

Frank Knight: an unexpected critic of free-market economics?

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While in 1945 there was a ‘broad acceptance of the need for a mixed economy’, by the year 2000 ‘the situation had changed dramatically’: the role of government had been minimized and that of the market maximized (Backhouse 2010, pp. 137-8). ‘Competition, markets and incentives replaced social justice as the dominant political discourse and in both the United States and Britain, inequality in the distribution of income was allowed to rise to levels that for much of the post-war era would have been considered socially divisive’ (p. 138). There has ‘been a broad commercialization of society and even of values’ (p. 138). The ‘climate of opinion’ or ‘fashionable general assumptions’ or ‘conventional wisdom’ had changed in two ways (Backhouse 2009, p. 17). First, those who championed ‘neoliberalism’ or free-market economics (and denounced any form of government action as ‘socialism’) had become more prominent. Second, apart from these free-market champions, even amongst those sympathetic to ‘social-democratic ideals’ there existed a widespread scepticism about whether government intervention ‘could ever raise social welfare’ (p. 17). ‘The media’s preference for simple, clear-cut solutions’ contributed to this change in the general climate of opinion (p. 24). Apart from this general change, there was also a change in the discipline of economics. Whereas in the early postwar years attention had generally been focused on ‘market failure’, since then research had turned increasingly towards ‘market solutions’ to economic problems (2010, p. 138). In addition there were a number of economists who were chiefly ideologically inspired: their championing of free-market economics was combined with emphasizing ‘government failure’ i.e. the likely failure of any sort of government intervention in the economy.

According to Kern (1993, p. 259), Frank Knight as a founder (along with Jacob Viner) of the Chicago School is ‘best known as an advocate of laissez-faire and defender of free market institutions’. He goes on to describe Knight as ‘synonymous with conservatism’ as reflected in his influence on his famous students such as Friedman, Stigler, Becker and Buchanan. Knight’s (1933) *Economic Organization* contained ‘the elements of theory that helped establish for Chicago its eminence in neoclassical economics’ (Buchanan 1968). The School engaged in a ‘positive program for laissez-faire’ (Simons 1934). ‘Many consider Knight [to be] the quintessential American twentieth century neoclassical economist’ (Emmett 1998, p. 153). And his role as the leading anti-Keynesian in America

is generally accepted. Given all this, it would seem that Knight would have welcomed the new-found enthusiasm for free-market economics in the 21st century. Yet such a conclusion probably reflects the conflation of Knight and the Chicago School, particularly its development in the postwar era. For most people, who have only a vague notion of Knight as part of the Chicago School and hence conflate Knight and the Chicago School, Knight would then appear an unexpected critic of the recent enthusiasm for free-market economics.

Yet, a closer analysis reveals several reasons why such criticism would not be unexpected. Whereas earlier accounts emphasize a continuity in the School (Reder 1982), more recent work has stressed the differences between Knight and the postwar Chicago School (Emmett 2007). One of the main differences is that, unlike the postwar Chicago School, Knight made clear the limitations of neoclassical theory. For example, it has been argued that Knight would have completely rejected Stigler and Becker's (1977) proposal that economists 'accept the assumption that tastes, preferences and values are stable over time and place, and the same for everyone' (Emmett 2006, p. 100). Indeed, if Knight is regarded as a classical liberal then he would need to be sharply distinguished from the leaders of the postwar Chicago School if we accept Mirowski's (2008, p. 112) emphasis of neoliberalism as a 'self-conscious communal project' in contrast to the individualism of classical liberals. (Mirowski points out that Friedman (1951) had used the term 'neoliberalism'.)

Apart from whether the Chicago School is interpreted as continuous or not, another reason that Knight's criticism would not be unexpected is due to his acknowledged role as a critic (Emmett 1999, p. xxi). For Reder (1982, p. 4), Knight was 'above all a critic'. Hammond (2001, p. 857) describes Knight as 'the ultimate provocateur'. In this vein, Knight once stated: 'There is always a principle, plausible and even sound within limits, to justify any possible course of action and, of course, the opposite one' (quoted in Burgin 2009, p. 521). Hence Burgin (2009, pp. 520-1) sees him as 'primarily a critic, more comfortable with exposing the obfuscations of other theorists' systems than constructing his own'. Knight as the critic reflected his determination 'to see all sides of the phenomenon he studied, to point out the limitations of the argument he himself accepted' (Heyne, in Brennan and Waterman 2008, p. xix). Given this background, Knight's criticism of today's enthusiasm for neoliberalism would not be at all unexpected.

