

## Part III: Towards an Evolved Capitalism

### Chapter 9: The Social Teachings and Economics: Ideas in Tension

*The prestige accorded to mathematics in economics has given it rigor, but alas, also mortis.*

*Robert Heilbroner*

#### **Some “Economic” Principles of Catholic Social Teaching**

##### *A “Catholic” Economics?*

The Church is the arbiter of justice, not economics. Therefore there can be no such thing as a “Catholic” economics. The Church does not claim competence beyond the realm of theology, but justice falls within this realm and the Church is competent to declare standards of justice that economics must observe. A society ignores such standards at its own risk, risks that involve the stability of society and even the profitability of investments. The Church regards economics as *normative* or “architectonic”; that is, a set of tools and principles by which societies realize, at a concrete level and however imperfectly, their own ideas of justice. In this view, economics is an arena of human freedom that allows a wide variety of systems. The architectonic view contrasts with the “positive” view of many economists who prefer to see economics as a positive science, akin to physics and therefore devoid of freedom. In the positive view, one is forbidden to think of “freedom” in the laws of supply and demand just as one would not think of “freedom” in the movement of the stars. After all, if economics is a positive science, like physics, then

disagreement over its laws and facts is moot: one may not like gravity, but one *will* abide by it. If, however, economics operates not by law alone but by choice as well, then multiple economic systems are possible. Thus, we can see that the question of a Catholic economics is really a question of the freedom of economics. The Church comes down on the side of freedom, and that has implications for the way she seeks for justice in social institutions.

With that in mind, let us first isolate some of the more important criteria given by the Church’s social teaching and then note the tensions that occur with a purely “scientific” view of economics.

##### *The Ultimate Purpose of the Economy*

The Church has a *teleological* understanding of the universe. That is to say, she believes that everything has a proper purpose and end. Man’s proper end is eternal happiness with God. These institutions are part of the quest man has for ultimate meaning and eternal happiness with God. Thus the Church includes all human institutions within the moral order. Cultural institutions help direct man to his final end. Recall that we can only discuss a moral issue when considering something with a *purpose*, and apart from some notion of a purpose, we cannot apply reason to moral

statements. The ultimate purpose of man, the attainment of final happiness, presupposes a journey through space and time which imposes certain requirements on each person. One of these requirements is that he must work, and this work will always occur within some social setting which requires cooperation. There are both *physical* and *spiritual* aspects of work and cooperation. Science will have much to say about the former, but nothing at all to say about the latter. This is because human "work" is not merely the expenditure of energy that it is for a machine or a mere physical process, but an aspect of the human person, something that always escapes a purely scientific analysis. The "positive" or "scientific" view isolates the "individual" from the person and treats this individual as a part of a machine.

This is the key to the difference between the two views: the Church treats of "persons" rather than individuals; that is, a person's individuality is not something isolated and abstract, but is always embedded within some social context, first and primarily the family, then larger associations of communities of various kinds, and eventually the whole human family. The human person is the measure of all things. Since the human person is the measure of all things, and since the person exists within social structures, the measure of any social structure is how well it serves the human person. And further, since the person must work, and that work will be organized by economic structure, it then follows that the measure of those structures ought to be how well they serve the purposes of human work. Here we have a standard

which allows us to engage moral reasoning in thinking about the economy.

### *Human Work*

*Work is both natural and spiritual.* Work is treated at both a natural and a spiritual level. Work is part of the process by which man achieves "dominion" over the earth. By work man participates in God's own creative act and has the opportunity to refashion the things given in the creation of the world into things that are useful, good, and beautiful.

*Work is both transitive and intransitive.* As transitive, human labor goes out of the person and into some object, re-creating it, as it were; this is the *objective* dimension of work. But work is also intransitive; the work remains within the man or woman who performs it. While we are busy forming the world, our work is forming us as well. Work is how we express ourselves and part of how we grow and develop.

*Work is both necessary and free.* Work is free since we freely choose our work, freely contract for it. But work is also necessary, since it is only by work that we earn sustenance for ourselves and those in our care. Hence the "freedom" of the work contract is bounded by the necessity implicit in the duty to survive provide for those in our care.

### *Property*

*Property is a sacred right, but not an absolute one.* Property allows us scope for freedom, self-expression, and security. However, property is not a part of the natural law, but a human addition designed to serve the common good, and loses its legitimacy

when it ceases to serve this good. Property is originally given by God to man for his common use and sustenance; property is therefore subject to the Universal Destination of Goods. Therefore, property is a *means*, *not an end*. Property must serve work and the common needs of mankind.

*Property originates in work.* We acquire valid title only by placing the stamp of ourselves upon the land, that is, by work. It is labor that makes property “proper” to a person. But property in land or minerals is a finite resource; huge accumulations for one can only occur by depriving others of even the possibility of acquiring property. This is true even for more abstract forms of property, such as financial capital; while they are in theory unlimited, they are at any given moment finite, and an imbalance of ownership by a few limits the ability of the many to acquire property of their own.

### *The Primacy of Labor*

*Capital is the result of labor.* Only by labor do states grow rich. *Labor is therefore the primary and efficient cause of wealth* and capital a mere instrument. Therefore labor cannot be separated from capital, or capital set against labor. Indeed, capital can only be considered legitimate when it serves the legitimate ends of the labor in which it originates: That is to say, when it serves the authentic needs of the human person. Capitalism, as long as it represents a division of capital and labor and gives a false priority of capital *over* labor, *always* represents a reversal in the right order of values.

### *The Just Wage*

*The just wage is the primary criterion of a just economy.* We have seen that all title

to capital originates in labor; that the entire purpose of private property is to serve work and the common destination of goods; that work is necessary to man, both in a physical and spiritual sense; that in both senses, man must work and must both earn his daily bread through work and express himself through his work. From all this it follows that man’s work must feed him and his family; hence a “just wage” is not only a moral requirement of an economy, but indeed the only real way to measure its success.

### *Subsidiarity*

*Solidarity implies a “bottom-up” view of society.* It starts with the family as the basic unit of society. Only the family, and not the individual, can perpetuate itself and therefore only the family can be the on-going basis of society. All economic, social and political activity is built around the family and serves its needs. But because no family is self-sufficient, families in turn require their economic and social contexts, including government. Higher social formations have a right to interfere in the affairs of a lower organization, including the family, but this is only a limited right; such interventions can only be used to correct egregious failures, and may last only for as long as necessary to correct the failure. Some problems, of course, don’t go away, such as unemployment: as long as the economic system is unable to offer all persons meaningful employment, then society must provide other means for their dignified subsistence. But this must be clearly seen as a defect of the system, in the same way that the need for a police force or an army is really a defect

arising from original sin. From the viewpoint of solidarity, society is highly “textured”; instead of a simple system of an “individual/government” relationship, there should be a rich collection of levels within society, each with its own realm of competence and authority. At present, government has absorbed functions which used to belong to the Church or other authorities such as the guilds. Marriage, education, charity, and commercial regulations had been guided by other bodies, even if their decisions were enforced by the state.

### *Solidarity*

*Solidarity is complimentary with subsidiarity.* Subsidiarity provides the vertical dimension of life, while solidarity provides the horizontal dimension; subsidiarity is a connection between elements of society viewed as a hierarchy, while solidarity provides the connections between the elements viewed as if they were on the same level. Solidarity connects us with the common good and impels us, in the name of Christian charity, to act for the good of all. There can be no vision of the common good unless there is solidarity between all the elements of society.

## **Conflicts with Economic Theory**

We can now contrast these conclusions of Catholic Social Teaching with the assumptions common in standard economic texts.<sup>1</sup>

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<sup>1</sup> When referring to “economics” in this context, we mean primarily *neoclassical* economics. There are of course many other schools of thought— Keynesian, Institutional, Marxist, Neo-Ricardian, etc. Neoclassicism is,

### *A “Neutral” Economy?*

In direct opposition to the Church’s teleological view of the economy, there is a tendency among neoclassical economists to regard economics as the application of “value-free” laws and therefore as being beyond any moral judgment. The sole criterion is often stated as a value-free “efficiency.” But efficiency is an empty term; it needs an object to have any meaning. In other words, we must ask, “Efficiency at what?” At producing the largest pile of goods possible? Or, at providing an equitable distribution of the goods necessary to life? These are two very different kinds of “efficiencies” and result in two very different views of economics. The first view, efficiency in production, is usually stated as something like producing the largest amount of goods for the least amount of inputs. While this may sound “value-free,” in fact it contains a host of “values.” For one thing, it focuses economic thought entirely on the production of goods, but surely that is a “value.” For no particular economic reason, “more” is equated with “better.” An exclusive focus on production inevitably leads to a culture of consumerism; after all, one must do something with the efficiently produced pile of goods. If the duty of the economy is to make as many things as possible, the duty of the citizen must surely be to buy them, or the system collapses. Consumerism may or may not be an economic truth, but it is certainly not “value-free.” Further, this view hides other value

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for the moment, the dominant but by no means unanimous view; it was chosen because it forms a convenient counter-point to Catholic Social Teaching.

judgments, namely that profit is the sole criterion for success. This lurks as a hidden but powerful assumption of the “efficiency” measure, and a value-laden assumption. In the final analysis, the refusal to address the question of values does not produce a “value-free” science, but merely an ideology in which values are hidden and therefore unexamined.

Mere efficiency in production cannot express the totality of economic values; we expect more than just “things” from an economic system. For example, an economic system must provide meaningful work for all its members. Or we can ask for a certain level of distribution, even to the lowest members of society. These are possible values. But if efficiency is limited to the production function, then distribution values cannot even be considered. Can this really be a complete description of an economy?

Furthermore, the “value-free” premise is a thoroughly individualistic view. Social values, if they are acknowledged to exist at all, are considered to reside solely in the rules of exchange between individuals, without any relation to the social content of the exchange. “Values” in this view have meaning only to individuals and cannot be allowed to determine the economic system. This view breaks the solidarity that is the foundation of any rational view of society, and hence any rational view of economics.

### *Work as a commodity.*

It is interesting that “work” is not even listed in the index of *The Economic*

*Way of Thinking*,<sup>2</sup> one of the more popular undergraduate economics texts, and nor is “labor” discussed in itself, but only the division of labor and its subjugation to laws of supply and demand. There is hardly a sentence in the book where some other term, let us say “pig iron,” could not be substituted for the term “labor.” For example, we read, “a smaller quantity of labor services will be demanded as the price that must be paid to obtain them goes up.”<sup>3</sup> If you substituted “pig iron” for “labor services” in that sentence, it would retain its meaning. Therefore in such a view labor is meaningless in itself; it is just another commodity. Nowhere in the text could you discover that labor, unlike pig iron, is the source of all economic values as well as the source of all capital. Nowhere would you discover that labor, unlike pig iron, has a variable rate of efficiency, one tied to its rate of compensation and the culture of the firm.<sup>4</sup> This is really not so surprising, since in this view labor is just another “commodity,” a factor of production, a means and not an end, and one hardly deserving of any separate treatment then would be received by any other factor of production as, say, a bar of pig iron. Labor as such is invisible in such a system, and

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<sup>2</sup> Paul Heyne, Peter Boettke, Dave Prychitko, *The Economic Way of Thinking*, 10th ed. (Delhi, India: Pearson Education (Singapore) Pte. Ltd, 2003).

<sup>3</sup> *Ibid.*, 275.

<sup>4</sup> See, for example, Adam Smith: “The wages of labour are the encouragement of industry, which, like every other human quality, improves in proportion to the encouragement it receives... Where wages are high, we always find the workmen more active, diligent, and expeditious, than were they are low... ” (*The Wealth of Nations*, I.VIII).

noteworthy only when it causes problems, such as strikes or demands for better conditions. Such a view of economics is clearly abstract and unrealistic, and unable to describe, much less predict, actual market and business conditions.

In fact, labor in neo-classicism is something to be eliminated, insofar as possible. We often hear that investment “provides jobs,” but this is not really an accurate description of what happens. The normal use of investment is to “economize” on labor; that is, to eliminate, downgrade, or outsource it. One grows rich by reducing the labor content of goods, not by increasing it. For example, if society devotes the work of one million laborers to producing all the widgets it needs, then one will grow rich if one has a method to produce the same number with half a million men. This is not all bad of course, but we must at least be able to accurately describe what is going on. It may be that the reduced cost of widgets will increase the market for widgets and absorb the laid-off workers, or that the capital freed up will find them new positions. But that is not a given and will lead at the very least to some temporary dislocations, and perhaps even permanent ones.

Labor is often treated as a very problematic machine, a resource that happens to be “human”, as the ubiquitous title of “human resources department” indicates. It is problematic because unlike other machines, it can rebel, join a union, call in sick, be insubordinate, etc. Much better to have a real machine than a human one. Recall that Malthus/Ricardo regarded labor as a

drag on the economy, a kind of thinking that is still prevalent. Labor is not regarded as a source of wealth, but as a competitor for it. What is missing from this view is an idea of labor as that which is at the heart of the values and purposes of an economy. Even if eliminating certain kinds of “toil” from labor is to be desired, labor by its true nature is a good.

### *The Absolutism of Property*

It is in the treatment of property that the Church’s position radically diverges from both socialism and capitalism. Both systems absolutize property, treating it either as an absolute evil (Marxism) or an absolute good (capitalism). The Church’s view avoids the twin evils of collectivism, which denies the private character of property, and of individualism, which denies the common good and common use of property. Since property has a *dual constitution*, neither socialism nor capitalism can provide a complete description of property. Again, many standard texts such as *The Economic Way of Thinking* do not delve into the nature of either property or of title to it; private property is merely an assumption, and an unexamined assumption, of the text. Under the individualistic assumptions of capitalism, property is an *unrestricted right* that can grow infinitely. Yet, if we consider the fact that certain forms of property, such as land, exists in finite quantities, it is appropriate to ask if it can accrue to a small group of owners infinitely without impacting the common use.

### *The Primacy of Capital*

The presumption of the primacy of capital is not always stated, but it is

always implicit; everything is ordered toward the concentration of capital, and people are constantly told that it is capital that creates jobs. The presumption is often made explicit in debates over tax policy, where we are constantly urged to lower marginal rates on capital income and place more of the burdens on labor income and consumption. But the presumption of the primacy of capital does not match economic reality. Summarizing the research of J. W. Kendrick and Theodore Schultz, John Mueller has noted that capital accounts for only one-third of economic growth, while human capital accounts for two-thirds.<sup>5</sup> Thus capital is not primary in the economy, but all depends instead on labor, that is, “human capital.”

The presumption of capital’s primacy confers political prestige and an economic power. In the naïve belief that capital is primary to growth, government policy applauds the concentration of capital in ever larger corporations, and often ignores its own laws by granting enormous privileges and favorable tax treatment. As Daniel Webster noted, “power naturally and necessarily follows property.” Webster’s law is inflexible; the concentration of property, whether in land or other capital, inevitably leads to concentrations of political power and an increase in oligarchic power.

