L.M. Hacker in emphasizing and amplifying the Clapham interpretation. They maintained that the immiseration theory had been inspired more by ideological and philosophical attitudes than by rigorous scrutiny of the evidence. Hayek's power of insight saw they were guilty of a simple intellectual error: the poor 'proletariat' were not existing people immiserated by early capitalism but a *new* population that would not otherwise have come into being but for the new industrial capitalism that had created new livelihoods by developing new tools and equipment to increase their productivity.

The difference between the two approaches was that the immiserationists were historicists who were apt to mistake a subsequence for a consequence, to argue, *post hoc ergo propter hoc,* that if poverty followed (or rather, was visible after) capitalism, capitalism was the cause of poverty. The counterrevolutionaries, or "Whigs,' being economists as well as historians, were analysts who asked what *would have happened* in the absence of capitalism, or the industrialization and urbanization that it brought. Their answer was that pre-capitalist poverty would have continued and the improvement in living standards *would not have taken place.* Like the Keynesians who forget Keynes, the Marxists forget Marx, who had emphasized the prodigious productivity of capitalism.

But the Marxist misinterpretation of history continues to be taught and to influence thinking and policy. So in 1971, prompted by a young English economist who had found that the description given by 19th century novelists of 'the condition of England' was still being regarded as true even where it conflicted with the findings of the counterrevolutionaries, I assembled nine economist/historians to present the new evidence in an attempt to correct the immiserationist interpretation in text books for schools and universities. R.M. Hartwell challenged the view that poverty had been created by industrialization. G.E. Mingay maintained that industrialization in agriculture had made for improvement. Norman McCord showed that private relief of poverty was 'more alive and enterprising than the official poor law.' (Beveridge, the architect of the post-war welfare state, did not, again unlike many of his followers, overlook the importance of voluntary action.) Private philanthropist were enabled to help the poor because of the very wealth created by capitalism. Rhodes Boyson (now Minister for Education) argued that the Lancashire cotton worker had gained from the Industrial Revolution, and that, if it had been controlled or planned by the state, the release of human energies and the rise in living standards would not have taken place. (Another example of the better insights from the analytical than from the historical approach.) G.C. Hanson, another economist, demonstrated that there was considerable spontaneous development of welfare by insurance and other mutual or commercial institutions before the welfare state. W.H. Chaloner and W.O. Henderson charged that Engel's evidence on 'the hungry 1840s' was selected to support his political convictions. And Michael Jefferson, who had prompted the book, revealed the biased and fictional descriptions in the novels of Charles Dickens, Benjamin Disraeli, Charles Kingsley, and others still today regarded as faithful accounts of 19th century capitalist England.

An early reinterpreter of history was E.G. West, whom I had to persuade in 1963 to assemble in book form material he had been gathering on the early history of education in Britain. The dominant, conventional naivete had been that education was rudimentary in the 19th century until the state began to foster local government schools in 1870, with the implication that it would have remained so if left to private, family initiative. From the neglected evidence in official enquiries, from other sources, and from *a priori* economic analysis Professor West destroyed the conventional naivete, once and for all, in *Education and the State,* which despite early scepticism from conventional historians soon became a classic.

Over the last 15 years or so, American economists had similarly reinterpreted USA history. Some have quantified their findings, but their method has, like the British, been essentially analytical rather than 'historical.' In studies of the railways, industrial concentration, slavery, anti-trust laws, the oil companies, cartels, the trade cycle, the Great Depression of 1929-31, and other subjects they have rebutted the conventional anti-capitalist view of American historians and of superficial economists like J.K. Galbraith and shown that state intervention invariably prevented the working of competitive markets from removing the excesses of industrialization.

The new economists have thus largely repulsed the false history of the conventional anti-liberal anti-capitalist historians who have dominated the teaching of economic history for a century.

3. The Theory of Political ('Public') Choice

In view of the increasing role of political authorities – government and bureaucracies – in the production and allocation of resources in North America and Europe, it was inevitable that before long economists, who for 200 years had dissected the conduct of industry and market 'failure,' would turn to the political 'market' and government 'failure.'

Although it originated in British classical economics, two American economists, J.M. Buchanan and Gordon Tullock (both of obvious Scottish ancestry and therefore distinctly akin to David Hume and Adam Smith), must be acclaimed as the Founding Fathers of what they described as 'public choice theory.' Their compatriot, Abraham Lincoln, would not now (another example of analytical rather than 'historical' history) regard present day government in the USA (or Britain or Spain or any other 'representative' democracy) as being "of the people, by the people, for the people." 'Public choice' is not that of the public, or people at large, but of their supposed political representatives in government, which in day-to-day reality means politicians and bureaucrats and their creations – from the Tennessee Valley Authority in the USA to the quangos in Britain (*q*uasi-*a*utonomous *n*on-*g*overnment *o*rganizations). In short, government in present day representative democracy does not faithfully reflect 'public choice.' There is no 'social welfare function' to tell government how to allocate resources to reflect public choice even if government so wished, which it cannot be assumed to do. Government in real life is a distorting mirror of 'public choice.' Indeed, a recent recruit to the new economists, James Bennett of the George Mason University, USA, is now arguing that government actively *avoids* public choice and 'goes underground' by taking some of its activities out of the budget. In England, I therefore prefer the terms 'the economics of politics' or '*political* choice.'

This branch of economics was founded in the USA in the middle 1950s. By the mid-1970s it was still little known in England. So in 1975 I invited Gordon Tullock to write *The Vote Motive* as an introduction, and, in 1978, Buchanan to open a seminar with a key-note address, followed by C.K. Rowley, Jack Wiseman and A.T. Peacock, Albert Breton from Canada and Bruno Frey from Switzerland. Earlier, in 1973, W.A. Niskanen had refined his economics of bureaucracy. And in 1978 S.C. Littlechild used 'Austrian' and political choice analysis to demolish the appealing but fallacious argument for a 'mixed' economy, which promises the best combination of state and market but ends with the worst.