The underlying reason for arguing that such criticism would not be unexpected is, of course, to be found in the works of Knight himself. Already in his first major publication, Knight (1921, p. 11) sought to 'search out and placard the unrealities of the postulates of theoretical economics'. He explained that his aim in doing so was not to 'discredit' the doctrine, but simply to 'make clear its theoretical limitations'. Knight (1922, 1923) provide 'a devastating criticism of the traditional economic belief in the ethical primacy of free enterprise' (Emmett 1999, p. xii). Indeed Knight (1923) has been described as 'among the most radical [pages] ever written in economics' (Patinkin 1981, p. 36). According to Emmett (1999, p. xix) expectations of increased government control in the wake of the Great Depression, together with the rise of fascist and totalitarian

governments in Europe, brought Knight's 'disenchantment' with liberalism to the foreground in his 'infamous' lecture entitled 'The case for communism: from the standpoint of an ex-liberal' delivered in 1932 but (publicly) published only years later (Knight 1991). Burgin (2009, p. 517) points out that 'the lecture's implicit indictment of capitalism' has generally been 'deflected' by arguing that that it was 'deliberately ironic', 'tongue-in-cheek' or even a 'joke'. Burgin takes issue with this traditional interpretation, arguing that Knight was perfectly serious in his 1932 lecture. Yet, he argues, it would be wrong to conclude that Knight was therefore 'heterodox' or 'radical'. Instead the lecture's 'condemnation of liberalism' stems from the deliberately paradoxical nature of Knight's social philosophy which reflected the fact that he saw himself as living in 'a world full of contradiction and paradox' (pp. 520-1).

Having argued so far that Knight, upon closer analysis, would not be an unexpected critic of today's enthusiasm for 'neoliberalism', the next question is to inquire into the nature of his critique. I argue that Knight's critique emerges from his 'six categories' which will be outlined in the third, and main, section of this paper. Since Knight's analysis relates to the interwar period, it raises the question as to what extent it applies to economics in the 21st century. During the second half of the 20th century there has, indeed, been a dramatic change in economics for many different reasons: the second world war, the Cold War and Vietnam, the demise of 'communism' and the Soviet Union (together with consensus that central planning had failed). Yet, I argue, the two ideas concerning economics that so occupied Knight's critical attention in the interwar years – liberalism and scientism – remain strongly embedded in orthodox economics in the 21st century. By 'liberalism' I mean the classical liberalism of John Stuart Mill (promoting individual freedom and limiting the role of the state). By 'scientism' I mean the idea associated with Hayek ('the slavish imitation of the method and language of Science') that 'the methods of the natural sciences are applicable in all inquiry, especially in the human and social sciences' (Mautner 1999, p. 511).

Regarding scientism, it has been argued that an important factor that drove the postwar change in the discipline of economics was the desire of economists to be regarded as scientific (Backhouse 2010, pp. 115, 117), as well as quite simply the aesthetic appeal of 'rigorous models based on questionable assumptions' (p. 136). According to Ross (1991, pp. xiii-xiv), American social science (with economics, sociology and political science as 'the three core disciplines') is distinguished by 'the degree to which it is modeled on the natural rather than the historical sciences and imbedded in the classical ideology of liberal individualism'. If we accept the points by Backhouse and Ross, then Knight's criticism of these ideas – scientism and liberalism - explains why his criticism would not only be unexpected, but, more to the point highly relevant to a critique of today's enthusiasm for free-market economics. Consequently, the bulk of the paper will concentrate on explaining why Knight was critical of scientism and liberalism by outlining his explanation of the need for a pluralist approach to economics. Before turning to this there are two issues that need to be discussed.