### *Commodity Pricing for Wages*

No idea from Catholic Social Teaching seems as strange to “positive” economics than the just

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<sup>5</sup> John D. Mueller, *God and Money* (Washington D. C.: ISI Books, Forthcoming, 2006), 194.

wage. Indeed, as we previously noted, any discussion of wages in neoclassical economics is problematic, since a “wage” is just a special name for the price of one particular commodity, labor; if labor is a commodity, its price must follow the rules for other commodities. Hence it is no surprise then that *The Economic Way of Thinking* in a chapter on the “Distribution of Income,” finds that there really is no way to affect income distributions. “Because income isn’t really distributed by anyone, it can’t actually be redistributed. No one is in a position to apportion shares of the social product.”<sup>6</sup> This is, of course, a restatement of the “Iron Law of Wages” and it is contrary to actual experience. Distributions of income vary widely from culture to culture and country to country.<sup>7</sup> But mostly, this statement removes economics from the sphere of human freedom and intentionality. The positive economists identify the production half of economics as an arena of human creativity and effort, which is certainly true, but then imprison distribution in “un-freedom” and

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<sup>6</sup> Heyne, p. 285.

<sup>7</sup> There is extensive literature on this topic. See, for example, Daniele Checchi, and Cecilia Carcia, “Labour Shares and the Personal Distribution of Income in the Oecd,” 2., “Contrary to the textbook approach in macroeconomics where factor shares are taken to be constant, variations in the labour share across countries and over time are large.” Also, the measurements of inequality, such as GINI coefficients and top-to-bottom decile or quintile ratios vary widely. Naturally, economists of all persuasions fiercely debate the interpretation of these data, but however one decides the issue, it is certainly not as intuitively obvious as the authors of *The Economic Way of Thinking* believe it to be.

constrain it by laws as iron clad as those laid down by Malthus and Ricardo, laws which have failed the test of empirical verification for 200 years. Whether or not these laws are true, they leave one with a profound sense of disappointment. Why, if half of economics is creative, must the other half be iron-bound and servile? Distribution is half of economics; there is something unsettling about saying that we can do nothing about half of the “science.” Wages form the bulk of demand; it is somewhat mysterious how one can understand the demand distribution without understanding the distribution of incomes, which for the most part for most men means wages.

#### *“Limited Government”*

No other principle is so firmly enshrined in rhetoric and so routinely ignored in practice as is the principle of limited government. We witness “conservative” administrations vastly expanding the power, reach, and cost of government. But this is not new. Since the growth of mercantilism/capitalism in the 16<sup>th</sup> and 17<sup>th</sup> centuries, government has always grown with the corporate world. This is less surprising than it seems. As wealth accumulates into fewer and fewer hands, so does power, and power always seeks advantages for itself, advantages which can be best obtained from a large and powerful state apparatus. Capitalism thus catches democracy in a conundrum: the more wealth it produces, the more it concentrates power, and the more power is concentrated, the more true democracy is weakened. Thus the Church’s warnings on the

concentration of property have a political dimension as well.

#### *Individualism*

Both solidarity and subsidiarity look to some shared notion of the common good in both the vertical and horizontal relationships within society. But capitalism takes no note of the common good, at least not directly; all “social” values are merely the summation of individual choices, choices made not for the common good but for private utility. In such circumstances, the very notion of a “common good” becomes problematic at best, and a matter of marketing at worst. Capitalism is built on the values of the Enlightenment, values that presupposed the individual as the measure of all things and ignored the person, the “individual-in-relationship.”<sup>8</sup> This flattens all social relations and “privatizes” all values. There is nothing between the individual and the government, and the richly textured social fabric of intermediate organizations is reduced to a series of lobbying interests.

### **Criteria for an Ethical Economics**

Before we can find a way to reconcile the tensions we have just noted, we must examine the questions that are posed by economics— any economics— and establish some criteria for judging the answers that a particular economic theory might give. Without such criteria, it is simply impossible to think about economics in an orderly or disciplined way.

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<sup>8</sup> See Chapter Two.

### *The Economic Problem*

*What is Economics?* “Economics is about social provisioning, or how societies provide for their material reproduction.”<sup>9</sup> This definition deals with a more basic problem than do the more common definitions of economics, which generally involve “the allocation of scarce resources among alternate uses.” Resources must be allocated, but such definitions leave out the purpose of these allocations. Further, the neoclassical definition biases the conversation in favor of “scarcity” rather than abundance; but the whole purpose of resource allocations—the whole reason for economizing—is to allow for a relative abundance. It is the means (resources) which may be scarce, but not necessarily the ends. We will take up the question of scarcity and abundance in relation to means and ends in a later chapter. For the moment we can note that the more basic question involves social provisioning. In answering this question, we must deal with three further questions: What to produce? How to produce it? To whom should the benefits be distributed?<sup>10</sup>

*What to produce?* What a society produces is a direct reflection of its dominant values, or at least of the values of those who dominate society. It would seem that some things *need* to be produced and are therefore *natural* and beyond cultural considerations. But while things like food, clothing, and shelter are necessary, the form

they actually take is always cultural. For example, we must eat to live regardless of what language we speak, but what we actually eat—spaghetti, or egg foo young, or hamburgers—is always a cultural product.

*How to produce it?* This is a question both of human technology and abilities. There must be a means of assigning tasks, something which normally has a large social content. For example, tasks will be assigned at least partially on the basis of education, but who gets educated and who doesn't is largely a social decision.

*To whom should we distribute the product?* This question has both discretionary and necessary aspects. Certainly the product must be divided so that enough members of society can subsist and reproduce the next group of workers. Beyond that, distribution has strong discretionary elements. Normally, the actual distributions will depend on the values of the society at large, or perhaps will reflect the values only of the ruling class. The solution is largely a matter of power relationships rather than of some “pure” economics.<sup>11</sup>

### *Solutions: Tradition, Command, and Market*

The answers to the questions of social provisioning can come from three sources: Tradition, Command, or the Market.<sup>12</sup>

*Tradition:* The past guides the present: What to produce this year is guided by what was produced last year; sons follow their fathers'

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<sup>9</sup> Charles M.A. Clark, "Catholic Social Thought and the Economic Problem," (2005), 1.

<sup>10</sup> Ibid., 2.

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<sup>11</sup> Ibid., 4.

<sup>12</sup> Ibid., 4-5.

professions. There is little change and less freedom. All three questions are answered, but answered, as it were, “in advance” and with little option for growth and change.

*Command:* Command economies rely on some central authority to provide all the answers. While this ensures that all the questions are answered, the quality of such answers may be open to some doubt, especially if the values of the planners are at odds with the values of society at large. The planners can be seeking either the interests of the common good or their own interests. Nevertheless, economies heavily dependent on command have functioned successfully and left behind great monuments such as the pyramids or the medieval cathedrals.

*Market:* The forces of supply and demand dictate the answers, with each individual responding to price signals in order to maximize utility. In this way, it is believed, the market is self-organizing and capable of creating order out of chaos. But as Charles Clark has noted:

This is the myth of the market. Markets are not natural phenomenon, but are socially created. In the real world the market mechanism is best at dealing with small changes to an already existing economic order, providing the signaling function of adjusting relative prices so that a small number of market participants can adjust their behaviour. Markets, however, cannot generate this order. All markets are social institutions, embedded in particular societies and in history. They have rules of behaviour, laws and customs. These come from tradition. Also they have property rights and methods for

enforcing these rules and customs. These come from command. Without the proper context, markets are inefficient and chaotic, as Russia is currently demonstrating to the world.<sup>13</sup>

Clearly, the markets do not generate order, but are based on a pre-existing social order which they then help direct. But they can also help to destroy that order. Indeed, the assumption that all things can be based on self-interest destroys the very basis of virtue which is presumed by the market. A pure market system has never been attempted, because it cannot be attempted; Markets require fully socialized and ethical participants in order to function. It is no accident that as the force of custom and virtue diminishes, the role of law— and lawyers— increases. So too does the role of politics and bureaucracies; Force, legal or political, must replace the virtues that a “pure” market system helps to undermine.

### *Values: Normative and Positive Economics*

Some wag somewhere has said that “scientific” economists suffer from physics envy. And indeed, many economists lay claim to a “positive” or “value-free” view of economic relations based purely on precise measurement and complex mathematics, just like physics. But astrology is also based on precise measurement and bewildering mathematics; its status as a science— and its relation to reality— is not thereby established. Economists may bristle at the comparison, but it is clear that math and measurement are

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<sup>13</sup> Ibid., 4.

insufficient to establish a science. In the first place, mathematics is not an empirical science; it is a set of formal and idealized relationships and indifferent to any particular reality other than its own axioms. There is nothing in economics that is driven by a mathematical logic: time, money, culture and uncertainty prevent this.<sup>14</sup> The *homo economicus*, the “pure” economic creature, simply does not exist, and were we to meet such a creature, we would regard him as grotesque.

In the second place, measurement itself depends on theory and all theories require value judgments. For example, in measuring unemployment, the economist must...

... first start by making the decision that it needs theoretical explanation and second [he] must define what unemployment is, both of which are blatantly value-laden (and political) activities. Furthermore, the choice of what methods to use to investigate this phenomenon also involves value judgments, as does selection of the critical criteria about what will be accepted as the “final term” in the analysis, the bases of what arguments will or will not be accepted. However, values and value judgments enter into theory construction on the ground floor by giving the theorist the “vision” of the reality s(he) is attempting to explain. This “vision” is pre-analytical in the sense that it exists before theoretical activity takes place.<sup>15</sup>

Neoclassical economics are therefore, like every thing else human, value-laden; it cannot be a question of

a false dichotomy between “values” and “facts.” Rather, it is a question of examining the values by which the facts are explained or even perceived. That will be the burden of the next chapter.

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<sup>14</sup> Ibid., 6.

<sup>15</sup> Ibid.

## Chapter 10: Towards an “Evolved” Capitalism

### Economism

#### *What’s Love Got to Do with it?*

The primary value of neoclassical economics is expressed by the term “economism,” the reduction of all possible social values to economic ones. For example, *The Economic Way of Thinking* is fairly typical of much economic literature in claiming that all economic thought is derived from one fundamental presupposition, “All social phenomena emerge from the actions and interactions of individuals who are choosing in response to expected additional benefits to themselves.”<sup>16</sup> In other words, at the heart of all human interaction is selfishness, the benefit to oneself. The text goes on to *deny* that this constitutes selfishness,<sup>17</sup> but offers no further explanation of why it shouldn’t be so called. The text further explains that everything from rush hour traffic, to charities, to government bureaucracies, to the operations of IBM can be explained by economics.<sup>18</sup> The authors claim that all persons “choose their actions on the basis of the net advantages they expect.”<sup>19</sup> The authors also claim that they “[do] not deny the reality or importance of generosity, public spirit or any other

virtue,”<sup>20</sup> but they do not explain how these fit into their theory.

The authors also fail to justify the presupposition of self-interest; it is to be accepted as an article of faith. But at least one economist has attempted to give a better explanation of the thesis that reduces all possible human actions to their utility. This economist was Ludwig von Mises, who attempted to raise this utilitarianism to the level of a serious school of philosophy which he called *Praxeology*, a philosophy he explicates at great length in his tome *Human Action*. Mises is attempting to reduce all human activity to marginal utility. Recall that with the discovery of marginal utility, economists had a powerful analytic tool which they felt moved their discipline from the realms of philosophy to those of pure science. The founders of the marginalist revolution were motivated by the need to find a useful term in the mathematics, one that would allow them to construct powerful economic formulae. However, it is an open question as to how far these models could claim to represent all possible economic relations. Mises attempted to solve this problem by rooting marginal utility neither in mathematics nor even in the physical world *per se*, but in the very structure of human action; that is to say, it becomes a psychological principle. If marginal utility can be shown to be the sole determinant of human action, then everything human can be explained by

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<sup>16</sup> Heyne, *The Economic Way of Thinking*, 4.

<sup>17</sup> *Ibid.*, 5.

<sup>18</sup> *Ibid.* It is interesting that neoclassical economists claim the ability to explain all other social phenomenon, but bristle when other social professions attempt to comment on economics.

<sup>19</sup> *Ibid.*, 7.

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<sup>20</sup> *Ibid.*, 5.

marginal utility, and the whole social world falls under the dominion of economics.

Mises starts with the thesis that all human action results from uneasiness or discontent.<sup>21</sup> He assumes a “methodological individualism,”<sup>22</sup> which isolates all human actions from their social context. As Mises puts it, “The hangman, not the state, executes a criminal.”<sup>23</sup> Mises then assumes that all of our actions are marginalized in that we attend to our most urgent need first and, having satisfied that, move on to the next most urgent need, etc.<sup>24</sup> Actions must be marginalized because means are always limited;<sup>25</sup> that is to say, we always want more than we have. From this “principle,” which is taken as self-evident, Mises goes on to derive all possible supply and demand curves and thus establish classical liberalism on a “self-evident” psychological foundation; after all, if human action is governed by marginal utility, then everything human must also submit to the marginal utility. Utilitarianism is all.

*Human Action* is indifferent to questions of human will and motivation. Delving into the will “would not add anything to our knowledge,”<sup>26</sup> while questions of motive simply do not affect the theory.<sup>27</sup> And yet, one wonders how one can adequately deal with human

actions apart from human will and motivation. However, the theory does *in fact* take account of motivations, but assumes that *all* motivations are the same, namely to maximize benefits to oneself. All actions, according to the theory, begin in discontent, proceed through evaluating scarce means, and terminate in actions intended to increase personal benefits. However, this turns out to be both circular logic, unrelated to actual experience, and unnecessary in any case. It is circular because it *assumes* what it intends to prove, namely that all human action is dependent on marginal utility; this may or may not be true, but it must be demonstrated rather than presumed *a priori*. Nor does the theory square with the facts of our daily experience. Everyone who has an important paper to write or client meeting to prepare for, yet sits on the couch zoning out in front of a tired TV re-run, recognizes instinctively that human motivations are complex, multi-layered, dense, and often impenetrable even to the person himself. The diligent Praxeologist will no doubt respond that at that particular moment, leisure was more “useful” than work. But if this is true, it is trivially true; if “utility” merely means we do whatever we do, it cannot enlighten us as to the source or structure of human action; if we cannot say why one action was more “useful” than another, we cannot give an account of human action solely in terms of utility.

In any case the theory is unnecessary for establishing the validity of marginal analysis; marginal utility is a physical principle, not a psychological one. It arises from the finite nature of the physical world. All physical processes, because they are

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<sup>21</sup> Ludwig von Mises, *Human Action: A Treatise on Economics*, 4th Revised ed. (San Francisco: Fox & Wilkes, 1963), 13.

<sup>22</sup> *Ibid.*, 41.

<sup>23</sup> *Ibid.*, 42.

<sup>24</sup> *Ibid.*, 120.

<sup>25</sup> *Ibid.*, 93.

<sup>26</sup> *Ibid.*, 13.

<sup>27</sup> *Ibid.*, 21.

finite, tend to be non-linear at some point. We add a spoonful of sugar to our coffee and stir. The electro-chemical bonds in the coffee take up similar bonds in the sugar and the sugar is dissolved. We add a second spoonful, but now there are not as many unoccupied bonds, so less of the second spoonful gets absorbed. We add a third spoonful, but now there are few bonds left, and the majority sinks to become a sludge at the bottom of the cup. Marginal utility can explain why the third spoonful adds less sweetness than the first, but cannot tell us why anybody chooses to add that third spoonful. And failing to explain this very human action, it fails as a theory of human action. Human actions are far more complex than physical processes and demand more from the philosopher and the psychologist than a simple reductionism.