Britain has, like a conservative country, retained longer than some other countries the romantic notion that government comprises benevolent despots whose essential purpose is to do good. No doubt Spain – and France and other countries in Europe – are also among the romantics. They also believe that government is equipped to achieve its well intentioned objectives. Keynes, Galbraith and a host of economists in Europe, including Spain, and every other continent (including, of course, Russia) continued with a stream of advice as if they were addressing philanthopic autocrats who stood at their beck and call. The political scientists are probably even worse than the economists in their naivete, or perhaps wishful thinking.

Individuals embody and express sets of preferences which normally vary widely. Even if incomes were equal, they could be spent very differently (unless government prevents it). The money raised in taxes is spent by government. In smaller, local, perhaps voluntary activities, people may agree to establish common bodies to decide joint expenditure. One of the very early Founding Fathers of 'public choice,' the British economist Duncan Black, in 1958 studied the machinery of committees that govern (act as 'governments') such collective activities.

And here is the first obstruction to the exercise of real public choice. There may be no motion or proposal or even candidate that will defeat all others in a majority vote. The collective outcome will depend on a relatively arbitrary or accidental event – simply the point at which the voting stops! And this, in turn, depends on even more arbitrary occurrences that have nothing to do with 'public choice' – the manipulation of the agenda and of the rules of order. And, of course, *the power to manipulate is not evenly shared by the public*. So much for the great 'democratic' god of the supremacy of the majority.

The notion that it might be possible to construct a 'social welfare function' that assembles and assimilates public choices so that government knows where to allocate resources – for a time a hope among social welfare planners – was declared impossible by Kenneth Arrow, one of its early designers. In 1978 to test this notion I attempted a field study in which a random sample of the British public was asked to say how *they* would wish their taxes to be spent. The main finding was that 70% said they would spend it differently from the way in which it had been spent by British Chancellors of the Exchequer. (The detailed findings are reported in Chapter 6 of *Over-Ruled on Welfare*, IEA, 1979.)

Public choice economists, including Nicholas Tideman (a colleague of Buchanan and Tullock) have worked on incentives that could induce voters to reveal their preferences. Referenda and plebiscites may be feasible for single issues. For some years I have attempted since 1963 to discover micro-preferences by field studies offering random samples of British heads of households two amounts of returned taxes in the form of vouchers for education and medical care. The finding has been a clear long-term rise over 15 years in the acceptance of vouchers worth a third or a half of the cost of private services, topped up to pay the full cost. The result is a hypothetical demand curve of around unit price-elasticity and with some income-elasticity. (These results are reported in Chapter 5 of *Over-Ruled on Welfare.*)

The theory of voting indicates that majority ruling satisfied voters in the middle of the range (the median) rather than voters at either extreme. The outcome of all the taxes raised and benefits disposed by the welfare state is not to transfer wealth from rich to poor but from rich and poor to the relatively affluent middle classes.

The new economics of politics concludes that the theory of public *finance,* in which economists analyze the most desirable or efficient pattern of taxation, cannot be divorced from a theory of *politics,* which explains how taxation is likely to be spent in a world in which the politicians and bureaucrats have motivations that may, and usually do, differ from most of the public. Here Gordon Tullock has found that majority voting on government spending financed by taxation can over-extend the budget and make *everyone* worse off than with no collective action at all!

Another early Founding Father, Anthony Downs, had in 1957 formulated a tendency among political parties in a two-party system to converge in their policies. A further finding is that parties in three-party systems tend to diverge. This may explain the more radical 'liberal' (anti-collectivist) doctrinal position of the British Thatcher Government and the tendency to the 'hard left' of the Labour Party.

Two new 'economics of politics' economists, Tullock and William Niskanen (now a Reagan economic adviser) have demonstrated that bureaucrats must not be supposed to be able to act as neutral, 'face-less' public servants or eunuchs faithfully executing orders from Ministers; they are policy *makers* concerned to expand the size of their bureau because their salaries and frills of office vary directly with the size of the budgets they administer. Niskanen concluded that taxpayers derive no net benefit from public goods because the benefits are appropriated by the bureaucrats.

Two more new economists of politics, Mark Crain and Robert D. Tollison have developed evidence that politicians respond to economic incentives much as everyone else. In other words, to elect any man a political representative does not make him a saint. And to appoint a man a public official does not make him a public benefactor.

The American constitution restraints on government expansion that worked for two centuries seem to have failed in recent years. Buchanan has concluded that the Leviathan-state has become a reality.

A conclusion of the economics of politics is that Keynesian economists have ignored the asymmetry in the policy of budget deficits to deal with depressions and surpluses to deal with inflationary booms. Politicians are eager to create deficits because it is popular to spend. They shrink from surpluses because it is unpopular to tax.

Nevertheless government can be constrained. A people can refuse to accept the near Hobbesian nightmare in which the inclinations of the government to spend, expand and inflate are unrestrained. Buchanan maintains that USA experience shows that constitutions can restrain governments. Bennett has also shown that government can avoid even constitutional restraints. I have argued for some years that a more effective discipline on government would be to require it – by constitution, or convention or custom – to *sell* its services for market prices – fees, charges, etc. (The only exceptions would be public goods, and even here the new economists are working on ingenious devices.) Hence the rule of thumb: tax where you must, charge where you can. Charging would prevent government going undergound, since it would have nothing to spend on extravagant adventures if its services had to cover their costs in the open market. (The argument is amplified in *Charge*, 1977, which estimated that roughly only half of British government services in kind are public goods. Since then a 1980 study has said that only a tenth or even less of local government expenditure is on local public goods.)

4. The New Economics of Charity

The new economic counterrevolution has liberated the noblest instinct of man – to help people in need by giving, charity, philanthropy – from its sociological confusion and shown it to be rational behavior that can be analyzed by micro-economics. (Macro-economic 'giving' by compulsion through the state and taxation loses the spirit of voluntary charity.)

My interest in the economics of politics and the political market thus led me to the economics of charity and the charity market. With the assistance of Gordon Tullock, who suggested two young American economists, I assembled in 1973 an Anglo-American collection of essays by some of the main exponents of the new economics of charity.