The first issue relates to scientism. This concerns Backhouse's argument that an important factor that drove the postwar change in the discipline of economics was the

desire of economists to be regarded as scientific (Backhouse 2010, pp. 115, 117). Depending on the meaning of ‘scientific’ and to the extent that this argument is accepted, it provides support for the view that what Knight had to say about the dangers of scientism in the interwar years would continue to be relevant to economics in the 21st century. Nevertheless it might be argued, against Backhouse, that what has led to economics being in the state it is in the 21st century is that it has been captured by an ideological clique stemming from the founding of the Mont Pèlerin Society in 1947 and reflected in the power and influence of the postwar Chicago School. I therefore review Backhouse’s argument to explain why, amongst many factors, it appears that economists’ desire to be scientific plus ideas on what it meant to be scientific seems to have been more important than ideology in accounting for the state of economics in the 21st century.

The second issue relates to liberalism. One of the points that occupied Knight in this regard was his well-known rejection of the assumption that individual wants and desires can be treated as given or data (Knight 1922, p. 20). Knight went on to say that the most important defect of liberalism is that it ‘takes the individual as given’ when in fact he or she is ‘very largely built up in and moulded by the social traditions, institutions, and processes of the culture in which the individual grows up’ (1939, p. 84). Given Knight’s questioning of this assumption, a brief discussion of recent work in this area should aid understanding of his call for a pluralist approach to economics. Consequently, I turn in the next section to a brief discussion of the theory of the individual in economics (Davis 2003).

1. Ideas about what it meant to be scientific drove much of the post-second world war change in the discipline of economics

Before the second world war economics in America was divided mainly between Marshallian neoclassical economists and institutional economists, for example Mitchell and those at the NBER who responded to the abstractedness of neoclassical theory by trying ‘to make economics more scientific by providing it with strong empirical foundations’ (Backhouse 2010a, p. 40). The institutionalist approach was related to the view of natural scientists such as Poincaré and Einstein that being scientifically rigorous ‘meant to be constrained by empirical data’ (Backhouse 2010, p. 100). ‘However, partly in response to the superseding of classical physics with the theory of relativity and quantum mechanics, [scientific] rigour now came to be associated with formal reasoning in science and mathematics. Modelling was about establishing the logical consistency of theories, rather than establishing firm links between theories and data’ (p. 100). In light of this the NBER approach was superseded by that of the Cowles Commission which constructed general equilibrium models of the economy in which it was assumed that all markets were perfectly competitive (p. 103). ‘Economics emerged from the war with its reputation greatly enhanced, both by its contribution to mobilizing the American economy and for what it had contributed to military activities’ (Backhouse, 2010b, p. 39). Economists ‘had rubbed shoulders’ with natural scientists during the war and Paul Samuelson ‘stressed the connections between economics and the natural sciences, not the social (Backhouse and Fontaine, 2010b, pp. 343-4).

The Cold War followed the second world war. Economists at RAND (a think tank started by the US Air Force) developed game theory as a way ‘to think rationally about the nuclear stand-off between the United States and the Soviet Union’ (Backhouse 2009, p. 20). “‘Rational choice’ came to be linked to the struggle for democratic over totalitarian values. Rational choice represented individualism against collectivism, and acquired a stronger ideological dimension (Amadae 2003)’ (Backhouse 2010b, p. 47). In the 1950s the Ford Foundation funded the development of business schools, most importantly the Carnegie Graduate School of Industrial Administration (GSIA) (Herbert Simon, Cyert, March and Williamson, Lucas) which under its economist director ‘fostered a view of economics in which firms and economic agents were seen as information-processing systems, the behaviour of which could be analysed using formal mathematical techniques’ (Backhouse 2009, p. 20). Lucas argued that rational expectations models should be ‘based on the allegedly unchanging “deep structural parameters” of tastes and technology’ (Backhouse 2010, p. 131-2). These postwar developments in economics reflected two things. First, they reflected the view that scientific rigour in the postwar period had now come to be associated with establishing the logical consistency of theories, with modeling – rather than with the prewar notion which emphasized the need for theories to be constrained by empirical data. ‘Economists saw themselves as modelers, and by the mid-1950s had come to accept that individuals should be modeled as maximizing agents and that markets should be modeled as perfectly competitive’ (Backhouse 2010a, pp. 53-4). Secondly, they reflected the extent to which economics had become involved in the anti-communist ‘military-industrial-academic’ complex. Despite such clear anti-communist ideological overtones, Backhouse argues that economists’ work in this complex focused on ‘developing quantitative techniques that could be used to organise resources efficiently, whether in the private or the public sector’ (Backhouse 2009, p. 20). In other words, there was no systematic ideological predisposition towards the private and against the public sector.