Working from a dubious principle to an unnecessary conclusion, Mises thinks that he has made economics “scientific” and immutable, the product of unchangeable laws as solid as those which dictate the movement of the stars. Indeed, Mises claims that Praxeology has the same epistemological status as do logic and mathematics, stating that it is “unconditionally valid for all beings endowed with the logical structure of the human mind.”<sup>28</sup> But what has actually happened is not that human action is explained by a comprehensive theory, but that human action is flattened to conform to a narrow ideology. It is not a question of excluding utility from human action,

for that will always be a factor, a part of the density of relations and motivations; rather it is a question of mistaking the part for the whole; the whole range of possibilities for human action are reduced to utility, scarcity, and personal benefit and all other considerations excluded.<sup>29</sup> People do indeed marginalize their actions according to utility, such as when they rank the items on a “to-do” list in order of importance; but this prioritizing is always the result of training, discipline, and character, and not something necessary, inevitable, and automatic.

Mises excludes the one question that would make the subject both interesting and useful, namely, the question of why some things are more useful to us than others. The real question here is why we love some things rather than others, since it is only love of one sort or another that makes anything “useful.” Answering this question will lead us in quite a different direction and should have a different impact on the way we model economic behavior. Ultimately, what this Economism represents is a confusion of means and ends, or even a priority of means (things) over ends (persons). Mises takes a principle that properly applies to things and applies it to persons. This confusion can distort even obvious economic truths

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<sup>28</sup> Ibid., 57.

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<sup>29</sup> This, by the way, is the normal course of philosophic error. It is ordinarily not a question of being absolutely wrong, but of being relatively right. Every thinker starts with some truth; indeed, it is difficult for humans to start anyplace else, aside from cases where actual malice or deliberate deceit is involved. The error comes in taking the small truth and making it stand for the whole of truth.

into palpable falsehoods. Take, for example, the case of scarcity.

*Scarcity, or “Can there ever be enough to go around?”*

Scarcity is the most obvious and self-evident economic principle: we live in a finite world. Indeed, scarcity is what makes economizing necessary.<sup>30</sup> However, when ends and means are confused, scarcity itself becomes not something self-evident, but something evidently false.

Let me illustrate with an anecdote. When I was a boy in New York City, we lived in an old brownstone apartment on Manhattan’s west side. We did not have a car; indeed there was only one person who owned a car on the whole street. And anyway, the street wasn’t all that amenable to cars, being cobblestone. However, for 15 cents one could buy a subway token, and for that fee the cultural and recreational wealth of New York City was ours, even as small children. My brother and I loved to go to the American Museum of Natural History to see the great skeleton of Tyrannosaurus Rex that dominated the lobby, or the great blue whale that hung in the basement. Or we would go to the Metropolitan Museum of Art and see the armor exhibit, with knights in shining armor mounted on steeds covered in steel plate, lances lowered so that, when you entered the room, they looked like they were charging directly at you. Or for the same fee, we could go to the beaches at Coney Island or Far Rockaway. We were indeed men of the world at the age of seven. But mostly, we were

independent; we were free. It was a poor neighborhood, but we were rich in cultural and recreational resources. By contrast, my children grew up in an affluent suburb in Texas. Everybody on the street had at least two cars, but my children had very little transportation. The means of transport were not available to them independently, and hence parents and children were bound together in a relationship similar to that of a lord and his chauffeur; both children and parents lost some of their freedom. It was perhaps good that there so few places to go, and that the major cultural resources were the mall and the movie theater.

In one case, there was a scarcity of means and an abundance of ends (transportation), and in the other an abundance of means and a scarcity of ends. In one case, cars were scarce and transportation abundant, and in the other cars were abundant and transportation scarce. Properly considered, scarcity should apply to means, not ends. If we reverse the terms, we end up manufacturing our way into scarcity, and an expensive scarcity at that. In place of robust systems designed according to some notion of the common good, we have narrow systems designed from the premises of individualism which always make the ends, transportation in this case, more problematic, and more problematic the more you invest in them; we spend huge sums of public money on systems that limit access rather than expand it. This same pattern of spending ourselves into scarcity can be seen education, health care, the military, etc. Expenditures for higher education increases while access to college

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<sup>30</sup> Heyne, *The Economic Way of Thinking*, 5.

declines, for example. What is lacking is a purpose, a *telos*, that is to say, a vision of the common good, and a proper distribution function informed by that vision.

### *The Economic Stork*

The methodological individualism of neoclassicism shifts the focus of economic thought from the family, where it rested in Aristotelian and Scholastic economics, to the individual. However, the individual, by himself, is sterile and not a self-sustaining entity. Neoclassicism thus has no way to explain how new workers come into the economy and hence it has no way to explain growth. John Mueller has characterized these shortcomings in economics as “The Economic Stork Theory” (EST). In the Economic Stork Theory, workers arrive in the economy fully grown, fully trained, and fully socialized. These stork-borne workers are a “given”; that is, there is no way to explain the growth in workers or their level of training and socialization, and hence little reason to support them with political or fiscal policies. Mueller describes the theory as follows:

I call this the Stork Assumption, since it literally means that adult workers spring from nowhere, as if brought by a large Economic Stork. Under the Stork Assumption, the accumulation of workers’ tools—buildings and machines—is the only possible source of economic growth that can be affected by policymakers. Moreover, under these assumptions the total tax burden not only should, but inevitably must, fall entirely upon the incomes of workers (who by assumption cannot avoid such taxes by having fewer or less-educated children, though property owners are assumed

able to avoid taxes on property income by investing less in property). The Stork Assumption, not economic theory, underlies the perennial proposals to abolish taxes on property income, which are advocated by a cottage industry of (mostly my fellow Republican) economists centered in Washington, D.C.<sup>31</sup>

As a corollary to the Economic Stork Theory, the only “useful” work done in the economy is work done for wages or other economic rewards, and hence there are only two kinds of human activity, work and leisure. Hence, there are only two kinds of Individuals in this theory: *Partially Useful Individuals* (PUIs) and *Totally Useless Individuals* (TUIs).<sup>32</sup> The PUIs are partially useful because they spend some of their time at “work” producing things in the money economy. The TUIs, however, don’t “work” at all. Rather, some of the TUIs, otherwise known as “mothers,” spend their time in such leisure activities as taking care of the household pets; some of these pets are called “cats” or “dogs,” and others are called “children,” another form of TUIs.

Since the standard of living in the EST is the result of a positive capital-to-labor ratio, increasing the number of PUIs does not increase the standard of living unless the amount of capital is increased by at least an equal amount. In other words, you can increase the standard of living by decreasing the number of people, or at least slowing the growth of the population. Therefore the crucial element in growth is capital, and people are problematic. The policy

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<sup>31</sup> Mueller, *God and Money*, 75.

<sup>32</sup> *Ibid.*, 184.

implications are that capital should not be taxed, only people, in the form of labor or consumption taxes. This will help to discourage the formation of new PUI/TUIs, while raising the capital-to-labor ratio.

Mueller points out that the EST’s most glaring error is the failure to recognize that the family is the basic economic unit. And within the family, the choice is not so much between work and leisure as it is between production for exchange and production for immediate use. Of course, economic theory simply has no way to account for production for use, even though it is actually the whole point of production for exchange; we work to provide money to buy meat and potatoes which we then use to produce dinner. Production for use does not show up in the GDP, but in fact the GDP presupposes such production. What the TUIs known as “mothers” are doing is crucial not just to the continuation of the economic system, but to the continuation of civilization itself. There is no economic growth without mothers and the job they do. Moreover, the social shifts of the last 50 years have moved us away from production for use to more production for exchange. Now, one may debate as long as one likes the soundness of this move into the workplace in terms of, say, women’s liberation. But as the feminists point out (quite rightly), if mothers were paid a salary for everything they do, they would earn a hefty salary indeed. But the attempt to monetize the work of mothers, to convert it from production for use to production for exchange, is futile and leads to endless debates that have no possible resolution. There simply isn’t enough

money to replace what mothers do everyday. The transfer of work from use to exchange does indeed show up as an “increase” in the GDP, but not as an increase in any actual output of goods and services, and likely involves an actual *decrease* in such services and in their quality. Do day care centers really provide the same level of “care” as does a family? Do fast-food stands really substitute for family meals?

Moreover, the policy implications are obvious. Differential rates of taxation between capital and consumption (or labor) misallocate resources and send the wrong signals. If you have the good fortune to be a robot, your “income” would be calculated by deducting the costs of your production, maintenance, and depreciation from your net receipts. But since you are merely a human, these expenses are treated with contempt by the taxing authorities and by the economic theories on which they rest. A robot reading this book can deduct the cost from his net; alas for the mere student it is a consumption item, and will get no favorable tax treatment.

### *The Distribution Function of Wages*

The commodification of labor is the most glaring and economically untenable example of the confusion of means and ends. The Liberal economists are certainly correct when they point out that labor, like any commodity, has a market clearing price fixed by supply and demand; hence, all unemployment is voluntary. However, price is not an absolute, nor is it determined absolutely by supply and demand, even in our own “free-market” economy. Rather, it is an allocation method influenced by a

number of factors. Recall the “just price” theories of the scholastics and how they actually functioned in the Middle Ages through the guilds and a combination of market forces and social regulations. This was not an invention of the Middle Ages, but something that occurs naturally and always occurs to some extent. Since there are no “pure” market systems, there are no “pure” market-wage systems.

One implication of the fact that prices are part of the allocation system is the conclusion, intuitively obvious, that wages are the part of production allocated to the workers; indeed, wages form the bulk of demand in a capitalist society; through its wages, labor is expected to clear the market of the bulk of goods. But how can one commodity—priced as a commodity—be expected to clear the market of all other commodities? How could the monies received for *any* single commodity, let’s say wheat, clear the market of all other commodities? Herein lies the central conundrum of Liberalism that Chesterton noted:

When most men are wage-earners, it is more and more difficult for most men to be customers. For the capitalist is always trying to cut down what his servant demands, and in doing so is cutting down what his customer can spend.<sup>33</sup>

Of course, output is distributed not only by wages, but by rents, interest, and profits, that is, by “factor shares.” However, the factor shares for interest and profit get distributed for the most

part to a small group; most men and women get their incomes from wages. In 1998, 17% of income went to 1% of the families, with a further 40% to the next 19%. That gives 57% of the income to the top 20%, with the remaining 80% of the people to split 43% of the total income.<sup>34</sup> This 43% of the total income is not enough to purchase all the goods and services we produce, or even 80% of it. To keep the economy going, workers must spend as much as they can. Here we see the thrift paradox; if people stop spending and start saving, will there be a shortage of consumption?

The economy requires a transfer of purchasing power from the top to the bottom (or at least to the middle). This has been understood for some time. Two methods are Keynesian transfers (welfare) and consumer credit. The former implies a “nanny state” with burgeoning bureaucracies and re-distributive taxes; it tends to make each person a “client” of the state rather than a citizen. But consumer credit carries an obvious contradiction when used as a transfer mechanism to sustain consumption. Consumption can be increased by a borrowed dollar today only by decreasing consumption by that same dollar—plus interest—tomorrow. This increased debt burden requires even larger transfers via credit and a vicious cycle is set up. This is the classic ponzi-scheme.<sup>35</sup>

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<sup>34</sup> Edward N. Wolff, *Top Heavy: The Increasing Inequality of Wealth in America and What Can Be Done About It* (New York: The New York Press, 2002), 8-17.

<sup>35</sup> A “ponzi-scheme” is an investment swindle in which high profits are promised from fictitious sources and early investors are

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<sup>33</sup> G.K. Chesterton, *The Collected Works of G.K. Chesterton* (San Francisco: Ignatius Press, 1987), 59.

*The Utopia of Usurers*

There can be little doubt that the American economy is addicted to debt, both in its public and private accounts. Without this debt, the economy would simply contract, perhaps disastrously. Our international debts require that we borrow \$2 billion/day to finance our consumption. America is now a debtor nation, and foreign nationals and governments now have a great claim on our goods and productive resources. This gives them tremendous leverage in dealing with the United States.

Debt is therefore at the heart of our distribution system, a fact which should lead to serious reflection on the nature of debt and the advisability of using it as a transfer mechanism. Yet there has been very little reflection on the nature of debt, and especially on the subject of *usury*. This is somewhat odd, given our addiction to debt, and especially since discussions of usury were a staple of economic analysis up until about 100 years ago. Usury has typically been prohibited or restricted in most societies. Today, however, these restrictions are considered primitive and outmoded. Nevertheless, in light of our present predicament, it may be well to re-examine the theory.

The definition of usury tends to shift with the culture. In some places and times, it was *any* interest whatsoever, in others it was interest on non-productive loans, and most recently it was simply excessive

interest.<sup>36</sup> At the heart of all of these definitions, however, was the notion that nobody should make something from nothing. That is, you should not be able to make a profit without producing something of value, without increasing society's stock of goods and services. To do so is to "use up" the social stock rather than increase it, hence the name "usury."

The most sophisticated discussions of usury come from St. Thomas Aquinas and the Scholastics. This analysis has been relegated to the realm of religious superstition by most economists, but the questions they raise cannot so easily be disposed of. One economist who realized its value was Lord Keynes, who said,

Provisions against usury are amongst the most ancient economic practices of which we have record. The destruction of the inducement to invest by an excessive liquidity preference was the outstanding evil, the prime impediment to the growth of wealth, in the ancient and medieval worlds... I was brought up to believe that the attitude of the Medieval Church to the rate of interest was inherently absurd, and that the subtle discussions aimed at distinguishing the return on money-loans from the return to active investment were merely Jesuitical attempts to find a practical escape from a foolish theory. But I now read these discussions as an honest intellectual effort to keep separate what the classical theory has inextricably confused together,

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paid off with funds raised from later ones. It is named after Charles Ponzi, famous for organizing such investment schemes.

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<sup>36</sup> For a good survey on the history of the notions of usury, see D. Stephen Long, "Avarice as a Capital Vice," (2005).

namely, the rate of interest and the marginal efficiency of capital.<sup>37</sup>

Usury for the scholastics was not merely interest, but interest on a non-productive loan. What they were attacking was wealth without work. Consider the case of someone who lends his neighbor a cow. The cow produces milk and perhaps a calf, and the lender has a right to some portion of this produce. The cow “fructifies”, produces something. Compare this with money. Money does not “fructify,” and charging interest on it is getting something for nothing.

However, money combined with human work can fructify, and the lender then has a right to collect a share of the profits. In other words, lending as an investment in some productive enterprise is entitled to share in the profits of that enterprise, since it also shares in the risk. Loans will then be liquidated by the success of the enterprise, or will be written off with the failure of the enterprise. But in either case there will be no additional burdens on the stock of society, hence no “usury,” that is, no “using up” the stock of society. But if the loan produces nothing, then nothing can be charged for the loan, or else it is a simply wealth transfer rather than real growth. The scholastics also recognized the right to receive compensation for certain “externalities” of money, namely for risk and the loss of the use of the money. But beyond these legitimate claims, usury is simply a transfer of wealth from one class to another that

produces nothing of itself: It is wealth without work. This is especially true of consumer loans. They are merely a claim against future earnings without contributing to those earnings. An economy that depends on consumer lending to fuel consumption is in fact merely borrowing from consumption in future periods.