The case for the market has long been outmaneuvered to appear on the moral defensive. Largely as the result of the influence of sociologists, led by the late R.M. Titmuss, selling has been represented as sordid or selfish but giving as moral and selfless. And from this superficial contrast has followed the familiar contempt for commercialism, competition and capitalism. In both Britain and the USA, in the 1970s the argument was crystallized by the question whether a shortage of blood could or should be alleviated by paying blood donors. The sociological or Titmuss case was questioned early in IEA papers by Michael Cooper and A.J. Culyer, who had argued in 1968 that paying for blood might supplement its supply if voluntary donors left a shortage. A counterattack by Titmuss in a 1971 book was condemned in the USA by economists Simon Rottenberg and Kenneth Arrow and sociologist Nathan Glazer.

The new economics of giving or philanthropy has been developed by Gordon Tullock, Gary Becker, Thomas Ireland, David Johnson and others in the USA, and by Cooper and Culyer in Britain.

The sociologists have confused the morals/ethics of giving with its economics, but economists must point to the economic principles that make for efficiency in giving. Selling is clearly not immoral if both parties benefit in a voluntary exchange. In contrast giving can be immoral if it creates a relationship of indebtedness or dependency. Collective enforced giving, as in the welfare state, can be immoral if it weakens the capacity and the will to develop independence. And economic analysis can help giving to be efficient.

The immorality of giving through the welfare state is clear from the increasing evidence that it has failed to redistribute income from rich to poor. The 'public choice' explanation is the median voter theorem: the middle voters use their *political* power to gain at the expense of the poor as well as the rich. I have also argued (above) that they use their *cultural* power to gain at the expense of the poor. In particular expenditure on state education and the National Health Service – which were supposed to help the poor with the taxes on the rich – are probably anti-egalitarian. Giving through the state has gone sour, and Tullock's conclusion is that the poor might be better off if all who receive a significant part of their incomes from government were deprived of their votes.

G. Becker has applied classical micro-economic analysis to clarify the activity of giving. Since all resources (including time) are scarce, giving may be the most efficient or least costly way of winning the approval or esteem of other people, contrasted with the cost of acquiring political power or other distinction. And as the prices of these alternatives change over time, giving may increase or decrease. Variations in giving do not necessarily indicate changes in selflessness over time or between classes or societies but in the underlying costs and prices of time and other resources. Charity can be explained better by microeconomics than by obscure sociological or ethical theory.

It follows, also, ahat lowering taxes for compulsory joint giving through state welfare would not necessarily reduce giving or welfare in total, because lower taxes would enlarge individuals' purchasing power available for expenditure, including on charity.

Charity, giving, philanthropy is one of the new subjects into which economic 'imperialism' has extended its powers of analysis and, I would say, replaced other social sciences that had shed little, or less, light. The other subjects are reviewed below.

5. Enclosure the Key to Productivity by Property Rights

What belongs to everyone belongs to no one. This apparent contradiction contains the essence of the new economics of property rights. (It is also the secret behind the fundamental superiority of private ownership over 'public' ownership, of capitalism over socialism.) Its meaning, quite simply, is that, if property belongs to everyone, or to a large number of people, no single individual will have an inducement to preserve, improve or use it effectively, because the large effort required will far outweigh the small benefit to him. The century-old claim that private property wil be used selfishly for the private benefit of the owner but common or public property will be worked unselfishly for the benefit of all is also revealed as a myth. In the sociological jargon of a 'caring' society: if everyone owns something, who 'cares?' And, again, in government services or socialism in general: if the taxpayer pays, who 'cares?'

This well established truth is the essence behind the brilliant reinterpretation of history by two 'new' American historical economists, Douglass North and Robert Thomas. They explain the transition from the stagnation of the feudal and guild systems to the progress, growth and rise in living standards first of Holland and then England by the transition from common property (usually in land) to private property by the enclosure of plots for the exclusive use of individual owners. And the secret of growth was that the individual owner would work harder and use tools to improve the productivity of the land because he would not have to share it with other owners who worked less hard or were less enterprising.

This is also the simple explanation of the low productivity of collectivized land in the USSR and the much higher productivity of private plots in Western Europe. And it is the reason why the productivity of the seabeds now debated by the new law of the seas will be maximized when means are found to enclose and appropriate parts of it to individual owners who will find it profitable to invest in making them productive.

The theory of developing property rights evolved historically by D. North and R. Thomas sheds new light on pre-industrial institutions. Serfdom was payment in labor on the lord's land rather than cash for his public goods of defence, security, justice, courts, necessary to farm with assurance by reducing 'information' and 'transaction' costs. Custom involved lower transaction costs than contract in frequent revision of the 'terms of trade' between public goods and labor. Payment in kind was inconvenient because the absence of developed markets made the transaction costs of measuring value high. Paying by taxes was impracticable because money was not widely used. Serfs changed to land owning peasant farmers because the growth in population brought new land into cultivation, increased specialization and exchange, and induced the serfs to bid for private plots as money and credit came into use to buy and sell surplus goods in markets.

The theory of property rights therefore emphasized that economic growth was founded not, as was the established view, on technical advance in the Industrial Revolution, but on the development and refinement of law. There was an increase in population and advance in agricultural techniques in the 11th century, but little growth. There was further population and technical advance in the 17th-18th centuries, and there was also unprecedented growth. The reason for the difference in growth is that in the 11th century land was largely communally owned with little or no individual incentives to invest and expand production. By the 17th-18th centuries there was enough privately owned land to make investment profitable. The difference was therefore not technology, but the law of property. The peasant owner had exclusive property rights; he knew the costs and benefits of investment, and he could make decisions knowing that he (and his family) would benefit. That was the secret of growth and advance in living standards.

Individual ownership also reduced or removed the transaction costs (which include 'persuasion' or 'consensus' costs) of organizing agreement between all the owners. The individual could advance on his own with no 'persuasion' costs. And in practice when one owner forged ahead, the *information* costs were reduced, because the others could see what gain was possible from work and investment.

Here, from the early history of Europe, is a demonstration of the power of *inequality* in demonstrating progress and mobilizing emulation; equality if enforced by law or custom would have slowed down or stifled progress, as it is now slowed down or stifled in collectivized societies. Moreover, the ability to advance as individuals was more egalitarian, since the power to persuade and organize others in collective movements is itself unequal. And that is why capitalism is potentially more equal than socialism.