The oil crisis of 1973-4 leading to dramatically high levels of inflation and unemployment followed the Cold War. Whereas up until the 1960s formal models had become increasingly prevalent in economics, such methods were not expected to explain everything. For example, it was accepted that macroeconomics could not be explained by microeconomics (p. 21). In the aftermath of the 1973-4 oil crisis the prevailing Keynesian consensus was superseded by Friedman’s monetarism and his concept of the natural rate of unemployment. ‘Where Friedman had argued that policy was in practice destabilizing, Lucas [who moved from the GSIA to Chicago in 1975] demonstrated that, if private agents were completely rational and if markets were competitive, it would be *impossible* for government to stabilize the economy’ (p. 21). In arriving at this conclusion, and in his method, Lucas’s theory demonstrated both the extent to which the discipline of economics had been transformed from largely verbal to mathematical analysis, and the extent to which it had been transformed from largely supporting a role for ‘social-democratic’ government intervention to one which supported a ‘neoliberal’ view which saw no such role for government.

Systematic ideological predisposition towards the private sector appears to have entered economics via the writings of the postwar Chicago School, Friedman and the monetarist

counterrevolution against Keynesianism. The background to this is to be found in the history of the Mont Pèlerin Society. Reacting to what he saw as the danger of socialism, Hayek argued that socialist ideas had become influential due to ‘a class of people he called intellectuals, whom he later called “dealers in second hand ideas”. They included “journalists, teachers, ministers, lecturers, publicists, radio commentators, writers of fiction, cartoonists and artists” (Hayek 1949, p. 418) – professional communicators but amateurs as regards the substance of their ideas’ (Backhouse 2009, p. 17). Hayek founded the Mont Pèlerin Society in 1947 in order to convert these ‘dealers in second hand ideas’ from socialists to free-marketeers. ‘The Society’s aim was not to exert an immediate influence on policy but to have a long-term influence on the climate of opinion’ (pp. 17-18). The Society gave rise to a host of free-market think tanks such as the Foundation for Economic Education (in the USA) and the Institute of Economic Affairs (in the UK) which ‘focused on retailing free market ideas not on academic research’ (p. 18). Amongst the members of the Society were the following members of the Chicago School: Director, Friedman, Stigler, Becker, Lucas, Buchanan and Tullock (p. 22). While the Chicago price theory approach (‘the basic theory of the rational consumer and competitive markets’) was ‘grounded on an ideological position’, the main reason the approach became so influential amongst economists in America ‘is that they were seen as doing rigorous [scientific] work in tackling important [economic] problems’ (Backhouse 2010, pp. 149-150). That is, Backhouse argues that the discipline of economics was not ‘captured’ by the Mont Pèlerin Society. The move towards formal mathematical modeling and ‘rational-choice theorizing . . . was not foisted on the profession by a small, ideologically committed group. It was accepted because it offered powerful, rigorous and apparently scientific methods that appeared to be successful in tackling economic problems’ (p. 185).

The influence of ideology undoubtedly played a part in the transformation of economics from being focused on government solutions, to being focused on market solutions, to economic problems. Whether or not we accept Backhouse’s (2009, 2010) conclusion that, rather than ideology, the main reason for the transformation of economics is to be found in the influence that the changed postwar concept of scientific rigour played in a profession which desired (for various reasons) to be regarded as ‘scientific’, for the purposes of this paper it provides support for the view that the postwar change in the concept of science played an important role in the transformation of economics.