Usury, aside from its character as avarice, as the desire for wealth without work, has troublesome practical consequences as well. On the one hand, it “covers up” problems in the distribution system, that is, with the allocation of factor shares. If we did not inject massive amounts of consumer credit, there would be a massive failure of demand and the problems of factor shares would become apparent to all. As it is, these problems are hidden and will remain so until the ponzi-scheme collapses (as it must), as it does in depressions. On the other hand, usury detracts from the amount of capital available for productive investments; the absurdly high rates of interest make investment in production less attractive than investments in financing consumption.

The problems associated with usury and with the mounting debt are likely to be the major concerns of the next decade. The solution is to find real growth, not just a growth predicated on short-changing the future. So what is the source of real growth?

## **Personalism**

### *Self-Interest vs. Self-Respect*

We have seen how the assumption of man as a pure “utility-maximizer” leads to an anthropology which treats a man’s deepest aspirations and most

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<sup>37</sup> John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (San Diego, New York, London: Harcourt, Inc., 1964), 351-2.

basic relations as mere calculations of individual benefit. Even love and sex must be reduced to computations of costs and benefits, while family life itself, the very origin of man, is treated as no more than an exchange of utilities. Indeed, the primary anthropological assumption of utilitarian economics has not changed since Mandeville’s *Fable of the Bees* in 1724; but as Robert Faulhaber notes:

The transformation of the water of “self-interest” into a wine of public interest [is] a fake miracle. No matter how free markets and society might be, they cannot make individual perversities add up to a total good... the apparent success of market civilization depended... on an endowment of ethical and institutional capital which it steadily consumed and, in the nature of the case, cannot replenish... In addition... the countervailing motive of self-sacrifice has gradually lost its status and force. Simple selfishness as “self-interest” has become generally acceptable and expected behavior and its opposite an object of suspicion.<sup>38</sup>

Faulhaber points to the importance of “ethical” and “institutional” capital without which the market cannot function. Neoclassical economics rarely recognizes the importance of these and in any case has no way to account for them in a “positive” science; after all, what dollar value would one put on honesty or on fair dealing? Yet without an expectation of honesty in the market, the market cannot function. The same author also points to the importance of self-sacrifice

without which no family, city, or society could prosper.

The main reason that a pure self-interest cannot add up to a public good is that it cannot add up to a private good. Self-interest is not something known in advance. It is, rather, *discovered* through the process of living and interacting with other. Rarely do we know with any degree of clarity where our self-interest lies. For example, does our self-interest lie with immediate or delayed gratification? Well, sometimes with the one and sometimes with the other; it is usually impossible to say until *after* the choice has been made. Self-interest is particularly inappropriate when conceived of in terms of “utility maximization,” the starting point of neoclassicism. This is because our needs are ordered and complex and the term “maximization,” which implies a numeric ordering, simply does not apply. It is true that we have purely physical needs which lend themselves to a numeric calculation. But our higher order needs, needs such as love, professional recognition, and self-actualization, are never a matter of quantity but of intensity<sup>39</sup>; for example, every man needs love, but a man’s “love-utility” (so to speak) is not maximized quantitatively by having a harem, but intensively by learning to love one woman ever more intensely. But this love is never subject (*pace* Becker and Posner) to a calculation of self-interest; as soon as it is, it ceases to be love and therefore ceases to have utility.

Nevertheless, it would seem to be very difficult, or even naïve, to drop

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<sup>38</sup> Robert W. Faulhaber, “The Rise and Fall Of “Self-Interest,”” *Review of Social Economy* LXIII, no. 3 (2005): 418.

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<sup>39</sup> See page 8.

the premise of a pure self-interest. It is undeniable that when we go into business we hope to gain some advantage for ourselves, some advantage that might not be obtainable when working for another. And as businessmen, we certainly hire others hoping thereby to benefit ourselves. Are we thereby stuck with the premise of utility maximization and with its grim anthropology?

Some economists would handle the problem by limiting the scope of self-interest to the business world<sup>40</sup> while reserving altruism for the home and other places. Yet this requires a bifurcated man, one who operates under contradictory sets of motives depending upon his location. Further, it requires a bifurcated economics, since the family, no less than the firm, is also an economic entity, or at least an entity with economic aspects. We seem, then, to be caught in a dilemma: either we surrender to a purely utilitarian anthropology or we divide man into pieces and parcel him out by time and place. Neither solution seems palatable. To escape the dilemma, we need a term that includes, yet transcends, self-interest. That term, suggests Robert Faulhaber, is *self-respect*.

Self-respect includes self-interest because every self-respecting person takes care of himself and his family; he does not allow them, if it is in his power, to become a charge on the charity of others nor fall below a certain level. By the same token, a self-

respecting person does not allow himself to be dominated by egotism or by mere things (consumerism). Self-respect allows us to give due consideration to the higher-order needs, that is, our need for love and belongingness, for competence and professional mastery, for independence and freedom, and finally our need for the pursuit of aesthetic beauty and knowledge as ends in themselves.

The indignant Praxeologist might respond at this point that these higher level needs can be described in terms of self-interest, but that is not really correct; indeed, the methodological individualism of the utilitarians presumes an egotism that “leads every individual to make more of himself than of any other [and] causes all the mutual damage that men inflict upon one another.”<sup>41</sup> The self-respecting person, on the other hand,

Takes nothing from others since he is the incarnation of the universal in himself. That he loves and desires in himself as well as in others, whereas the egotist loves only himself, or better, the self which others can be made to see.<sup>42</sup>

Self-respect, unlike self-interest, allows us to perceive and act on a common good, without which civil society is impossible. Self-interest proposes an alchemy that transforms private interest into public interest by a mere arithmetic summation, but this alchemy simply does not work. The issue here may seem unnecessarily “philosophic,” but in fact it is closely related to both economics and business

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<sup>40</sup> Robert H. Nelson, *Economics as Religion: From Samuelson to Chicago and Beyond* (University Park, Pennsylvania: The Pennsylvania State University Press, 2001), 280.

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<sup>41</sup> Faulhaber, “The Rise and Fall Of “Self-Interest,”” 421.

<sup>42</sup> *Ibid.*

practice. “Self-interest,” conceived of in terms of “utility maximization,” lies at the heart of all utilitarian economics and such economics are impossible without this assumption. Any economic system serves what is perceived to be the good of the person. If that “good” is conceived of in merely numeric and subjective terms, the higher order goods, as well as the common good, are likely to get short shrift or be ignored entirely. This is an economic tragedy, because it is the human person who is the source not only of all “spiritual” values, but all material and economic values as well. For at the heart of economic growth and prosperity stands not capital, but the human person.

*The Source of Economic Growth:  
Persons*

The economic policies fostered by neoclassical models tend to regard the creation of capital as the main source of growth. Indeed, at the current moment we are witnessing efforts to increase capital by shifting the entire tax burden to wages and consumption, on the neoclassical theory that capital investment drives growth. However, this assumption was challenged some 40 years ago by Theodore Schultz who noted that the neoclassical model could, at best, account for only one-third of the growth we actually witness.<sup>43</sup> As Schultz put it:

The income of the United States has been increasing at a much higher rate than the combined amount of land, man-hours worked, and the stock of reproducible capital used to produce the income. . . . To call this discrepancy a measure of 'resource

productivity' gives a name to our ignorance but does not dispel it... Unless this discrepancy can be resolved, received theory of production applied to inputs and outputs as currently measured is a toy and not a tool for studying economic growth.<sup>44</sup>

Where does the other two-thirds of growth come from? Schultz offered the hypothesis that missing growth came from “human capital,” the growth in the population and in their skills. Thomas Kendrick was able to verify Schultz’s hypothesis and showed that “human capital,” the rearing of children and education, accounted for 63% of growth, intangible capital (research and development) accounted for 5%, and tangible capital for 32%.<sup>45</sup> Note how well this fits in with the Church’s teachings that it is the worker that is the source of all wealth and capital the mere instrument, precisely the opposite of what neoclassical theories teach. Indeed, people are problematic in neoclassical economics. In neo-classicism, productivity increase is a function of the increased ratio of capital to labor. The more workers you add, the lower the ratio becomes unless you can add capital faster than workers. Hence, “people,” the only legitimate object of any economy, become problematic at best. Based on these false notions of growth, we see a concentration on population control policies especially for developing countries; our sages will venture into the most thinly populated places, such as Africa, declare them overpopulated, and start passing out condoms and birth control pills.

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<sup>43</sup> Mueller, *God and Money*, 75.

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<sup>44</sup> Quoted in *Ibid.*, 190.

<sup>45</sup> *Ibid.*, 193.

These, combined with the bizarre investment strategies of the World Bank, do indeed lead to increased capital to worker ratios, but they also lead to increased poverty and a reversion to tribalism.

We can think about this problem by reflecting once again on the situation of our 10<sup>th</sup> century farmer on the cusp of the medieval agricultural revolution.<sup>46</sup> It was not an increase of capital that brought about this revolution, for the amounts of capital involved were trivial, even by the standards of the time. Rather, it was the action of the serfs in experimenting with dozens of small changes that produced the wealth that fueled the next four centuries of growth. And these changes were themselves enabled by a change in the land system which allowed the serf to keep the greater part of his output. It was not the return to capital that was crucial, but the return to labor. In fact, capital was forced to accept a smaller share, albeit of a much larger output.

Clearly, economic growth requires an investment in child-rearing and education. These are regarded by the neoclassical theory as “consumption” rather than as investments. Thus what should be the whole point of economy, sound and stable families, becomes a mere “consumer choice” without any real theoretical or practical importance. Here we see the problem with neo-classicism’s choice of the “individual” and not the family as the economic unit. Whether a person has or does not have a family is, in the standard theory, a meaningless choice in itself. But, of course, it *is*

meaningful. It is the family, and not the individual, that is the basic economic unit because only the family is capable of reproducing and sustaining itself. Further, as we have seen, it is only the family that can provide the main instruments of growth.

### *The Entrepreneurial Firm*

It may seem tautological to talk of an “entrepreneurial” firm, since all firms are entrepreneurial in the sense of being founded and run by entrepreneurs. But as long as the entrepreneurial spirit is confined to the owner or the general manager, the firm will not really be fully “entrepreneurial” and the potential that is inherent in all the “human capital,” the persons who make up the firm, will simply go to waste. Employers, raised on an intellectual diet of utilitarian economics which considers work to be a “disutility,” end up ignoring their most important assets. Indeed, every self-respecting person wants to make a contribution to the workplace and to his fellow workers. There are, to be sure, slackers in the world, but more likely the work environment discourages real contributions by its very assumptions that entrepreneurship is a scarce commodity, rather than a general quality of human beings.

What the idea of “entrepreneurship” often comes down to is a question of authority. “The meaning of ‘authority’ embraces authorship, as the word implies.”<sup>47</sup> The “author” may be the person who

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<sup>46</sup> See Chapter 3.

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<sup>47</sup> George Goyder, *The Just Enterprise* (London: Andre Deutsch, 1987), 30.

founds a company; what his authority means is that he is the author of some idea of making a product, no less than the poet is the author of a given poem. As author, he is the instigator, champion, and promoter of the idea, and this confers authority. This is the “original” authority of the firm, which often comes to be a delegated authority that works through the board of directors and the managers. The corollary of authority is discipline, for there is no authority in the company without the ability to command. Discipline will be most easily accepted when there is a perception of shared risks and rewards. To the extent that employees see their most important interests and their advancement tied to the interests and advancement of the firm, they will accept the discipline necessary to build an enterprise.<sup>48</sup> But to the extent that they see the rewards going elsewhere, and their contributions dismissed or taken without compensation, monetary or otherwise, they will turn to law, lawyers, and unions for their protection. Managers and owners may fear or despise unions, but they cannot deny that they are themselves the enablers of unions by their own attitudes towards work and workers.

But in addition to the authority that comes from the “author” of the firm there is an authority that comes from the shop floor. This too is an “original” authority that arises from the process of production itself:

The shop-floor worker knows what has to be done and has often discovered, or will discover by trial

and error, how best to do it. This knowledge represents the accumulated wisdom of shop-floor experience... Thus authority in business is another name for the willingness and capacity of individuals to submit to the necessities of co-operative systems... The most efficient form of management will be that which engages the consent and co-operation of the workforce by aligning formal authority with the inner authority that comes from the job and the people who work the shop floor... there is a large reserve of productivity latent in human attitudes on the shop floor. It is the single biggest resource we have. If we could tap that resource, the growth of productivity would be explosive. Nothing holds us back from increased production but ourselves.<sup>49</sup>

Work is necessary to the growth and fulfillment of the person. Once a manager realizes this fact, his or her attitude towards job design and management changes. Once each person in the firm is regarded as a potential entrepreneur, they tend to become entrepreneurs, creating values for themselves, the firm, and the community (customers). The legitimate authority of both management and workers must be acknowledged; the authority of the former is delegated from the “authorship” of the firm, and the authority of the latter from their connection with the production process. To be truly successful, there must be a shared sense of authority and discipline based on a common purpose. A shared or common purpose can only be reached through a sense of justice that recognizes the

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<sup>48</sup> Ibid.

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<sup>49</sup> Ibid., 31-31.

legitimate concerns of all who are involved in the firm. As George Goyder puts it:

In its relations with the workforce the ultimate source of management’s authority must be its concern for justice. This means holding to a purpose that seeks to balance the interests of those it serves. Holding a just balance in human affairs is no light task. It means working to principle rather than expediency, taking long views which may require times of waiting and recuperation from adverse market forces.<sup>50</sup>

Lest anyone view this as a mere platitude without practical application, let it be noted that there are highly profitable business organizations built on just this model,<sup>51</sup> a model where, as Fr. José Arizmendiarieta puts it, “Everyone is an owner and everyone is an entrepreneur, without discrimination, in good and bad times, contributing with the available capital and the needed work.”<sup>52</sup>

*The Mother’s Problem, or “Ludwig, Listen to Your Mother!”*

There is an economic problem which makes the questions we have been dealing with less abstract; by putting the question into concrete terms, it provides a challenge for anyone who purports to be able to explain economic choices. That problem is called “The Mother’s Problem” and was originally proposed

by Philip Wicksteed in 1910 in *The Common Sense of Political Economy*. His idea is that an economic theory should be able to explain, in its own terms, what actually occurs in an ordinary household when, for example, a mother allocates the scarce family resources among members of her family. In doing so, she evaluates the needs of each member of her family against both the current resources and the need to save for longer-range goals, such as education, etc. When she buys something, say milk, she must weigh the price against her family’s needs and against alternatives. In the utilitarian description of the world, she must be acting out of the utility she derives from each member of her family; she gets such and such an amount “utility” from the baby, another amount from her husband, from her children, and from her cat, and dispenses the milk in accord with the utility she derives from each one of them; whichever one is more “useful” to her on that day will get the first allocation of milk.

But this is nonsense; the mother does not have children, change diapers, cook and clean, and attend to the education of her children for reasons of the utility she derives, but for reasons of love. She evaluates the allocation of milk not in terms of benefit to herself but in terms of the needs of each member of her family. So in this case, it is likely that the needs of the baby will come first and be satisfied before anyone else’s needs. Then the children will receive their milk at breakfast, her husband will lighten his coffee, she will use some for a cake, and if there is anything left over, the cat will get a saucer of milk. As John Mueller points out, the

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<sup>50</sup> Ibid., 33.