The reason why advance began in Holland before England is the historical accident that the dukes of Burgundy in the 15th century resisted the attempts of the guilds and corporations to monopolize trade and so encouraged farmers to produce surpluses to sell to the towns, which in turn stimulated fairs and markets for the general expansion of specialization and exchange. In England common land for grazing lasted longer and the emergence of private property rights was delayed; the common pastures were therefore over-grazed until market forces – the desire to farm more efficiently – led to the enclosure movement, with its more intensive investment and higher productivity. What is now in England called 'privatisation' (the new word for desocialization) was the key to economic progress.

Thus again the new economics demonstrates its microeconomic origins in explaining historical change by movements in the prices of land, labor and time and the rewards to individual effort and investment (which are also its prices).

Unfortunately, in our day, as the economics of politics explains, authority, which was at first created by the people to provide the public goods of defence and justice, has grown to provide far more, and is even in danger of enveloping and suffocating society by extending to services that are not public goods. Such is the scope for the reduction of government indicated by the new economics.

6. Money, Inflation and Unemployment

The new economics of money takes several forms. The most familiar is the monetarist explanation of inflation and unemployment, in which the leading figure is Milton Friedman, which provides rules for government to observe in the control of the supply of money. The second is derived from the economics of politics: J.M. Buchanan and a colleague maintain that no monetary rule will work in a democracy unless government is disciplined by the constitution. The third would be ultimately even more revolutionary in removing the power over money from government – the argument of Hayek that money should be provided not by a political monopoly but by competitive private suppliers. Finally there is a new classical theory of the economy formulated by the British economist Patrick Minford.

The writings of Milton Friedman and other monetarists since the 1950s have passed into the literature of economics and are accessible to students and observers of public policy. The Buchanan-Wagner thesis first appeared in a book in 1977, the argument of which was refined and applied to Britain in an IEA paper in 1978. The *locus classicus* of F.A. Hayek on the demonopolization and depoliticization of money is a short book published in 1976 by the IEA, to which he turned as a tribute to the sponsorship of his earlier thinking and of its work on micro-economics in general. The Minford theory first appeared in 1982, refined from USA thinking in the 1970s.

The central and fatal criticism of Keynes was the micro-economic argument of Hayek that managing *total* demand by manipulating the supply of money would not ensure lasting full employment because the volume of unemployment depended on the ability of the price of labor (wage, etc.) to adjust the demand for and the supply of labor *of each kind.* Keynes had restored the old view, going back to the early 18th century, formulated by John Law:

> "as the additional money will give work to people who were idle and make those already working to earn more, the output will increase and industry will prosper."

The micro-economic counterrevolution against Keynesian macro-economics is to demonstrate that unemployment depends on *relative* prices, not on the movement of *average* prices manipulated by managing the total supply of money.

The Friedman monetarist counterrevolution against Keynes may seem to do battle with him in macro-economics, since it speaks of managing the money supply so that "a steady rate of monetary growth at a moderate level can provide a framework under which a country can have little inflation and much growth" (a lecture published by the IEA in 1970). But the foundations are micro-economic, and that, as argued above, is why it is superior to Keynesian or other macro-economic theorics of inflation and unemployment. The conclusion from the Friedman analysis is that the causes of inflation and unemployment are not inherent in capitalism but lie in the activity of government; and here the important question is whether rules can be evolved to control government and its behavior, or whether it is in the nature of government to act as it does.

A basic Keynesian 'model' envisages that government management of taxation, expenditure and interest rates affects the whole economic system through the operation of 'multipliers' and 'accelerators.' Through the (falling) 'marginal propensity to consume,' the proportion of additional income spent on consumption falls relatively to the proportion saved. Micro-economically this was true of each earner or household, but macro-economically it was not true that, as national (or average) income per head rose over the long run a higher proprotion of total income would be saved, so that investment would be insufficient to maintain employment. Friedman demonstrated that in the long run a *constant* proportion of rising national income would be saved because individuals do not change their consumption in response to *short* term changes in wages. They have a long term conception of their income and expenditure — the Friedman notions of 'permanent income' and the 'life cycle.' Consumption is therefore more stable than supposed by Keynesian macro-models. And so are market economics ('capitalism') in general. Extensive government manipulation is therefore first, unnecessary; or, second, it is damaging, because it intensifies the amplitude of the mild fluctuations that would otherwise exist; or, third, even if it might in theory even out the fluctuations, government could not or would not manipulate as required. And in this objection, the new economics of monetarism and public (political) choice join forces.

The Friedman critique also rejected the notion that government could 'fune tune' the economy: short term policies were pretentious and ineffective, if not harmful. Here there is a link with micro-analysis. The economy comprises large numbers of decisions made by individual buyers and sellers, employers and employees, savers and investors; these decisions are refelcted in prices of all kinds (wages, salaries, interest rates, rents, etc.) in the market, and will be made with more assurance if avoidable changes in prices can be avoided by a stable, gently growing, supply of money to minimize both inflation (and deflation) and unnecessary unemployment (or over-full employment). Friedman thus arrives at macro-economic (money supply) policy through micro-analysis of the economic system.

This can be regarded as the main element in the defect of Keynesianism because it gives them more power over taxation, expenditure and borrowing, but they will fail if they follow other governments, as in Britain, that tried Keynesianism and found it led to inflation. Even the British Cabinet recognized in 1976 that it was not possible to end recession by spending. The more recent talk in Britain – and other countries – of 'reflation' is nerviously allied to proposals for 'income policies' to prevent the *inflation* that, it is implied, would otherwise follow. But the experience is that 'income policies' are either voluntary and short lived or, if they are compulsory by statute, lead to creeping collectivization which few in Europe want once they understand the inevitable train of events.

Other elements in the monetarist counterrevolution are refinements – not least, the demonstration that government cannot simply 'trade off' inflation against unemployment; the 'natural' rate of unemployment that is compatible with stable prices generally and determined by underlying structural conditions such as national insurance unemployment benefit, trade union power and housing subsidies that restrict the mobility of labor; the slow adjustments of long term labor contracts and wages and the impulse to reduce transaction costs of renegotiation as businessmen and consumers react to uncertainty and imperfect information.

Monetarists would thus leave money in the control of government, but disciplined by rules. Two further elements in the new economics also seek strong disciplines on government.