2. The theory of the individual in economics

One of Knight’s criticisms of the liberalism involved in orthodox economics relates to his well-known rejection of the assumption that individual wants and desires should be treated as given or data (Knight 1922, p. 20). Knight went on to say that the most important defect of liberalism is that it ‘takes the individual as given’ when in fact he or she is ‘very largely built up in and moulded by the social traditions, institutions, and processes of the culture in which the individual grows up (1939, p. 84). Given Knight’s questioning of this assumption, a brief discussion of recent work in this area should aid understanding of his call for a pluralist approach to economics. Consequently I briefly review the theory of the individual in economics as set out by Davis (2003).

According to Davis, both neoclassical and contemporary mainstream economics, ‘which make the individual central to their analysis lack an adequate conception of the individual’ (p. 17). This stems from their response to difficulties in the modernist conception of the individual, upon which their theories are based. The modernist conception originates ‘in the Cartesian-Newtonian dualism of human subjectivity and objective nature’ (p. 2). Both Descartes and Locke saw the individual as subjective inwardness, or consciousness, which is disengaged from the world (p. 2). For Locke, individuals are autonomous because their private states of consciousness remain unchanged. In neoclassical economics individual tastes (cardinal utility theory) and preferences (ordinal utility theory) remain unchanged when they interact with others (p. 24). Their consciousness, that is, remains disengaged from the world. This raises the problem of how their inner subjective worlds link up with the outer world (p. 25). Locke’s conception suffers from being solipsistic and idealist (p. 6). While the concept of (cardinal) marginal utility (what the individual subjectively wants) appeared to bridge this link by explaining what the individual does (her actions or demands in the objective world) this explanation was incompatible with the objective Newtonian scientific world view (p. 26). This incompatibility seems not to have been viewed as a problem by Wicksell, Marshall, Pigou and Knight for whom ‘one could only understand the behaviour of real-world economic agents when one thought in terms of the motivations behind their actions’ (i.e. a human psychological interpretation of utility). However the incompatibility with the objective Newtonian scientific world view meant that ‘the dominant trend’ was away from human psychological interpretations of utility (p. 29). The trend began with the change from cardinal to ordinal utility. Since the rank ordering involved in ordinal utility applied to combinations of goods, ‘after Pareto, individual preferences were only nominally [humanly] subjective’ (p. 28).

Friedman argued in an ‘as if’ manner that it was unnecessary to think in terms of utility functions to be able to explain demand. ‘Stigler and Becker (1977) made preferences insignificant in the determination of price by assuming them neither to vary nor to differ importantly between people’ (p. 30). In terms of Samuelson’s (1948) revealed preference theory, ‘preferences do not dictate an individual’s choices, but rather an individual’s choices are said to be revealed preferred according to the observable choices the individual makes’ (p. 30). Reference to human psychology in explaining economic behaviour was now seen as unnecessary. ‘With his ambition of making economics “scientific”, Samuelson [thus] resolved the problem of Enlightenment dualism by dropping Locke’s inward subjectiveness side ‘and recasting the world in pure Newtonian terms’ (p. 30). He also demonstrated that choice could be explained in purely formal terms’ (p. 30). In terms of the Cowles tradition of Walrasian general equilibrium theory ‘preferences lost their psychological characterization altogether, since their interpretation now depended on their formal specification rather than on their description as natural phenomena’ (p. 31). That individual ends are specified entirely formally in terms of objective functions is a view more appropriate to Newton’s object world (p. 27). The private psychology of ‘the neoclassical subjectivist conception of the individual’ was thereby given up for the ‘purely formalist [abstract] conception’ that characterizes today’s mainstream economics (p. 23).

In contrast to neoclassical and modern mainstream economics, heterodox economics, ‘which generally does not emphasize the individual, in fact offers elements of an adequate theory of the individual’ (p. 17). This is because it draws on the ‘social science’ and postmodernist critiques of the modernist conception of the individual. According to the ‘social science’ critique, ‘our experience is not essentially private and inward, as Locke believed’ but ‘must be understood in terms of our relation to society’ (p. 7). If we understand identity ‘in terms of the ways that individuals seek “social identification” then we can view individuals as ‘replacing the burden of maintaining personal identities for the security of group identities’ as constituted variously by consumerism, religion, ethnicity, mass media etc (p. 7). In these terms ‘the view is not that the individual ceases to exist, but rather that individual identity is continually created and re-created in terms of external group associations’ (p. 7). The postmodernist critique ‘has its origins in the work of Nietzsche [a world without God], who regarded the concept of the self as a fiction we impose upon ourselves through language [no more than a changeable play of masks] to veil the world’s terrifying nature as ceaseless change and endless becoming’ (p. 8). In these terms ‘individual identity always dissolves away whenever we attempt to locate it’ (p. 9). ‘Ontological depth’ and ‘subjective inwardness’ to do not lay claim to a world beyond discourse (p. 9).