<sup>51</sup> See Chapter 17.

<sup>52</sup> David Herrera, “*Laborem Exercens*, “Traditional” Organizations and the Democratic Mondragón Model” (paper presented at the Work as the Key to the Social Question Conference, Vatican City, September 12-15 2001), 243.

mother is actually doing two things: she is ranking people as ends and things as means. People in the family are regarded as an end in themselves and their needs evaluated against the means at the family’s disposal. And this is true of *all* human action: “it is done not by individuals for ‘utility,’ but by persons for persons”<sup>53</sup> out of motives of love. Sometimes, it is motives of self-love, and here the utilitarian argument holds sway as everything is viewed from the standpoint of self-interest. But when self-interest is the dominant motive, whether in the family or in society at large, we label that family or that society “dysfunctional.” Without love, and especially love of others, neither society nor the family can function.

This point is precisely denied by Mises:

Social cooperation has nothing to do with personal love or with a general commandment to love one another... [People] cooperate because this best serves their own interests. Neither love nor charity nor any other sympathetic sentiment but rightly understood selfishness is what originally impelled man to adjust himself to the requirements of society... and to substitute peaceful collaboration to enmity and conflict.<sup>54</sup>

Thus in reality, the final source of action in Mises is not utility at all, but violence or the fear of violence, and this is true for every materialist philosophy; we cooperate not out of love but out of fear. Utilitarianism, as expounded by Mises, is quite literally— under its own terms— a *disease*; all actions begin in *dis*-ease,

proceed for maximum benefit to oneself and occur within a climate of violence and the fear of violence. It did not occur to Mises— although it is something that occurs everyday— that actions could result from an abundance of contentment: love, the contemplation of beauty, and sacrifice, and proceed in an environment of cooperation and love. Rather, Mises constructs a theory that excludes every noble virtue and every unselfish act.

### *A Civilization of Love*

John Paul II declared that a capitalism which represents the priority of capital over labor always represents an inversion of right values. Further, he condemned the notion that it is futile to address questions of justice within economics because the system is controlled by inflexible “laws” which dictate the outcomes in advance. But I am confident that the system is susceptible to change, and that now is the acceptable time. The first requirement of such change is that we recover our sense of freedom within the system. That is, we view economics as an arena of human freedom that allows us to construct systems which mirror our sense of justice. In order to do this we must recognize that economics serves human needs first and foremost. That is, we must end the tyranny of “things” over persons. We must rediscover the fact that the economy is about people, and people are what bring growth and stability.

In order to do this, we have to lose the assumptions of utilitarianism. Economics, indeed, civilization itself, is based not on utility but on love; this is not a pipe dream, but a reality because utility itself is based on love. Only

<sup>53</sup> Mueller, *God and Money*, 90.

<sup>54</sup> Mises, *Human Action*, 168-9.

because we love somebody is anything useful to us; the limiting case is self-love, where all things are done for self-interest, that is, utilitarianism. But such egocentrism, while always present to some degree in a sinful world, is the norm only in periods of decadence and decline. To reverse the decline, we will have to discover love of neighbor and the common good.

We must confront the confusion of means and ends and regain the confidence that we can build robust and affordable systems of transportation, education, health care, retirement, and work which are available to all.

We must recognize that the economy exists only to serve the needs of the family, or the whole system is just a pointless and unstable accumulation of things that have no meaning, and indeed no real utility. In other words, someone must shoot the economic stork.

Also required is some sense of the common good that is greater than the mere collection of individual choices. Here we must establish solidarity, which is the only basis for a vision of the common good.

Finally we must end the dependence on gigantism in government and industry through the principle of Subsidiarity.

The Church’s strategy for dealing with these issues revolves around the just wage and associating the means of production, insofar as possible, with the workers. The just wage is therefore the key. But here is precisely the point at which the Church finds herself most at odds with standard economic theories, and the question stands or

falls on whether or not wages can be associated with justice, or are just the product of a mechanical system, and therefore beyond the reach of human freedom. That question we will take up in the next chapter.

## Chapter 11: Marginal Productivity and the Just Wage

*As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for the natural produce.*

*Adam Smith*

### The Capitalist Narrative

When we look at the tensions between Catholic teaching and capitalist practice, we cannot escape the conclusion that the two seem to have irreconcilable differences. We noted in Chapter Two that such differences, which do not seem to admit of a rational resolution, could usually be traced to a difference in the narratives that are the hidden basis for each position. Capitalism is not different in this regard, having its own myth which completely predetermines the vision of its adherents. The capitalist narrative starts with the autonomous individual who freely decides all things based solely on utility to himself. Utility, measured as pleasure or pain to the autonomous individual, answers all questions of value; the individual, by his own choices, raises or lowers himself by his own efforts, and his success or failure is his own. Any purely “social” values, if they can be considered to exist at all, are merely summations of the freely derived choices of individuals. Society as such is merely an epiphenomenon of individual choice. Using free choice and individual utility as the mainspring, a complete economics can be assembled using relatively simple mathematics, and this economics will result in a strict order—called “equilibrium”—which follows mechanically from the system: supply and demand will be in perfect balance with full employment of all resources including labor. The driving metaphor

for this vision comes from Newton’s laws of motion, in which a few simple laws provide an explanation for all the apparent complexity of the universe.<sup>55</sup>

In the same way the mathematics of marginal utility can resolve all supply and demand curves and reduce all the apparent richness of complexity of human exchanges to a few simple equations. Further, based on marginal utility, Capitalism can make two purely *ethical* claims, namely, that price encodes all the relevant information, so that equal exchange (that is to say, corrective justice) is satisfied, and that the factors of production, capital and labor, get their fair shares, each get what they produce, which satisfies distributive justice. Both of these claims are related to the miracle of marginal utility.

### *Price and Externalities*

Concerning price, capitalism holds that, barring fraud, prices determined competitively under the rule of marginal utility encode all of the relevant information and hence give the purchaser all the information she needs to make a comparison between products. However, there is a great deal of information left out of the price, specifically the *externalities*, which by definition are excluded. For example, if I develop a way to make widgets at less

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<sup>55</sup> Charles M.A. Clark, "Economic Insights from the Catholic Social Thought Tradition: Towards a More Just Economy," (2005), 2-7.

than the current market price, the buyer can compare the prices offered by the various widget-makers and come to an informed decision. But if my “improved” method of making widgets dumps 100 tons of lead oxide into the air and 100 gallons of mercury into the stream, this information will not be encoded in the price; it will be “external,” and the purchaser has no way of knowing, from price alone, the effects of the product. Nevertheless these effects constitute a real and palpable cost. The cost will be paid in the form of increased birth defects and miscarriages, lower IQs, and a host of other health concerns. But it will never show up in the cost accounting for the product, and hence the price will never reflect the costs.

The question of externalities leads us to a general principle, namely that most of the problems of relating justice to economics are really problems of proper cost accounting. *All* products contain externalities. This is because every product is both the product of a particular firm and a social product. For example, every car bears the trademark of its maker, Ford or Honda or GM, but also the trademark of the society that creates it; the car depends on the existence of a road and highway system, insurance systems, gasoline distribution systems, a functioning police force, and a certain expectation of what transportation means on the part of the public. Some of these costs may show up (accidentally) in the tax rates corporations pay, and hence in the price, but many do not; they are external to the price. Moreover, there are costs to having a transportation system so dependent on one mode (e.g., higher levels of fossil fuel use) that are also external to the price. And all this is before efforts to “externalize” costs, such as getting the

government to build roads to the plant, grant concessions or subsidies, or take over costs such as health care. Therefore the ethical claims of the price system cannot be justified as a simple matter of cost accounting. Some “social” mechanism is required to assure full cost accounting. But in the current environment, these social constraints, even when imposed in one country, can easily be circumvented by relocating production to another venue, one less sensitive to social costs.

Labor itself may be the biggest and most important externality. When an employer hires a worker, what she really wants is the work, not the worker. Compare work with any other commodity. If the price of steel, for example, does not cover the costs, then soon or late, the producer will withdraw it from the market. The price must, over any appreciable length of time, cover all costs of production including depreciation of the equipment, labor and material etc. Labor also has “production” costs, in the costs of a family, and depreciation costs in the form of health care and retirement. But unlike a bar of steel, a worker cannot withhold herself from the market for very long. The worker needs to eat each and every day and may be forced to work just for her daily bread, while the other costs are “externalized,” either in the form of welfare, charity, or simply increased illness, poverty, and shorter life span. The question then arises, “How can the externalities be incorporated into the price system?”

The second ethical claim of marginal utility is that it ensures that the factors get their proper share; that labor gets that which labor produces and capital gets that which capital produces.

Here “marginal utility” becomes “marginal productivity.” Since each factor gets its marginal product, the resulting social product is correctly distributed. Hence distributive justice is satisfied and no further demands need to be made on the capitalist system. This is a powerful claim, and needs to be examined in great detail. At base is the question of whether marginal utility is a fact of “science,” true for all times and places, or simply part of the overall cultural narrative. It is a categorical claim. If it is correct, then either the “just wage” is nonsense, or the market determined wage is already “just.” The best place to start this examination is with the theory that is at the historical root of marginal productivity, the Law of Rents.

### **The Law of Rents**

David Ricardo developed the Law of Rents partially to validate Malthus’s “Iron Law of Wages” and give it a stronger theoretical foundation. By the Law of Rents, the rent on any particular parcel of land will be equal to the difference in the product of that parcel and the product of the least productive parcel in use, that is its “marginal productivity.”<sup>56</sup> For example, if one parcel A of land, the least productive in use, produces 1 bushel of wheat per acre, and another parcel, B, produces 3 bushels/acre, the rent on parcel B will be 2 bushels/acre, while A, as the least productive, will command no rent at all. If a less productive parcel of land, C, is put into production, perhaps because of population pressures, and that parcel

produces only ½ bushel/acre, the rent on parcel A will rise to ½ bushel and on parcel B to 2½ bushels/acre. An increase in population would force marginal land into production, thereby raising the rents on all other tenants. The least productive land that can be used is that which provides subsistence, so that eventually, as more land is placed in production, wages will sink to subsistence levels. Indeed, it is not just wages, but all non-rent returns, both returns to labor and to capital, that are limited by the Law of Rents.

The Law of Rents rests on three assumptions: One, that land is necessary for production; two, that land has varying productivities; and, three, that demand is rational, informed, mobile, and driven by financial calculations of value.<sup>57</sup> Assumptions one and two seem to be self-evident. The third assumption is “no more than the assumption of a perfect market. If actual markets are near perfect, then this proposition will be true. Hence, the operation of Ricardo’s rental relationship will be an indication of how closely an economy is to the perfect market ideal.”<sup>58</sup> It would seem then that the Law of Rents should hold, at least in an idealized state.

If Ricardo is correct, then any increases in productivity will eventually flow to rent rather than to the workers; no matter how productive. A concrete example is available from the late 1960’s when reliable chemical birth control methods allowed women to enter the work force in increasing numbers. As more work was converted from production for use to production for exchange, there was an immediate

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<sup>56</sup> Garrick Small, *An Aristotelian Construction of the Social Economy of Land* (Sydney, Australia: University of Technology, Sydney, Australia, 2000), 252.

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<sup>57</sup> *Ibid.*, 255.

<sup>58</sup> *Ibid.*, 256.

increase in family incomes. However, there were now more consumer dollars competing for the same pool of goods. Further, there was expanding debt capacity which had the effect of increasing the money supply and producing an upward pressure on interest rates.<sup>59</sup> The net effect was that inflation consumed the increases in family income so that they normalized, in real terms, around the former levels of family income with only modest increases.<sup>60</sup> Thus the dual incomes which were once a luxury became a necessity for many families and what was once an act of freedom, women working for exchange rather than use, has now become a matter of survival. To the extent that there have been increases in the standard of living since the 70's, that increase has been far below the increase in productivity due to the increased hours of work given by each family.<sup>61</sup> Where did the income from the increased productivity go? Ricardian theory suggests that increases in productivity eventually flow to land rents. And if it did not flow to land-rents, nor to labor, there is only one other place it could have gone, and that is to the rent of capital. Capital rents, as well as wages, are dictated by a special case of the Law of Rents: marginal productivity.

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<sup>59</sup> Ibid., 270.

<sup>60</sup> One could be tempted to see this process as a confirmation of the Iron Law of Wages. But it is not. Here it is not a question of increased population, but merely a movement from production for use to production for exchange; the amount of output is the same overall, but with a higher proportion in the exchange economy. With population increases, you get an actual increase in output: new homes must be built, more children raised, educated, clothed, etc.

<sup>61</sup> Small, *The Social Economy of Land*, 272.

## Marginal Productivity

As the Law of Rents holds that the worker can earn no more than the produce of the least productive parcel of land, so the law of marginal productivity holds that he can earn no more than the least productive worker, the "last worker" hired. Marginal productivity is based on the intuitively obvious "law of diminishing returns." It is well understood that only so many workers can be set to work on a given process before their output starts to decline. For example, let's say one worker in a strawberry field can pick ten boxes in an hour and that this rate can be constant for the first ten workers hired. But at some point, the additional output (that is, the "marginal product") from the last man hired will decline; the additional workers will just start getting in each others way. Let us say that the output declines to six boxes/hour for the eleventh man, three boxes/hour for the twelfth, one for the thirteenth and none for the fourteenth; the fifteenth picker will actually decrease the overall output by some amount. If the pickers are paid the equivalent of three boxes/hour, then it makes no sense to hire the thirteenth man; his wage would exceed the value of what he could add to production. The law of marginal productivity states that *all* of the pickers will be paid only what the last man that can be hired is paid, or in this case the equivalent of three boxes of strawberries/hour.<sup>62</sup>

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<sup>62</sup> Bradley R. Schiller, *Essentials of Economics*, Second ed. (New York: The McGraw-Hill Companies, 1996), 172.

*J. B. Clark and the Distribution of Incomes*

This was explicit in all of the theorists of the marginalist revolution, but John Bates Clark attempted to show that it was not only a scientific “fact,” but revealed the very workings of the moral order; workers were paid the marginal product because that is all they deserved. While wages might *appear* to be based on free bargaining of the free market, they are in fact based on “a deep acting natural law” which dictates the outcomes for these “free bargains.”<sup>63</sup>

*Where natural laws have their way, the share of income that attaches to any productive function is gauged by the actual product of [that function]. In other words, free competition tends to give labor what labor creates, to capitalists what capitalists create, and to entrepreneurs what the coordinating function creates.*<sup>64</sup>

The task for Clark was then to show that the marginal wage, the wage of the least productive person (or as Clark termed him, the “marginal man”<sup>65</sup>) represented the “specific product of labor,” and of labor alone. His strategy was to start with the law of rents. As Ricardo noted that the least productive land commands no rent, Clark reasoned that the least productive tools and machinery also commanded no rents, and that workers could keep all the income they could get from them. This amount corresponds to the marginal rate for labor and is its natural wage.<sup>66</sup> How was this wage correlated to the “specific product of labor”? Clark argued that it

was possible to fix the specific amounts of production that were separately attributable to capital and labor.<sup>67</sup> If the product of the one could be fixed, then the product of the other would be the remainder, since Clark only allowed for two factors of production, labor and capital, with land being just another kind of capital.<sup>68</sup> To fix the portion of the product attributable to labor alone, Clark reasoned that the “marginal man” could be hired “with no change in the amount or character of capital goods.”<sup>69</sup> Therefore, the amount he added to production—and this amount alone—was the only part of production attributable to labor alone and constituted the “specific product of labor.” Labor was therefore entitled by “natural law” only to this part of the produce. Clark made no attempt to fix the “specific product of capital”; he merely assumed it was the whole product minus the wages.<sup>70</sup>

Clark believed that the forces of free competition would force prices to equal the cost of production,<sup>71</sup> driving the rate of profit to zero, so that the entrepreneur would earn little more than the worker.<sup>72</sup> This introduces somewhat of a conundrum for the theory, since the whole system depends on the entrepreneur who seeks a profit, yet, to the degree that the theory works at all, no profit is possible.<sup>73</sup>

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<sup>63</sup> John Bates Clark, *The Distribution of Wealth: A Theory of Wages, Interest, and Profits* (New York: Augustus M. Kelly, 1899; reprint, 1965), 2.