In 1977 J.M. Buchanan, with a colleague at Blacksburg, Virginia, Richard Wagner, wrote a condemnation of Keynesianism on the ground that it was not merely inaccurate in its economics but, even worse, unrealistic in its politics. Keynes had argued that the free enterprise system could settle into an equilibrium with less than full employment. The solution was for government to use the budget to maintain the whole economy in full employment by neutralizing fluctuations in activity – boom and slump – with equal and opposite fluctuations in budgetary surpluses or deficits.

This diagnosis was questioned from its very beginning in 1936 by economists in the classical tradition, not least, Hayek and Hutt. The Buchanan-Wagner criticism was essentially that the instrument Keynes had devised, budget deficits and surpluses to stabilize the economy, could not be used in representative democracy, with its sectional pressures and irresistible importunities on politicians obsessed with keeping power. Their conclusion was that only constitutional disciplines could prevent government from misusing the power to over spend or under tax. Government would be tempted to expand budget deficits to avoid slumps but scared to create surpluses in order to avoid booms. Government was not a benign, neutral 'external' power, keeping the economy on an even keel; it was an interested 'internal' power working for its own ends. The interest of government is not the same as that of the people but in *conflict* with it, because its short term electoral objective operates against the long term public interest. Keynes had opened the floodgates to growth of government by providing politicians with an academically respectable argument for unbalancing budgets by borrowing or printing money.

Here again, the Buchanan-Wagner constitutional critique of government in monetary policy has roots in British classical economics. The classical economists understand that a constitutional rule was required to make government balance its budget, otherwise representative democracy would tend towards budget deficits and uncontrolled growth of government expenditure. The rule became a constitutional convention. And it protected Britain from uncontrolled state expansion not because government was *technically* incapable but *politically* incapable of controlling its budgets. Keynes' error was in the economics of politics; he supposed that economic policy was made by wise politicians, capable of ignoring political pressures or temptations, and advised by disinterested economic technocrats called 'public servants.' In practice politicians and bureaucrats given the power to borrow rather than tied by the obligation to tax or charge for services took off into the financial stratosphere. (96% of the inflation in England since the year 1281 in the feudal system has followed Keynes' 1936 bible, *The*

General Theory!) The economic systems of the West became asymmetrical by developing a bias towards state expansion and inflation. Keynesianism – or the use of Keynes made by politicians – has made the West market economies of free enterprise capitalism unstable. A new monetary and fiscal constitution was essential to discipline government and reduce the instabilities. Otherwise the corruption of Keynesianism would destroy Western democracy.

The third element in the new monetary economics is the most drastic. Indeed, when it was put to a former Governor of the Bank of England, he responded sympathetically "That is for the day after tomorrow." But we have learnt that what practical men, preoccupied with day-to-day pressures and crises, believe is politically impossible, can rapidly become possible when circumstances change and the evils of current thinking and policy become too acute to ignore. In any event, the task of economists is to ignore what is currently (but often erroneously) thought to be 'politically impossible' and by argument to help make it politically possible.

In a lecture in Switzerland in 1975 F.A. Hayek had argued that the power of government to force its people to use its currency as the only legal tender should be broken by allowing them to use any *other* government money. The British could then be able to use, say, Deutschmarks if they preferred. This new freedom of international money would induce national governments to limit the output of their currency and so maintain its value. In the 1976 IEA book he argued further that government be deprived of its power to issue money as the only monopoly source *within* a country. Although it might continue to issue government money, it should have to compete with private suppliers of money. This revolutionary proposal is one of the most far-reaching in the new economics, and its implications have yet to be considered by economists, still less by politicians or bankers. For it controverts the view held by economists for 200 years (though not by Adam Smith) that the issue of money is one of the essential functions of government.

Hayek analyzed four defects of the Western world: the recurring bouts of acute inflation and deflation that have intensified in the last 60 years; the more deep-seated recurring waves of depression and unemployment that have been 'a justified grievance' against free enterprise capitalism; the spectacular increase in government expenditure over the last 35 years; and the government restriction on the international movement of men, money and capital that safeguards the ability of dissidents to flee from oppression – such as British doctors escaping from the National Health Service or Russian writers from communist orthodoxy. All four evils have a common origin, the government monopoly of money, and a common cure, its replacement by *competition* from private suppliers. The solution, as for all commodities and services except public goods, was to discipline government by the market.

Hayek refuted the conventional view that money has to be created 'legal tender' by government. He argued that, like law, language and morals, it would become acceptable as legal tender if it was found reliable in value by experience and usage, and no law could make money 'legal tender' if it was found unreliable. If money had to be managed by government, a gold standard, despite its imperfections, was tolerable since it required government to relate the supply and value of its currency to an outside standard over which it had no control. But this system would not be as effective as subjecting government money to the competition of other sources of money.

The reason again has its roots in the economics of politics. It is not surprising that Tullock had an early article – in 1956 – in which the idea was approached. So long as democratic government is subject to pressure by organized interests, we cannot count on its benevolence, intelligence or understanding to give us the institutions we want. Here Keynes, who in 1945 said the problem was "insufficiency of cleverness," was again wrong. What was required was sheer self-interest to induce government to do what was required. In other words, in the language of public choice, government has to have *incentives* to do what is desirable. And the inducement would be the risk of losing its function as an issuer of currency if people came to prefer private currencies or the currencies of other governments.

Unknown to Hayek, the case for competing currencies had been explained in a paper written by Benjamin Klein in the USA published in 1975. The idea has clearly taken root among younger economists and we shall hear more of it. "The day after tomorrow" may come sooner than the Governor of the Bank of England thought.

Keynes taught demand management, or rather that the management of demand was the way to change supply. In recent years economists have emphasized more direct action on supply – 'supply-side' economics – by reduced taxes to intensify incentives to innovate, take risks and invest and thus thaw out the supply side of industry frozen by high taxation, monopoly, subsidies and tariffs. If tax cuts, and their concomitant cuts in government expenditure, have not had these effects so far it is because they have been too small, and further tax cuts could be made possible by reducing expenditures on superfluous welfare and social security benefits, so that individuals can cover themselves by private insurance, and shifting other services to the market.