The postmodernist critique highlights the fact that the modernist conception of the individual lacks a ‘positive account of what subjective inwardness actually involves’: it is concerned with ‘what the individual is not, rather than what it is’ (p. 10). While it is true that very many people hold on to an idea of the individual in terms of a subjective inwardness or consciousness which is on a completely ‘different plane from principles that explain the natural world’, the weakness of this view makes it liable to be replaced by ‘a darker view of the individual’, namely, the [naturalist] view of cognitive science that the mind is only a type of computer’ with the individual as a machine-like or ‘cyborg’ being (p. 11). With this in mind, Davis argues that orthodox economics could strengthen itself by acquiring a more adequate theory of the individual from heterodox economic theory, in spite of the individual being embedded in this theory (p. 17). My argument in this paper is that orthodox economists need not even look that far, at least to begin with. This is because they could look first at the work of that most orthodox of orthodox economists, Frank Knight.

3. Knight on the pluralism of categories, or levels, of interpretation required in the realistic treatment of human-social subject matter: Knight’s ‘six categories’

It is in order to combat the dangers inherent in the view that social science must be conducted in the manner of a natural science that Knight (1934, p. 327; 1940, p. 26; 1941a, p. 125; 1942, p. 287) repeatedly emphasizes ‘the pluralism of categories required in the realistic treatment of human-social subject matter’ for each of these ‘contains a large element of truth’ (1942, pp. 286-7; 1934, p. 327). Knight distinguishes six categories: three positivistic and three non-positivist or problem-solving categories. The first two positivistic categories concern ‘man’ as a physical mechanism and ‘man’ as a biological organism. Both of these lie in the domain of natural science. The third

positivistic category concerns ‘man’ as a ‘social animal’. It lies only partly in the domain of social science. In this category, society is conceived as based solely upon tradition or ‘institutions’ or habit (1941a, p. 124). ‘Laws are to be discovered inductively by “observing the phenomena’ (1934, p. 331). The category includes sociology or ‘culture anthropology’ of which one branch consists of institutional economics (1941a, p. 125). These three positivistic categories share the same concepts of causality and subject matter. They share the same Humean, empirical notion of causality. In this view ‘causality is a matter of discoverable and describable order in phenomena’ (1943, p. 137). This allows us to ‘predict’ i.e. to describe ‘in terms of reliable and stable patterns of uniformity of coexistence and sequence’ (1943, p. 140). They share the same concept of subject matter as that of dealing with the material.

The three non-positivist or problem solving categories: categories 4, 5, and 6

By contrast the three non-positivistic categories use different notions of causality and subject matter. Concerning causality, use is made of ‘interpretive principles of a non-empirical, metaphysical, more or less dynamic, character’ (1943, pp. 137-8). (Knight points out that such principles are used even in physics e.g. the notion of (causal) forces (1943, pp. 137-8). In these non-positivistic categories ‘man’ is treated as consciously purposive, goal seeking or problem-solving. ‘Man’ deliberates rather than acts instinctively. Knight argues that ‘motives in human behavior play the same role in discussion as [causal] forces in mechanics; they are essential for ultimate intelligible interpretation’ (1943, p. 139). They share the same concept of subject matter as that of dealing with the ideal.