<sup>64</sup> *Ibid.*, 3.

<sup>65</sup> *Ibid.*, 94.

<sup>66</sup> *Ibid.*, 97.

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<sup>67</sup> *Ibid.*, 47.

<sup>68</sup> *Ibid.*, 190.

<sup>69</sup> *Ibid.*, 101.

<sup>70</sup> *Ibid.*, 195.

<sup>71</sup> *Ibid.*, 16.

<sup>72</sup> *Ibid.*, 111-2.

<sup>73</sup> E. K. Hunt, *History of Economic Thought: A Critical Perspective* (Armonk, New York and London, England: M. E. Sharpe, 2002; reprint, Updated 2nd edition), 306.

Since Clark had relied so heavily on the Law of Rents to determine the “natural” distribution of incomes, it was necessary to show that all income—whether from land, labor or capital—was a form of rent. In so doing, he was attempting to complete the project begun by Nassau Senior.<sup>74</sup> Clark argued that since wages are a “differential gain” they were the same as ground rent. From this stunning non-sequitur, Clark concludes that:

It is one of the most striking of economic facts that the income of all labor, on the one hand, and that of all capital, on the other, should be thus entirely akin to ground rent.<sup>75</sup>

Why the effort to equate all incomes with ground rent? Ground rent, as opposed to rent of man-made things like homes, buildings or machinery, is rent paid for the ground that stands beneath any productive asset. The problem with ground rent is that it has no economic function and hence represents a pure *economic rent*. Economic rent is an amount paid to a factor of production over and above that which is necessary to keep it in production; it is the very measure of economic inefficiency. But land has neither production cost nor depreciation cost. Thus the entire amount paid for such rent is economically and morally suspicious. No one claims that the landowner, merely by virtue of owning the land, adds any value to it; indeed, it is not contentious to point out that his title adds nothing productive to the land. The landowner’s claim to all but the marginal product is a purely legal one, and neither a moral one nor an economic one. It is based solely on the

monopoly status that land and the landlord enjoy.

The reduction of all incomes to rent also served a practical purpose: Since all incomes are from the same source, they can be treated by the same mathematics. It has already been noted that Clark disembodied capital goods to treat them as a more abstract “capital” with no fixed content.<sup>76</sup> Clark performed the same courtesy for labor. He argued that labor was a “permanent” force<sup>77</sup> apart from any individual laborer and that it constantly changed its form.<sup>78</sup> This disembodiment of labor and capital was the last bit of the theory necessary to unite all factors of production under the mathematics of the Law of Rents. In classical economics, it was necessary to have different explanations for the different forms of income; the Law of Rents for land, the Labor Theory of Value for Labor, and some sort of surplus value theory for profits. But now all three of these factors, in their disembodied states, could just be interchangeable “*x*’s” in a production function solvable by differential equations.

### *Aristotle Overthrown*

Clark believed that in the workings of marginal productivity he had discovered the workings of God himself; he published in purely religious journals claiming to have worked out the laws of the moral order, “natural laws” which was merely the working of God’s plan and which would eventually lead to the New Jerusalem, the kingdom of God on Earth.<sup>79</sup> But this happened in a

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<sup>74</sup> See page 52.

<sup>75</sup> Clark, *The Distribution of Wealth*, 191.

<sup>76</sup> See page 91.

<sup>77</sup> Clark, *The Distribution of Wealth*, 157.

<sup>78</sup> *Ibid.*, 158-9.

<sup>79</sup> Nelson, *Economics as Religion*, 102.

deterministic fashion, under the auspices of a mechanistic God. There was little room for any human or divine intentionality as the whole system operated completely on “auto-pilot.” It is therefore the supreme irony that Clark’s implicit view of history was no different from that of Hegel or Marx.

Nevertheless, if Clark’s claims are correct, then it is a remarkable achievement. All of economics, and all of justice, are reduced to the “science” of exchanges, that is, to corrective justice. Aristotle’s claim that distributive justice has an irreducible cultural element would be false and economics would be a completely self-contained science that is entirely free of moral, historical, or cultural elements. If Clark is correct, then Aristotle must be wrong. Any attempt to introduce normative considerations into economics would be, at best, counter-productive and, at worst, anti-scientific.

### *The Ethics of Marginal Productivity*

Clark was following in the tradition of Malthus, Say, and Senior in identifying the rules of economics with the moral order. Therefore we can conclude, with James Galbraith, that marginal productivity states a “theological position”:

*From all according to their average product, to each according to his marginal product.* That is the rule. Everything that is required in order to make the rule hold, including constant returns to scale, perfect competition, a smoothly differentiable production function (with capital and labor measured in efficiency units and with well-behaved factor-price frontiers), and full employment of resources, is assumed. The rule then implies that an optimum of efficiency and a Pareto

maximum<sup>80</sup> of social welfare will be achieved.

It follows that anything that interferes with the market mechanism, so to say *artificially*, will produce a decline in efficiency. In particular, interference in the price mechanism will certainly do so. Any increase in my wage— the price of my labor— relative to my marginal product can only discourage my employer from demanding my services. The resulting fall in my employment can only reduce average product, generating a “dead-weight loss” under the demand function. This is the “efficiency/equity” trade-off: equality produces unemployment, and so reduces output and wealth below what they would have been.<sup>81</sup>

In other words, there is an absolute a trade-off between equity and efficiency. Viewed in this way marginal productivity would be a reincarnation of the Iron Law of Wages that we saw in Malthus. Further, any attempt at redistribution will only makes the problem worse; transfer payments raise the effective wage as effectively as wage increases and therefore raise unemployment. The ethical claim is that distributive justice is satisfied and any further redistributions are excluded as counter-productive. To make it even worse, even charity is counter-productive.<sup>82</sup> Thus, marginal

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<sup>80</sup> Pareto optimality, named after Vilfredo Pareto, is a situation which exists when economic resources and output have been allocated in such a way that no-one can be made better off without sacrificing the well-being of at least one person.

<sup>81</sup> James K. Galbraith, "The Importance of Being Sufficiently Equal," in *Should Differences in Income and Wealth Matter?*, ed. Ellen Frankel et al. Paul (Cambridge: Cambridge University Press, 2002), 202-3.

<sup>82</sup> For example, this from Fr. Robert Sirico of the Acton Institute: “As we enjoyed a simple fish dinner, something struck me about the nature of

productivity supposedly imprisons the wage system (and profits) in an iron grip that neither the government nor good intentions nor charity nor any other thing can mitigate.

However, this is a somewhat paradoxical view of marginal productivity; the theory *should* provide a kind of equality; all wages and profits should be normalized around subsistence levels; the ethical claim *should* hold. Thus the claims of an “equity/efficiency” trade-off would seem to run counter to the claims of marginal productivity; if marginal productivity holds, there should be a rough equality normalized to subsistence. The very existence of high levels of inequality should be evidence

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our charitable work. We knew that the pub's proprietor lived in the neighborhood and he and his family worked hard to keep the business afloat. It dawned on me that my classmate and I, and the numerous well-intentioned people who contributed food, money, and service to the soup kitchen, were his competitors. Just a block away, we provided a product and a service that made this man's efforts to provide for his own family more difficult... We must also examine the extent to which such programs help or hinder structural progress in poor areas. Supposing we had served plainer meals--with an emphasis on nutrition over taste and variety. Would we have offered less competition to the fish house proprietor? Would another inexpensive restaurant have opened up--and hired local residents who were then unemployed? ... When charity creates a disincentive for an able-bodied person to work, it leads this person down the wrong path. It encourages indolence. Real work provides the individual with the vehicle for a productive and virtuous life.” “Samaritan's Dilemma”, <http://www.acton.org/ppolicy/editorials/sirico/samdilemma.html>. There is, to be fair, a “Samaritan's dilemma,” especially when speaking about development (as we shall see); I doubt that it applies very much to soup kitchens or that “plainer meals” contain the solution to poverty.

that marginal productivity is *not* working in the way the theory predicts. The only ones who should get overly rich in a competitive market system are those who are not subject to the market: *rentiers* and monopolists; for them, marginal productivity becomes the Law of Rents with significant economic profits. The presence of high levels of inequality should not be taken as a sign of the operation of marginal utility, but as a sign of its failure.

On an empirical basis, if we consider just equity in wages, marginal productivity would seem to work very well, judging by the close correlation of equality and high employment levels. James K. Galbraith has tracked wage inequality and unemployment in the manufacturing sector on a month-to-month basis back to 1947 and on an annual basis back to 1920 and found that they rise and fall together.<sup>83</sup> Galbraith concludes that, “Indeed, the relationship between pay equality and employment is so close as to raise the question of whether these two phenomena are really anything other than different ways of measuring the same underlying economic condition.”<sup>84</sup>

Thus, the vaunted trade-off doesn't seem to be borne out in practice; the Iron Law appears to be made of straw. Societies with greater equity have lower

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<sup>83</sup> James K. and Cantu Galbraith, Vidal Garza, “Inequality in American Manufacturing Wages, 1920-1998: A Revised Estimate,” *Journal of Economic Issues* 33, no. 2 (1999): 735-43. Galbraith takes this data as evidence of the failure of marginal productivity theories, whereas it seems to be evidence of their operation. It does refute the equity/efficiency trade-off, but that trade-off itself runs counter to the equality demanded by marginal productivity.

<sup>84</sup> Galbraith, “The Importance of Being Sufficiently Equal,” 209.

rates of unemployment, along with lower crime rates, better health statistics, etc., and unemployment and inequality rise and fall together, month by month and year by year.<sup>85</sup> It is often argued that the equity/efficiency tradeoff is confirmed by the experience of the European Union. However, the tradeoff appears to hold only when considering the countries individually rather than the Union as a whole; using the later standard, Europe is both less equal and has higher unemployment than the US. Some countries within the Union, such as Denmark, the Netherlands, and Norway, have less inequality and consequently less unemployment.<sup>86</sup>

But while marginal productivity seems to hold for the wages side of the equation, there seems to be great inequality on the capital side. Something is going on; the theory states that both sides should get what they produce and that product should tend towards subsistence, but one side is getting a lot more. Thus the law of marginal utility is operating more like the Law of Rents; one side of the equation only is driven to subsistence while the other enjoys the income of a *rentier*. What is the problem?

### **The Critique of Marginal Productivity**

#### *The Reality Check*

When examining any theory that purports to explain empirical reality, we need to examine it in two ways. First, we need to apply an *internal critique*, one aimed at noting whether the theory is logically coherent on its own terms. Second, we need to test the predictions of the theory against the real world to

see if indeed the theory has any predictive or explanatory power. This we may call the *external critique* or, more simply, a *reality check*. Here we ask simply, “What would we expect to see in the world if the theory was correct?” In the case of marginal productivity, in economies where the wages tended to be at subsistence levels we would expect to see full employment, a high rate of labor force participation, little difference between the very rich and the very poor, and a full utilization of all economic resources. Conversely, in high wage states we would expect to see low labor force participation, high unemployment, under-utilized economic assets, and high differentials between wealth and poverty. Yet, when we look at the real world, we find precisely the opposite, and we find this in nearly every single case. Now, in any single case there may be any number of *ad hoc* explanations for the divergence of actual results from the theoretical ones. However, when every single case seems to require an *ad hoc* explanation, we may begin to suspect that there is something wrong with the theory itself, no matter how logically consistent it may be.<sup>87</sup> Logic, after all, is only a test of validity and not directly a test of truth.

#### *The Necessary Conditions*

One critique of marginal productivity is conceded by all sides in the debate: The theory requires a long list of conditions to be fulfilled which cannot in fact be fulfilled. Some of these include perfect competition, constant returns to scale, full employment of resources, etc. Perfect competition, for example, is impossible even at a

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<sup>85</sup> Ibid., 208.

<sup>86</sup> Ibid., 209.

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<sup>87</sup> Lawrence A. Boland, *The Principles of Economics: Some Lies My Teachers Told Me* (London and New York: Routledge, 1992), 206.

theoretical level because there are always barriers to market entry, aside even from the barriers created by market power and government action. Further, this assumption presupposes a large number of small firms such that none of them has much power to influence the market price to any great extent. But many industries are in fact composed of a small number of large firms with tremendous market power. As Paul Ormerod points out,

By definition, any model necessarily abstracts from and simplifies reality. But the model of competitive equilibrium is a travesty of reality. The world does not consist, for example, of an enormous number of small firms, none of which has any degree of control over the market in which it is operating. Small firms may be fashionable at present, but it is large multi-national companies... which dominate the world economy. It is entirely illegitimate to make the link between the model and the observed success of the Western market economies.<sup>88</sup>

Indeed, it is just this kind of market power which characterizes the American economy. What is needed then is an analysis of marginal productivity under conditions of monopoly, duopoly, oligopoly, and government power. In the absence of such an analysis, it is impossible to gauge just how far the departures from “ideal” conditions affect the operation of the theory; hence the arguments remain at the level of ideology and take on the shrillness that is typical of that form of argumentation.

### *Empirical Verification*

An even more serious critique is the fact that marginal productivity is an empirical theory that simply does not permit of empirical verification. For all of its theoretical power, marginal productivity is not actually used by businesses, which is suspicious. The example of the berry-pickers previously given seems to be so obvious—to economists—that it needs no verification. But a *businessman* will immediately spot the fallacy. If an entrepreneur has 10 workers in the field, it is highly unlikely that he has ten pickers. That is, he does not have a *homogenous* workforce as the theory presumes. Rather, he might have eight pickers and two supervisors, or one supervisor, seven pickers, and two performing a collection function, or some other configuration of labor. For a process that is losing money, the question becomes, “Who is the ‘marginal man’?” Are there too many supervisors, or too few? Too many collectors, or too few? Too many pickers, or too few? Marginal productivity cannot answer these questions, cannot be computed, and therefore can give the businessman or woman no useful information.