A new counterassault on macro-economics is mounted by P. Minford in a refined classical view of the economy. He was formerly deeply steeped in Keynesian macro-thinking but has propounded a micro-economic Rational Expectations theory derived from an idea of John Muth of Massachusetts Institute of Technology in 1961 that economic expectations are based on the efficient use of available information. This approach was ignored for some years until the 1970s when its importance was seen by Robert Lucas of Carnegie-Mellon University and Alan Walters (then of the London School of Economics, later at Johns Hopkins University and now Economic Adviser to the Prime Minister of Britain). They saw that changes in money supply that are *anticipated* have smaller effects on output and larger effects on prices than if they are *unanticipated*. An increase in the supply of money could then raise prices but not expand output. Even a change in government or opinion polls affects market expectations and reactions. The changes in policy are discounted before they occur. And in practice, as inflationary policies have come to be expected, they have been soaked up in prices and have had lessening stimulus on production. Government can therefore become impotent in economic management to master inflation or create full employment, forcefully argued by C.K. Rowley in *The Journal of Economic Affairs* (as the Austrians argue, economic law has again prevailed over political power). Yet these market reactions, familiar in everyday buying and selling, and long studied by micro-economists, were virtually ignored by macro-economists as reflecting subjective sentiment not worthy of objective economic science.

The Rational Expectations revolution would transform the economics of government, which may be effective only if a change in policy is sharp and determined and so unanticipated. (Hayek has urged a six-month rather than a five-year destruction of inflation.) Gradual change may be ineffective because it can be anticipated: only shock treatment may work. This view may explain why Margaret Thatcher's *unexpected* determination to risk the politically adverse effects of restricted money supply and government borrowing – not least, a rise in unemployment – has at last mastered the 10-year old British inflation as well as raised productivity, lowered interest rates, revived demand and diminished trade union obstruction to technological innovation. Once again, the economists are returning to the basic, day-to-day micro-economic market reactions to explain macro-economic policy. Keynes' solution for unemployment of digging holes and filling them was rightly recognized as nonsense by practical men who worked in, and economists who studied, markets.

P. Minford is one of the sophisticated economists who have rejected Keynesian macro-economics. Michael Bennstock has subjected macro-models to a neo-classical critique. Alan Budd has written a book in which he indicates a conversion of faith from the state to the market. All three have worked at the British Treasury and know its macro-models.

7. The Failure of Government Regulation

The comfortable conventional view of government was that it could intervene in the economy to regulate industries that were exploiting the consumer. The new economics of George Stigler, the 1982 Economics Nobel Laureate, and other economists is that regulation ends by favoring the regulated industries. Government regulation of USA transport, energy, banking, etc., is imposing costs on industry, which passes them on to the public as consumers in higher prices; or they appear as high taxes; and both lower living standards. Once again, there is 'government failure' to set against the 'market failure' it was supposed to correct.

Much research into the effects of government regulation has been pursued by economists in North America, and their findings must be a warning to other countries. Road transport charges were found to be around half as much again as in countries without regulation like Belgium. Short distance urban transport passengers were found to subsidize long distance passengers. The market produced 'jitneys' – large taxis – which gave passengers more flexibility in deciding routes and fare costs, but they were suppressed in favor of local government transport; so people made more use of private cars, and road congestion intensified: the market worked after all, but government made it produce bad results. The subsidization of municipal road transport and state railway systems – not least, in Europe – imposes concealed (or under-stated) burdens on private transport and industry generally.

Regulation in health preservation has slowed down the production of new medicines because the regulatory authority is over cautious – it risks being discredited more by the highly publicized adverse consequences of new drugs than by the unrevealed lives suppressed drugs would have saved. Over caution in compulsory seat belts for motor-cars shifts injury or the loss of life to pedestrians. Continued protection of long established 'public utilities' from competition from new services made possible by technological innovation – as in electricity, telephone, broadcasting and postal services – subsidizes producers at the expense of consumers. Even worse, since the market for them is restricted by government regulation, the production of new technology is slowed down.

Much the same applies to air transport (almost the only USA industry where deregulation has been allowed to demonstrate its benefits in lower fares and better services). In all, the results of governmental regulation, now demonstrated by far-reaching research, have been not only failure to achieve their aim – to protect the consumer; they have penalized the consumer at the expense of established producers. Perhaps Britain demonstrates even more than most countries the producer opposition to competition from new technology: its trade unions have been the most reactionary force in slowing down the adaptation of industry protected by government ownership or regulation in fuel (especially coal), transport (especially rail), telecommunications, education and medical care.

A major lesson, I would emphasize, is that government regulation is ineffective in protecting man as consumer from *himself* as producer. If the producer interest is allowed to dominate and rampage over the economy and society, the result is gradual economic debilitation, stagnation and decay. That was the result of medieval producer dominance in the guild system of England, Spain and elsewhere. It is the danger that now confronts the countries of Europe until man as producer disciplines himself to accept the primacy of *his* interest as consumer. That was the hope of the European Common Market, which has largely worked internally, except in agriculture, though not between it and the outside world. But it has confirmed the lesson of history that the market is better than government, in making the consumer interest prevail. To borrow the language of the new economics, the West will have to recognize that the market is, in sense, a public good from which all benefit by the enthronement of the consumer and to which 'free-riders' should contribute. This is what the members of the Common Market have in effect agreed to do: they have recognized that Europe is a public good despite the risks and dangers of party politics and bureaucracy revealed by the economics of political choice and confirmed by the Brussels apparatchiks. The difficulty is that other countries such as the USSR and East European countries gain from the information derived from the prices of world free market economies, and there is no easy or direct way to make them pay for the 'free ride' they take on the capitalist public good of pricing. But within the free world the failure of government regulation is further damaging argument against the state and for the market.

The role of research in establishing empirical evidence, I should add, is not always indispensable. Where the evidence is persuasive, it strengthens the influence of the general logical, *a priori,* argument. If it is contestable, it may blur the general argument. In any event, the advocates of state economy, regulation and welfare rarely used the 'facts and figures' of empirical research, yet their influence over the minds of men and women, especially of the young, is enormous. Indeed, their influence continues despite contrary evidence from research of repeated government failure. The sources of influence are therefore not necessarily 'facts and figures.' Moreover, the case for the market cannot wait for empirical evidence, since the market must be established *before* its benefits can be produced, seen, and measured. Down the ages knowledge and understanding have proceeded by the recognition of new insights confirmed by experience. The insight that voluntary welfare would have developed in the absence of the welfare state cannot be established by empirical research; but it does not require 'evidence': it is selfevident because logically persuasive. The new economics rests more on analytical insight than on empirical evidence.