Category 4: ‘Man’ as an instrumental problem-solver

Knight regards this category as only partly a social science. Orthodox economics falls into this category. ‘Traditional or “classical” economic theory’ addresses the most basic kind of problem-solving – [instrumental problem solving] (1941a, p. 128; 1934, p. 329). Economic theory has two branches or topics (1934, p. 277ff.). It studies:

a) a type of individual behaviour – the ideal of ‘economic man’

This basic kind of individual behaviour concerns the instrumental problem of using given means to realize ends which are given i.e. they are defined by the actual preferences of the individual whatever their source (1941a, p. 127). The economic problem is then the limited one of efficient procedure via correct allocation of means (1940, p. 27).

b) a type of social organization – the ideal of the ‘perfect market’

Here economic theory deals with social in the sense of ‘interindividual relations’ i.e. ‘with co-operation or organization between individuals for increasing efficiency in the use of means to realize ends . . . the market is simply a mechanism for organizing relations of mutual advantage’ (1943, p. 146). ‘The Economic man neither competes nor haggles [but] treats other human beings as if they were slot machines’ (1939, p. 80).

The social organization dealt with in economic theory is best pictured as a number of Crusoes interacting through the markets exclusively. To the economic individual, exchange is a detail in production, a mode of using private resources to realize private ends (1934, p. 282).

By the nature of its fundamental conceptions, theoretical economics is an *individualistic* science . . . the “economic man” is not a social man, and the ideal market dealings of theory are not social relations (1934, p. 337).

While problem-solving instrumentalist economic conduct may be interpreted within such economic scientific terms, the analysis is severely limited for two main reasons. First, individual ends, desires or wants are in fact not given. Second, ‘economic man’ is not a social ‘man’. Category five addresses the first limitation and category six addresses the second.

Category 5: ‘Man’ as a valuation problem-solver

Category 6: ‘Man’ as a social being

It is only these two final categories that Knight regards as fully dealing with the issues of social science. The fifth category is concerned with ‘action in which the evaluation of the end is the main deliberative problem’ (1940, p. 27). The sixth category (‘groupism’ or ‘societalism’) ‘takes social phenomena as expressing a *motivated social choice*’ (1934, p. 332). While Knight acknowledges that the concept of social decision raises problems surrounding the (metaphysical) concept of a group or social mind, this must not distract attention from ‘the fact that social phenomena cannot be completely accounted for in terms of interaction between individual minds taken as *data*’ (1934, p. 332n†). Society is not merely an aggregate of atomistic individuals. ‘The irreducibly social residuum . . . must be recognized as having the same general properties, powers or “faculties” as an individual mind’ (1934, p. 332n†). As Knight (1934, p. 334) points out there is a close relationship between these two categories, that is, between ‘social choice [category 6] and the effort to realize norms or values [category 5]’. ‘For practical purposes’ these two categories are ‘largely identical’ (1934, pp. 337-8).

a) The problem with economics is that by taking individual desires as given and indisputable (*de gustibus non est disputandum*), it cannot solve value problems

‘The scientific mind can rest only in one of two extreme positions, that there are absolute values, or that every individual desire is an absolute and one as “good” as another. But neither or these is true’ (1922, pp. 39-40). According to Knight, economics wrongly takes the second extreme position of treating every individual desire as an absolute value: ‘Of the various sorts of data dealt with in economics no group is more fundamental or more universally and unquestioningly recognized as such than human wants’ (1922, p. 20). Knight questions this ‘starting-point’ of economics i.e. he questions the view that wants can properly be regarded as (scientific) data. Economics, he says, ‘has always treated [individual] desires or motives as facts . . . as causes of activity in a scientific sense’ (1922, p. 21). However, Knight argues, ‘the “creation of value” is distinctly more than the satisfaction of desire’ (p. 21). The mistake economics makes in taking the extreme

position that every individual desire is an absolute, and that one is as good as another, is that the process of ‘valuation is inherently a social activity’ (1942, p. 280).

Economics falls into this trap because it takes the individual as given. ‘The assumption that this can be done runs counter to clear and unalterable facts of life. The individual cannot be a datum for the purposes of social policy, because he is largely formed in and by the social process’ (1939, p. 84). It should be fairly obvious that the three elements of the economic individual (wants, means and technology) ‘are very largely built up in and moulded by the social traditions, institutions, and processes of the culture in which the individual grows up’ (1939, pp. 84-5). For instance, individual wants are also social, ‘partly created by the unconscious social processes of society and partly decided upon or chosen through intellectual activity, which is always fundamentally social in character’ (1941a, p. 130). {[Knight emphasizes the fact] ‘that social phenomena cannot be completely accounted for in terms of interaction between individual minds taken as *data*’ (1934, p. 332n†). Society is not merely an aggregate of atomistic individuals as methodological individualism would have it.}