We could of course force a homogenization of labor on the formula by divorcing the work from the worker and reducing everything to some unit, let us say the wage of the lowest paid worker. So if our ten workers are divided into seven pickers (the lowest wage), one supervisor (who makes half as much again as the pickers, or 1.5 picker-units), and two collectors who make 25% more than the pickers (or 2.5 picker-units), we would have a total of 11 picker-units. Now we have a number to plug into the formula, but the formula can yield no

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<sup>88</sup> Paul Ormerod, *The Death of Economics* (New York: John Wiley & Sons, Inc., 1994), 48.

useful results, just as before. For example, if we find that our picking operation is losing money, then we can run our productivity formula and discover, let us say, that we are 2 picker-units past our point of marginal productivity. But which two units? Do we have too much or too little supervision, collection, or picking? We have abstracted out the very information that would make the formula useful. And this is even before we add in the other factors of production, land and capital. Is the land just too expensive to grow strawberries? It turns out, as we shall see, that the problem of aggregating capital is even more difficult than the problem of aggregating different kinds of labor.

It comes therefore as no surprise that attempts to verify marginal productivity empirically have proven a failure.<sup>89</sup> As Garrick Small notes of marginal analysis in general:

Some economists therefore have suggested that prices can sometimes be shown to behave *as though* firms were performing marginal analysis, even though it is known that they do not. ... Apart from looking a lot like Ptolemaic astronomy, actual prices cannot be shown to be capable of being reliably predicted by marginalist methods because of the practical impossibility of generating the mathematical relationships with anything like the precision necessary to yield a specific price.<sup>90</sup>

### *The Social Nature of Production*

The reason the individual factors of production cannot be computed has to

do with the assumptions of the marginal productivity theory, assumptions which are hidden in most accounts but which Clark, at least, attempted to make explicit. Clark was searching for the amount that labor “separately” produced. He assumed that the “marginal man” could be added without any addition of capital and therefore represented “empty-handed labor.”<sup>91</sup> This is simply empirically false. The marginal man is not added without an addition to capital; at the very least there is the capital represented by his wage, and he can produce nothing without consuming some capital in the form of tools and materials.

Clark did not actually attempt to compute the “separate product of capital” as he did for labor. Had he attempted to do so he would have discovered that the separate product of capital— or of labor— is the only precisely known number in all of economics; it is precisely zero. Take some item of capital, say a truck, and watch it all day with a careful eye to see what values it produces. There will be exactly none, unless and until a driver mounts the cab to make some deliveries. Take a pot of capital, let's say some cash, and fertilize it and water it with all the care you can. It will still refuse to grow. Unless and until someone takes the money out of the pot to purchase tools, materials, and the labor to work them, it will not produce any values. All production is *social*; it is the intersection of land, labor, and capital, and nothing happens independently; hence there can be no “specific” or “independent” theories of production. The same rule applies to labor. “Empty-handed labor”

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<sup>89</sup> Anwar Shaikh, “Laws of Production and Laws of Algebra: Humbug Ii,” in *Growth, Profits and Property*, ed. Edward J. Nell (Cambridge: Cambridge University Press, 1980).

<sup>90</sup> Small, *The Social Economy of Land*, 159.

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<sup>91</sup> Clark, *The Distribution of Wealth*, 171.

is simply another name for “unemployment”; without capital, labor can produce nothing. The factors of production—land and labor—do not in themselves even have a marginal product, only the process as a whole does. One particular arrangement of supervisors, collectors, and pickers will have a different marginal productivity than another arrangement, and it is only these various arrangements that can be compared. Marginal productivity for a given factor cannot be computed because it does not exist.

Therefore, management must use its best judgment in allocating the rewards in a way that best utilizes the company’s resources and best encourages the contribution of the workers. There is no “natural” division of the product; it is a matter of distributive justice and, as Aristotle pointed out 2,500 years ago, distributive justice follows no “natural” rule, but will always involve a cultural decision. Contribution to the production process is computed by merit, but merit will involve a judgment on the part of management, a judgment that can be reduced to no set formula.

### *Two Factors or Three? Or One?*

The marginalist revolution reduced the three factors of production found in classical economics to two, labor and capital; land simply disappeared from economic theory and became another form of “capital.” Clark carried the process further by “eliminating” labor and treating it as just another “bit” of the capital fund. This made the mathematics much simpler. But alas, it allowed for a clean break with reality. Land and capital are not identical and obey different economic laws. And labor is different from land and capital in ways too obvious to mention.

Marginal productivity might work very well for man-made things, at least in some circumstances. If the price of widgets is high enough to collect an economic rent, then widgets will attract capital and entrepreneurs, the supply will be increased and the price lowered. If the price is too low to pay for production costs and depreciation, producers will exit the market, lowering the supply and raising the price. Thus, the promise of marginal productivity is an economy free of economic rents with great equity and full employment. After all, equity equals equilibrium; they are practically the same word and very nearly the same thing. And economic rent is the enemy of both words. But the theory breaks down for land and labor. Since you can't manufacture land, no one can undercut the market and hence marginal productivity will not apply; land, having no production or depreciation costs, will always earn a pure rent. Labor cannot be withdrawn from the market when the price does not cover production costs (the family) and depreciation (sickness and old age.) Hence marginal productivity does not fulfill the basic requirements of any economy: to provide the necessities of life to all participants. Therefore marginal productivity cannot be a description of any reality. It describes a world where land is manufactured at will and workers, when not needed, can shut themselves off until the market improves. Hence, marginal productivity does not even rise to the level of good science fiction.

### *Marginal Productivity as Metaphor*

When theories part from reality, they tend to become metaphors based on their own myths. And this is what has happened with marginal productivity.

The theory states what turns out to be a metaphorical description, namely that the factors of production (“both” of them) produce what they get and get what they produce. This description implies that each factor “produces” something independently and its rewards can be computed as a factor share. But as we have noted, this is simply incorrect. Capital does not produce anything by itself. Production requires a responsible agent, that is, a worker, including the form of work known as management. Therefore, to describe capital as producing anything *ex nihilo* and by itself is a metaphor and not an empirical description of reality. In logic, this is called the *pathetic fallacy*, the attribution of human qualities to non-human things. Capital is not an agent of production; only humans can fill that role.

This first metaphor depends on a second one, the “distributive shares” metaphor, which states that each factor “gets” what it “produces.” This is metaphoric because neither factor “gets” a share of the whole product; rather, the whole product is owned by the *residual claimant*, who has the legal liability to pay the suppliers of each factor, that is, the wages of the worker and the bills for the capital.<sup>92</sup> What the owner of the output, the residual claimant, is required to pay the factors of labor and capital is not a share of the output, but rather whatever the market demands on the basis of the power relationships involved, relationships that will normally be dominated by supply and demand but may also include such things as

government regulation, custom, or hidden knowledge. The correct empirical description is, “the residual claimant owns the whole output of the production process and the responsibility of paying the liabilities for the use of labor and capital.”<sup>93</sup>

Who is this “residual claimant” to the whole output? By custom it is the capitalist who owns the firm. By custom, the capitalist hires labor and claims the output. But this is a matter of custom, not economics. There is no *economic* reason why it can’t be the worker who hires capital and claims the full output. In fact, that is a fairly common and largely successful form of organization, and we will examine successful firms built on just this model. For the present, it is necessary to separate the claims of science, metaphor, and culture and correctly identify which is which.

### *The Definition of Capital*

As badly as marginal productivity works for labor, it does even worse at describing the productivity of capital. The marginalists have to aggregate capital into some common number in order to use it in the marginal productivity formula. But quite obviously, buildings and trucks and machinery are all different things and have different rates of return. So what number should we use to plug into the formula? All too easily we answer “price!” but this doesn’t work at all, because the price depends on the return. That is, someone would be willing to pay more for an asset that returned \$100/year than he would for one that returned only \$50. How much an asset

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<sup>92</sup> David Ellerman, *Intellectual Trespassing as a Way of Life*, ed. Philip Mirowski, *The Worldly Philosophy: Studies at the Intersection of Philosophy and Economics* (Lanham, Maryland and London: Brown & Littlefield Publishers, 1995), 108.

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<sup>93</sup> David Ellerman, *Property and Contract in Economics: The Case for Economic Democracy* (Malden, MA: Blackwell Publishing, 1993), 132.

returns is supposed to be based on its marginal productivity, just as the wage is. But this turns out to be circular: the price depends on the productivity, but the productivity depends on the price.

Clark aggregated capital goods (trucks and buildings and so forth) into a mysterious fund called “capital,” a fund that was distinct from any physical thing that was in the fund. The necessity of doing this is obvious: It is difficult to use a machine in the formula and would be much better if one had a number. But this aggregation makes even less sense than it did in the case of labor. We need to compute the formula to know what return to use in the formula, which means we need to compute it before we compute it. The whole logical structure is now shown to be totally incoherent. As Joan Robinson noted:

We must agree (though mumpsimus will continue in the textbooks) that marginal productivity of capital in industry as a whole has been shown to be a meaningless expression. We must look somewhere else to determine the laws which regulate the distribution of the produce of the earth among the classes of the community.<sup>94</sup>

### *Summary: Equity and Equilibrium*

We started with something that was— and is— intuitively obvious, the Law of Diminishing Returns, and tried to make it into a formula which solves all allocation, pricing, and distributive functions. At that point, the theory becomes incoherent. How could we have moved from the intuitively obvious to the patently incoherent so quickly? It is certainly true that the returns from any

asset— be it land, labor, or capital— diminish as further units are added, so that at some point we cannot profitably employ an additional unit of that asset. But where does that point of marginal productivity come? It would greatly simplify the task of management if this could be known by a formula. If the marginal productivity of all factors could be known, then the proper allocation of resources would be equally obvious to the CEO and the janitor. The preparation of the most complex budgets would be a trivial matter: Each function would state its marginal productivity and the entire budget would be a matter of a few moments work with a calculator. Executives would have even more excuse to spend their afternoons on the golf course than they already do, presuming there could be found a reason to hire executives in the first place.

Thankfully for the profession of management, the problem is not nearly that simple. Judgment— managerial judgment— is required for the proper allocation of resources and the compensation of employees. These judgments cannot be reduced to a formula. The problem is that the marginalist mathematics tried to reduce all production to exchanges and derive distributive justice formulaically from corrective justice. This cannot be done. Insofar as production is a *social process*, the distribution of rewards must be a social decision. In other words, the theory has reversed the natural order between distributive and corrective justice. Distributive justice must be prior because it deals with production, and production is prior to exchange; you must *make* something before you can *exchange* it.

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<sup>94</sup> Joan Robinson, "The Measure of Capital: The End of the Controversy," *The Economic Journal* 81 (1971): 602.

In the same way, the theory assumes that equity would result from the attainment of equilibrium, when in fact the reverse is true: equity is prior to equilibrium. If we examine the assumptions of the marginal productivity theory, assumptions such as a large number of small firms and perfect competition, we find that they are assumptions more naturally connected with *equity*. But the theory is supposed to produce equity. Therefore, the whole theory assumes what is supposed to be its result as its starting point. The theory will have to be reconstructed, and reconstructed in the right order. That is, from distributive justice to corrective justice, from equity to equilibrium.

We can summarize our conclusions in this way: ***Since all production is a social process, we can compute a marginal productivity only for a process as a whole, never for a factor within that process.*** There is no “empty-handed labor” whose “productivity” can be calculated, nor any capital independent of labor that can produce any values. It is *only* the intersection of land, labor, and capital that produces economic values. This being the case, how then can we judge the relative compensations to be given to the factors of production? If marginal productivity formulas produce no useful results which can be examined by all sides, how then shall we construct a theory of compensation—that is, a distributive theory—that can be acknowledged by all parties to the production process?

## The Just Wage

### *Natural Law and Property*

The neoclassical economists attempt to build a system based on natural law,

but their concept of natural law hides a number of purely cultural assumptions, such as absolute property. The Christian idea of natural law views the law in light of the meaning and purpose of things, their *teleology*. Thus an economy cannot be merely the operation of “automatic” laws that have no necessary relation to the objective needs of human beings and their social situations, but is something subordinated to the ends and purposes of persons and societies. The perception of these ends and purposes will vary from culture to culture, but we can nevertheless detect some common threads: the necessity of providing for all citizens, the necessity of providing some rules of exchange, and so forth. But the most primary economic question that a culture must deal with is the question of property. The claims to some portion of the output of production are claims of property rights. Yet, very little attention is given to examining the basis of property rights so that in effect the whole theory rests on unexamined and wholly non-economic assumptions. Property is taken as a given or self-evident assumption, but is it? We have already seen that the system of property which we regard as “natural” is in fact a social convention of relatively recent origin and that many other property systems have existed and do exist.

We noted in Chapter 5 that property rights were made up of two considerations: ownership and use, with the former subordinated to the latter, at least to some degree. The common use of property was part of the natural law, while the private ownership was a social convention, valid to the degree that it helps us to bring forth all the goods of the earth and make them widely available. Thus while property is conventional in itself, it can be used to

serve the purposes of the natural law. However, this discussion refers to property in *things*, land or goods. But there is at least one form of property that is prior to both of these, and this form of property is completely natural. Thus while we have already discussed property under the headings of ownership and use, we can now discuss it under the headings of *natural property* and *conventional property*.

### *Natural Property*

When we look at property, we can note that each person has a property in himself. This constitutes a “natural” property as it is self-evident and reducible to nothing else. Furthermore each person has a natural title in his labor and to what his labor produces. A person who makes something is considered the owner of that thing, to the extent that the labor and the materials are his. Of course, people make most things in cooperation with others, so that the product is a social product, and hence no one person can claim the whole output, but only what is proportional to his contribution. This right to a proportional share is based on the fact that to produce something a person must contribute a portion of his life, and he therefore has a just claim to support for that portion of his life, his own property, which he has contributed to the product.<sup>95</sup> This leaves unanswered the question of the *level* of support, whether we will make of the worker a prince or a pauper, but unquestionably establishes a right to some level of support.

In producing anything, however, each person or each firm also makes use

of two other factors: previously man-made things (capital) and land, which includes the raw materials that land supplies. How are these other factors to be compensated? Note that we are dealing with *three* factors of production, land, labor and capital, rather than just *two*, labor and capital. Land is a gift of nature and labor the gift of the worker. But what about capital? Capital itself regresses to land and labor (and to previous capital, which regresses to land and labor), so that if we sort out the compensation between land and labor, we can also determine capital’s compensation.

### *Conventional Property*

We discussed labor’s compensation as based on the portion of his life that a laborer contributes to the final product. But what contribution does the landowner make? In the first place, we note that the landlord makes neither the land nor the raw materials which can be extracted from it. His claim is a legal one, based on whatever operations of title prevail in his society, that is to say, on purely social conventions. So how does the landowner come into possession of the land, and what is the nature of his title? Almost all theorists, from John Locke to John Paul, agree that land was originally meant for common use and given to all; it is taken out of common usage by some variant of the labor theory of value. For John Locke, this strips land of all communal values, but for Aristotle, Aquinas, and John Paul II, land can *never* lose its social values. The privatization of land is justified on pragmatic grounds alone, namely that this best serves the common use of land. Since the justification is only pragmatic and not “natural,” it fails when land ownership no longer advances the

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<sup>95</sup> Small, *The Social Economy of Land*, 242.

common good. But whatever view of land one takes, what is obvious is that it arises not from natural law, but from social convention and positive law. Thus the compensation given to land is fixed socially, not “naturally.”