8. The Theory of Human Self-Investment

A powerful part of the new economic counterrevolution is its invasion of new territories and subjects thought to be the province of sociology, political science and other social sciences – the family, the household, marriage, love, fertility, prostitution, war conscription, diplomacy, non-profit enterprises, teaching techniques, biology, crime, medical care systems, like the British (or Italian) National Health Service, based on the principle of *equal* service in a period of increasingly *varying* expectations; it will cause them to break down unless incomes are equalized, which is impracticable in any kind of economic system, capitalist or socialist, or incomes are spent similarly, which would require coercion unacceptable in Western (and Eastern) Europe.

Similar analysis applies to self-investment in education and to the purchase of labor-saving devices such as washing machines. As productivity rises, the value or price of time spent on unpaid work at home or at paid work in the market rises. So we invest more in education. And we buy more domestic equipment that makes kitchens look like the engine room of ships. The aim again is to save increasingly costly time. We have not been 'persuaded' into buying useless 'gadgets' as Kenneth Galbraith and other critics of advertizing, the market and the familiar bogey, 'capitalism,' have *persuaded* (!) gullible but superficial critics of the free market economy. (This element in the new economics was anticipated in early IEA books on advertizing in 1959 and 1962 by Harris and Seldon.)

9. The Externalities of the Welfare State

Research in the USA has revealed that, as in transport and telecommunications, government regulation has largely failed in its purpose in the welfare state. It has largely disfavored the poor and the unfortunate – for two reasons. First, education, medical care, housing, pensions and other social security or social insurance systems are operated, as public choice analysis shows, by the strong in their own interests at the expense of the weak. Second (and this is usually overlooked by the new economists although it occurs naturally to an economist in the Austrian tradition), the welfare state has suppressed the emergence of voluntary welfare organizations of all kinds that would have catered more effectively for the requirements and preferences of the poor – from voluntary 'mutual' organizations such as provident insurance to commercial entrepreneurship. These consumer oriented and competitive services were emerging before state welfare repressed them, and they will not develop as much as they would as long as the welfare state continues.

There is a further argument of the new economists that could be refined and deployed much more than it has been. The sociologists or economists argue that state welfare is essential to generalize the external benefits – in literacy, health, housing, income when earnings are removed by illness, unemployment or age – that would not be generated if individuals were left to their own efforts in the market. These are the supposed 'externalities' of the welfare state.

It is remarkable that these academics emphasize the external benefits but rarely the external costs and other damage of the welfare state. This is a theme that the new economists have largely ignored. Yet a summary list demonstrates the high *price* that is being paid for the small benefits, if any, of the welfare state:

1. high taxation which depresses incentives, the inducement to take risks, and therefore production
2. the cost of tax collection
3. the cost of minimizing tax 'avoision' – the tax rejection that proceeds from (legal) avoidance to (illegal) evasion
4. the effect of tax 'avoision' in undermining the respect for law
5. the cost of bureaucracy
6. the neglect of quality in government services
7. the denial of choice
8. the regressive effect of replacing *price* by *power* in government services
9. monopoly
10. the repression of innovation
11. the strike threat of government sector trade unions
12. syndicalism in place of consumer sovereignty
13. social conflict (below)
14. loss of resources in a world market, as British doctors by emigration
15. corruption
16. resistance to change from political, bureaucratic, professional and trade union vested interests
17. loss of spontaneous development of market based,

consumer oriented mutual or commercial services

The final lesson from this catalogue (which could be lengthened) is that the market, as Böhm-Bawerk emphasized, cannot be suppressed by the state but, if it is fragmented, it escapes from the state and harms the people who remain locked in.

10. The New Economics of Minimal Government

The most fundamental and most revolutionary element in the new economics – the element that provides the scientific basis for the instinctive reaction of the common people against the state – reappraises critically what the classical Jeremy Bentham described as the 'agenda' of government. Adam Smith in 1776 defined them (apart from external defense and internal law and order) as goods or services that:

> "can never be for the interest of any individual, or small number of individuals, to erect and maintain: because the profit can never repay the expense .... though it may frequently do much more than repay it to a great society."

He did not include money among the 'agenda,' as noted in Section 6. In 1926 J.M. Keynes' formulation of the agenda was remarkably similar: he said the role of the state was:

> "... not to do things which individuals are doing already and to do them a little better or a little worse but to do those things which are not done at all."

In our day these functions are described as collective or 'public goods': essentially those that cannot be refused to people who refuse to pay (like defense, law and order), or for which the payments (prices, charges, fees) would yield less than the costs of collection so that although technically not public goods they are economically public goods (like park lands). Whether they should be provided at all would have to be decided by the people (by some form of majority, although unanimity is the only certain evidence that everyone wants them) and paid for by taxes.

What is clear is that all European states now provide far more than public goods, and the economics of government, politics, democracy and bureaucracy shows why government has grown far beyond its required functions (which I have suggested would reduce it in Britain to about a third). But it goes further and is showing that government does not necessarily have to supply even what have long been regarded as public goods. Public choice economists have been trying to evolve methods of revealing preferences in public goods by referenda, vetoes, or taxes or financial inducements (or penalties for concealing preferences).

Professor Arrow's 'impossibility theorem' demonstrates that there is no way by voting to assemble a collective decision on the disposition of resources in a 'social welfare function.' This 'theorem' nevertheless implied that, if such a voting system could be constituted, government would be able to carry out the collective wish. It implied that representative government could work.

The public choice economists have demonstrated that, even if government knew the aggregated social decision, it might *not* execute it because its own interests could or would conflict with it. In short, representative democracy does *not* necessarily work.