If all values from land are “privatized,” then the landlord will be able in principle to extract all marginal values and the Law of Rents will hold. But the entire structure of private ownership rests on convention and not on economic law; different conventions will yield different results, as we have already seen. These conventions, whichever ones a society chooses, will rest on moral considerations entirely. It may be the morality of the jungle where the strong prey on the weak in the name of pure self-interest, or it may be based on some vision of the common good and the natural right of people to the true products of their labor. The task of the social scientist here is not to arbitrate among these visions and pronounce an “economic” decision, but to compare the likely results of various social conventions using both theory and history as a guide. And in this case, we have fairly clear historical precedents. If, for example, the economic police had been on the job to enforce the Law of Rents in 9<sup>th</sup> century England, Europe would still be mired in servility. The vast expansion of the 9<sup>th</sup> through the 11<sup>th</sup> centuries simply would not have taken place; if the peasant was entitled to no more than subsistence, then that subsistence could have been as easily supplied by a scratch plow as by a moldboard plow, and he would hardly have bothered to innovate. Had the landlord received all the marginal values, there would be few values over the margin. Moreover, we can note the failure of the Statute of Laborers (1351)

to control wages because the wage earner had alternatives in the form of the commons, customary rents, and secure tenures. The problem perceived by the authorities in the 14<sup>th</sup> century was how to dampen demand through control of wages. Two centuries later, when land had been privatized and the commons enclosed, the Law of Rents came into play, the problem would be how to prop up demand through the poor laws, the foundation of our modern welfare system; this system has continued to this very day, not because, as some suppose, of a “do-gooder” liberalism, but because hard-headed economics demands some prop to demand under conditions of marginal productivity and the Law of Rents. We have adopted Keynesian economics because it seems to work, but its true father is not Keynes, but Henry VIII.

### *Subsistence*

Several points flow from the discussion so far:

1. The worker has a *natural* right to the values produced proportional to the share of his life that he surrenders to the production process.
2. The capitalist has the same rights proportional to his labor and to the capital he supplies, which regresses to prior labor.
3. The share of the landowner is set by social convention with a view towards the legitimate needs of the landowner and the common good. His right is not natural because he surrenders no portion of his life to supply land and raw materials, but based solely on social conventions.

The question now becomes, “How we can place a monetary value on the

natural property the worker has in the final product?" The answer is rooted in the share of his life that the worker surrenders to make the product. It would seem to have three parts: subsistence; a premium for training, skills, and responsibility levels; and something left over for savings to acquire one's own property and provide for one's own security in time of need.

Subsistence would seem to be the most "objective" of the three, but it turns out to be a slippery concept indeed. This is because humans have an amazing capacity for enduring hardships. Since survival is necessary, people are not free to withdraw their labor as conditions worsen. Therefore, they will continue to bid jobs down to the level of their daily bread if they have no other options. The free market is therefore not a very good guide to subsistence levels, since it tends to arbitrate power relationships rather than economic values and not only drive wages towards subsistence, but also drive subsistence itself to ever-lower levels. Further, subsistence has to be measured not just from the standpoint of the worker, but from the standpoint of his family. This is because the economy of exchange in any sane society will include support for the economy of use; it will include support for what Ivan Illich calls the right to "useful unemployment," that is, for people who produce use values outside of the exchange economy.<sup>96</sup>

Useful unemployment includes, pre-eminently, the domestic arts of the household. This is not just a moral and social issue, but an economic one as well.

In many areas, such as child rearing, production for use is more economically efficient than production for exchange. Exchange systems impose an entry cost of their own. For example, mothers who enter the workforce often find that increased expenses for wardrobe, child-care, transportation, meal preparation, and house cleaning and maintenance often consume so much of their incomes that the benefits from their marginally calculated wages are marginal indeed. Another example of useful unemployment is education, something which adds to the productive stock of society. The best of example of useful unemployment might be childhood itself, which should be free of undue burdens of work.

Regarding labor premiums for skills and responsibilities, the market seems to do well when these are correlated to scarcity, but otherwise not so well. Of course, many jobs will get much better than subsistence because of the political power of the groups involved or because of scarcity premiums; political power can come from unions or from laws which set wages, such as a minimum wage. Or the power may come from a particular position one has, as in the case of CEOs and senior executives working with overly compliant boards of directors.<sup>97</sup> Scarcity premiums are normally related to the cost of training or to some special talent that a worker has. It is important to note here that it is *not*, as generally supposed, the training itself or increased productivity which confers the higher wage, but solely the scarcity premium. This principle is evident when we look at two specific

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<sup>96</sup> Ivan Illich, *The Right to Useful Unemployment and Its Professional Enemies* (London: Marion Boyars, 1978).

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<sup>97</sup> John C. Bogle, *The Battle for the Soul of Capitalism* (New Haven & London: Yale University Press, 2005).

cases, software engineers and seamstresses. In the case of the programmers, the training required kept the numbers scarce for a long time so that engineers could easily command \$40-\$50/hour. However, as the skills became more general, and as their own work at building the internet made off-shoring more possible, the work is being outsourced to Indian programmers working for \$10/hour. A seamstress is also a highly skilled job; however, it is a skill that is routinely taught to nearly half the world's population from the time they are young girls. Hence, the supply is nearly infinite relative to the demand, and their skill commands no more than starvation wages. Clearly, it is the scarcity, and not the skill, that commands a premium. Nor can the wage differentials be laid at the door of "productivity" of the workers, because in the case of the Indian programmers, the productivity is assumed to be at least the same. Productivity may perhaps form the ceiling for the wage, but the actual wage is based on supply and demand and only the scarcity, and not the productivity *per se*, commands a premium in the market.

Finally, there is the difficulty of determining a "savings premium." However, this might be tied to the rate needed to insure a decent retirement.

The problem then is to determine wage levels in accordance with the dignity of the worker and his family. In theory, one can support one's family in a lean-to in the park, trapping rabbits and wearing a loin-cloth; hence in theory very little cash is required. However, the city building inspector will not permit lean-to's and those who go for job interviews wearing loin-cloths tend not to get the best offers. In other words,

there is a certain minimal standard that society establishes and which constitutes for that society a "dignified" existence. This varies widely from culture to culture, but is nevertheless knowable for any given culture. This means that there is a cultural aspect which is irreducible. The problem here is that a culture can set the bar too high or too low. How much do we really need in the way of clothing? What constitutes a decent home? Do we need a television? Or two? Cable? A computer? A certain number of trips to the movies? An argument can be made that a minimal participation in our culture requires at least some of these things. But whatever the answer, there is some standard below which we regard people as being not full participants in the society.

### *Measuring the Just Wage*

But there is in fact a measure of the distance between the just wage and the prevailing wage, at least approximately and in the aggregate. This distance can be measured by the amount of transfer payments necessary to sustain demand. These transfer payments are of two types: welfare payments and consumer credit. Both of these constitute transfers of purchasing power between one group of citizens and another made in order to support demand; without these payments, there would be both a disastrous reduction in demand and a sudden implosion in the standards of society. To the extent that these things are necessary, they may serve as a proxy for the distance between social standards and actual pay. By the same token, to the extent that consumer credit exists merely to continue a cycle of pointless consumerism, it is destructive and needs to be excluded from any calculation of what a dignified life needs. Of course,

some amount of consumer credit is acceptable, since it is proper to finance a long-lived item, such as a house or a car, over some portion of the life of that item. But when we end up paying next year for groceries we consumed yesterday, the situation has gotten out of hand, and all too frequently, that is what is happening; we are, too many of us, still paying for things we have consumed, discarded, or no longer care about. In any case, transfers, by subsidy or by credit, are required to insure purchasing power in the mass of men sufficient to keep the economy going; the distance measured by these transfers is an indication of the deficiency in the just wage.

The problem is complicated by consumerism, which makes the determination of the social component of the just wage much more difficult. Each of us receives 10,000 to 20,000 messages a day urging us to purchase things that may not really contribute in any way to our well-being, but are in fact the mere trash and detritus of a marketing industry gone insane. Consumerism has another effect that is pertinent here: namely, that it can easily create the illusion of poverty where none exists. The more we identify our well-being and dignity with things rather than persons, the more dissatisfied we become with ourselves and our situations, and the more difficult it is to perceive a just wage. But suffice it to say that we need to concentrate on what is really helpful to our well-being as citizens and family members: a proper measure of nutritious food, decent housing, transportation, education, health care, etc. This requires not only economic good sense, but a certain change of heart, a conversion, a certain realization that the good life is not really about goods at all, but about

our role as persons and our relations to other persons and to God. This in turn requires a conscious effort to reject the messages which come at us on a moment by moment basis.

The just wage, then, is not so much a number as a criterion of judgment. We can say that the just wage is fulfilled under the following four conditions: One, that working families, as a rule, appear to live in the dignity appropriate for that society; two, that they can do so without putting wives and children to work<sup>98</sup>; three, that they have some security against periods of enforced unemployment, such as sickness, layoffs, and old age; and, four, that these conditions are accomplished without undue reliance on welfare payments and usury. While it may be difficult to give precision to any of these factors, it is certainly possible to make reasonable judgments and set reasonable standards.

### *Implementing the Just Wage*

In the following chapters we will be looking at theoretical and practical approaches to the just wage and examining some actual implementations. For now, we can just touch on some of the possible solutions. The first "solution" is to do nothing, or rather, do more of the same. The proponents of this solution, largely neo-conservative or libertarian theorists, believe that the current system can be made to work, although they can not always agree on

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<sup>98</sup> This is not to be taken as an argument against child labor *per se*, but only against child labor in an adult context that lends itself to exploitation. Children in fact need to work, certainly inside the home and to some extent outside of it; it is part of the socialization and education process. One of the advantages of having mothers employed in the home is that they can supervise and enforce children's work.

how to do that. The general “get the government off my back” attitude misses the historical point that the government has been on everybody’s back since the 16<sup>th</sup> century when the ownership system shifted from feudal to allodial, from a system of customary rights to the system of the Law of Rents. Almost immediately, a welfare system was necessary to support aggregate demand and insure against social breakdown. The system, and the debate about it, has continued for more than four centuries, with nearly every regime promising to reform it out of existence, while continuing it in practice. If the system hasn’t worked in four centuries, there is little reason to believe that it will suddenly start working now. Madness can be defined as to continuing to do the same thing over and over again and expecting different results.

Minimum wage levels pegged to a real consideration of poverty are a possible solution, but a messy and inefficient one. These levels will always depend on government mechanisms that are burdensome to those who must obey them, but easy to avoid for others. Further, the setting of a “poverty line” is a political process, and the public can be expected to be stingy when they are expected to provide support for all below this line.<sup>99</sup> Finally, a minimum wage treats all workers alike, when clearly this is not so; a high-school student working a part-time job and the father of a family have different requirements; setting the

wage to benefit the one may harm the other. Still, in some situations, a minimum wage may be a necessary stopgap. Better, however, to find a solution that works “systematically,” with the least possible amount of government interference.

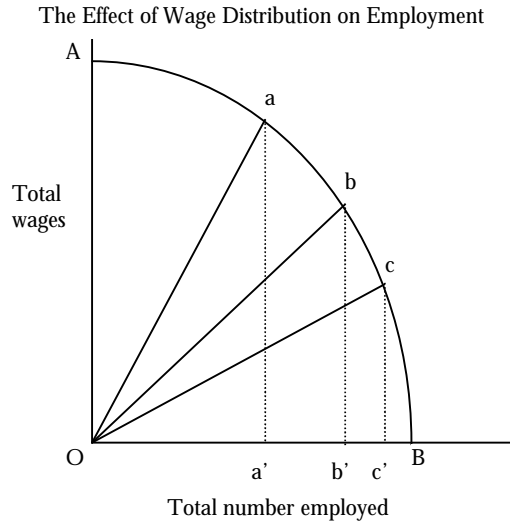
Since the closure of the frontier and the enclosure of the commons, it has been difficult to find some refuge for the worker which would allow him to refuse a disadvantageous work contract. But the key seems to be in restoring the things that frontier and commons provided. We will have to discover the common use values of land and find some way of distributing them. Indeed, the second part of the Church’s strategy involves the wider distribution of property, and we should note here that the Church means productive property. For Leo XIII, writing in 1891, this meant land, as most people were still dependent on the farm or came from families that were. By our own time, “capital” had replaced land as the primary means of wealth. Thus John Paul II could broaden the definition to include plans to associate the workers with ownership of the company for which they worked.

The key point is that we must start with equity, since equity is prior to equilibrium. Where there are vast differences in wealth and poverty, where there is monopoly or oligopoly, where there is government granted privilege, equilibrium will be unlikely, or will be maintained only by virtue of massive government intervention in the economy. For example, we can easily see the effect of a too-steep gradient (the difference between highest and lowest paid workers multiplied by the number of workers in each category) in pay scales.

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<sup>99</sup> However, we can note the brilliant suggestion of John D. Mueller to set the standard income tax deduction equal to the poverty line. Suddenly there would be a great interest in the poor and their line, interest that is largely lacking right now, and the general public would have an incentive to be more generous.

Let O-A be the total amount paid in wages, O-B be the maximum number employed, and the arc A-B be the possible distributions of the wage fund O-A. The lines O-a, O-b, and O-c represent different



gradients of wages and O-a', O-b', and O-c' different levels of employment corresponding to the different wage gradients. Obviously, the greater the equity, the larger number of workers can be employed. There needs to be a sufficient gradient to ensure that workers with greater skills and responsibilities have proper compensation; this is a requirement of equity. However, a too steep gradient will mean that some will go unemployed and equity will therefore be violated. There is no formula that can give the correct gradient; rather, it arises from how the culture views proper rewards. If it views everything in terms of money, then a steep gradient will be required to motivate people to accept more responsibilities. However, this is rarely the case. Greater respect and recognition and job satisfaction, for example, are also great motivators.<sup>100</sup>

<sup>100</sup> In this respect, the experience of the Japanese economy is enlightening: “The Japanese have understood that what people are largely pursuing in the workplace is not so much money as the respect of the people around them, and therefore maintain a sophisticated – indeed, bizarrely over-elaborate to the Western eye – economy of *respect* in addition to the economy of money. They have understood that a large part

Few people see their jobs solely in terms of cash, but also in terms of fulfilling the higher order needs such as fulfillment and self-actualization. This has profound impacts when considering job design as well as compensation packages.

In any case, we can begin to perceive, in a concrete fashion, the real relationship between equity and equilibrium.

The remainder of our study will largely consist in examining practices and policies which contribute to equity, and thereby to equilibrium. But we can never lose sight of the fact that equity is not a by-product of equilibrium, but that equilibrium is dependent on some rough equity. There is a cliché in social justice: “If you wish for peace, work for justice.” The economic equivalent is, “If you wish for equilibrium, work for equity.” For equilibrium is economic peace and equity is economic justice, and you will never see the former without the latter.

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of what money-seeking individuals really want is just to spend that money on purchasing social respect, though status display or whatever, so it is far more efficient to allocate respect directly. Did you really think people as obviously intelligent as the Japanese were doing all those odd-looking bows for nothing? Sure, these behaviors are derived from tradition, but there’s a reason they kept these traditions and the West hasn’t. Interestingly, this understanding on their part of the need for unapologetic status differentials contradicts the emphasis in Western socialism on a *culture* of equality.” Robert Locke, “Japan, Refutation of Neoliberalism,” review of Reviewed Item, *post-autistic economics review*, no. 23 (2004), <http://www.paecon.net/PAERreview/issue23/Locke23.htm>.

The two are practically the same words and very nearly the same thing

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