This is the alarming conclusion from the new economics. The democratic notion of representative government is as improbable as the technical device of a social welfare function, but for the political reason that the interests of the people – politicians, their advisers and officials – do not necessarily coincide with those of the people they 'represent.' Moreover, to this conflict of interest we must add the natural but fatal tendency of democratic government to pass laws that grant favors to vocal interests. So everyone is induced to form pressure groups, and if government yields to them it 'represents' not the people in general but the groups that are organized. Finally, I must add an element that tends to be overlooked in this analysis: *there is no equality in the ability or inclination to organize.* 'Representative' democracy is therefore not only not representative; it is inequitable, arbitrary and probably prejudiced against the *least* able to make their opinions heard or claims heeded in the general political clamor that is more like a shouting match than an election in which every elector's vote counts equally. And that is what we observe in the media – especially television – used by the spokesmen of vested interests, usually of producers because they are more concentrated than consumers.

The consequence is that so-called 'representative' democracy, in conception the ideal form of government, has in day-to-day practice endangered social harmony, provoked social conflict, and risked political cohesion. Since the decisions on government disposal of resources are made by majorities, minorities – by faith, religion, sex, occupation, region, nationality – see themselves at the mercy of majorities whom they cannot hope to displace. Scotsmen in Britain will remain a minority forever. So will Basques or Catalans in Spain. Or Catholics in Northern Ireland. Or Portestant in Spain. *The only ultimate solution, so long as government provides non-public goods, is not by voting but by regional separatism or racial secession from a state that wields the vast powers of 20th century democracies.*

There is one other solution: *to reduce government to irreducible public goods.* That is the conclusion from the Buchanan-Tullock school. The future view that there are no public goods produces the solution, or what may now seem the Utopian but is the closely argued case, of the USA stream of new economists headed by Murray Rothbard, who follows in the Austrian tradition of the late Ludwig von Mises and David Friedman. Although regarded as on the 'right' in party lable terms, the self-chosen description of 'anarcho-capitalists' shows their affinity with the 'gentle' philosophic 'anarchists' on the 'left' who want minimal or no government, except that the new economists favor private ownership as the better safeguard against the state than the public ownership (even of self-managed worker cooperatives favored on the 'left.'

The Rothbard-Friedman new economists follow the classical tradition but take it further by questioning the economics of the conventional public goods. They argue that, even if not yet, technological change will make most of all of them, even some forms of defence and justice, police and roads, saleable to individuals, so that they will not have to be provided by government and financed by taxes. Education could be provided in the market in response to parents' preferences, facilitated in, say, 10 years in which vouchers to pay for education from competing sources replaced 'free' education provided by monopolistic politicians and officials. Personal medical care could be supplied similarly for most people and eventually for all as the remaining older people who cannot pay or who cannot handle money have passed away. As social benefits and other services in kind are replaced by a reverse income tax, all citizens would have the dignity of choice exercized by consumers who pay. The remaining inefficient representative government in politics could then be removed since every man would effectively represent himself in the market. Organizing vocal vested interests would become unnecessary. The tyranny of majorities would have passed away. Social cohesion would be secured by voluntary association. The new economics, like classical political economy, would have shown how to put government into its insignificant place.

Envoi

This short paper has been able to review in outline only the main tributaries to the mainstream of the new economics. The new economists are growing in number, ideas and literary output from year to year.

The new economics that has flowered during the last 15 years, mainly in the USA, by brilliant insight and technical sophistication is the spearhead of an intellectual counter-revolution of decades. It is reasserting in new forms and new language the essence of classical British and European political economy, and demonstrating its latent strength by extending it from working and earning to all human behavior: in government as well as industry, in the family as well as in the firm, mutual aid as well as commercial exchange, giving as well as selling. It is reaffirming the principle, repeatedly confirmed by experience in Eastern as well as in Western Europe, Africa and Asia as well as America and Australasia, that civilized, harmonious society cannot be imposed by government but must rest on the power of individuals to decide the degree of acceptable coercion. And it is demonstrating that fallible individuals have inducement to correct error but government to conceal and perpetuate it.

For 'old' economists, and the 'old' politicians in Europe and elsewhere who are still misled by them, the most damaging conclusion is that government is ill-equipped, inefficient and unrepresentative in performing the role argued for it over a century by appeals to poverty, inequality, economy, monopoly, regulation, externality, and macro-economic management. No analysis or evidence now justifies continuation of government powers, functions or services on their post-war scale. The old economics – macro in method, collectivist in spirit, inflationist in results – lingers because the men now in their 50s or 60s who learned it in the immediate post-war years and wrongly thought the war economy had validated it, will not admit error in their last 10 or 15 years of power in government or of influence in academia and the media. But the new economics has undermined its legitimacy. The post-war world has revealed as myths its promises to produce prosperity, liberty, equality and fraternity.

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IDEOLOGY AND LABOR LAW IN AMERICA

By Barry W. Poulson

Labor relations in America have evolved from sporadic discontinuous negotiations between employers and groups of employees to formalized collective bargaining insititutions circumscribed by a legal framework that defines the rights of employers and employees. The usual practice is to trace the legal framework for labor relations in terms of several distinct phases including 1) an early period of government hostility to labor unions, 2) a period of neutrality in which government policies were neither hostile toward nor supportive of labor unions and collective bargaining, 3) a period of encouragement in which government policies support labor unions as collective bargaining agents, 4) a period of control in which government regulates labor relations. This type of chronology may be useful for describing major trends in government policies toward labor unions, but there are several problems with using this type of chronology in the present study. Of major importance in understanding the legal framework for labor relations is the role of the courts in defining and enforcing the rules of the game. Until the 1930s there were public policies affecting labor, but no government legislation directly relating to the collective bargaining process. The rules of the game for labor relations were established primarily through the evolution of that institution in the private sector and the legal precedents established by the courts through common law. The role of the courts must be examined as an independent institution which at times constrained the government and at other times sanctioned goverment policies affecting labor.

A number of writers have interpreted this legal environment in terms of the influence of economic interest groups on legislation and on the judicial process. For example, Lieberman and Gregory interpret the hostile legal environment for early unions and collective bargaining as a response to the influence of propertied interests.(1) More recently, Posner and Landes have elaborated an interest group theory of justice.(2) The problem with this interest group explanation for the legal environment of labor relations is that it does not always fit the