In contrast to *individual* desires Knight, as we have seen, argues that valuation is a *social* activity. ‘Human social problems arise out of conflicts of interest between individual members’ (1941a, p. 125). ‘Values arise out of conflicts between interests. . . . A value is the solution [to a social] problem’ (1942, p. 281). Knight proceeds to explain the necessity of the field of ethics for any social science relevant to social problems (1934, p. 343; 1939, p. 153). ‘Ethics deals with the problem of choosing between different kinds of life, and assumes that there is real choice between different kinds of life, or else there is no such thing as ethics’ (1923, p. 71).

For Knight, social science must be relevant to social action which is essentially ‘group self-determination’ and consists of making (and changing) the law (1941a, p. 132-4). This social action is a process of rational discussion that attempts to solve ethical problems by establishing agreement upon ethical ideals or values – the social problem is one of values, not one of fact. Such values are objective and ‘belong to a value-cosmos which has the same kind of validity, or reality, for our thinking as the external physical world’ (1941a, p. 133).

The social problem is, in the main, the current political problem . . . [and] . . . is a social problem only in so far as it is present to the social consciousness as a problem for conscious and intelligent solution. Any social science relevant to social problems is therefore restricted . . . to the sixth of the list of our possible approaches . . . the other approaches merely provide data and set limits to the alternatives of social choice (1934, p. 343).

b) Solving social problems – or value problems – via an ‘absolute’ ethics: the practical case of liberalism

Knight accepts that it is possible to argue that values are purely relative i.e. ‘that it means nothing to say that anything is good or bad except in comparison with a worse or better alternative’ (1923, p. 44). However, he argues that when ‘higher’ questions are at issue ideals are formulated and actuality compared with these i.e. an ‘absolute’ ethics is

involved. This ethics is not really absolute because the ideals ‘are never cut loose entirely from the real world and its possibilities of growth and transformation’ (1923, p. 44).

Knight now proceeds to use this ‘absolute’ ethics approach to examine the extent to which a particular kind of life – liberalism or the organization of life on a competitive basis - can ‘bring about an ideal utilization of social resources’ i.e. he examines the competitive system ‘from the standpoint of its ethical standards’ (1923, pp. 54, 45). For Knight, liberalism refers to the ‘social order accepted as a working ideal in European civilization in the later nineteenth century’ (1939, p. 58). ‘The essential social-ethical principle of liberalism . . . is that *all relations between men ought ideally to rest on mutual free consent*’ (1939, p. 60).

Knight argues that in a liberal social order the economic system is a competitive game. The motive for business is emulation. The rewards are wanted as signs of success – medals – in the game (1923, p. 46). ‘In a competitive game it is absurd to speak of equality as an ideal’ (1923, p. 61). This economic system influences the character of individuals. The modern idea of enjoyment and achievement is getting ahead of others ‘in a rivalry for things about whose significance, beyond furnishing objectives for the competition itself, little question is asked (1923, p. 47). Knight describes this psychological hedonism as ‘the economic philosophy of life’ (1922, p. 22). Knight appears to argue that the ethical foundations for this psychological hedonism lay in utilitarianism. He points out that economists have long dominated the utilitarian school of ethics according to which what is good is an entirely individual matter: ‘what is good is that the individual shall get what he wants’ (1929, pp. 3-4). This utilitarian political philosophy of *laissez-faire* was set out by Adam Smith. In his examination of liberalism, Knight’s ‘special purpose’ is to show that ‘in the conditions of real life no possible social order based upon a *laissez-faire* policy can justify the familiar [benevolent] ethical conclusions of apologetic economics’ (1923, p. 49).

According to Knight ‘the fatal defect’ in the doctrine of *laissez-faire* is its confusion of freedom and power . . . ‘the practical question is one of power rather than of formal freedom’ (1929, p. 7). (Underlying this fatal defect of confusing freedom and power is the fact that ‘*liberalism takes the individual as given*’ (1939, p. 84).) Even the most free form of exchange (in a competitive market) can at best maintain the values of the original stocks before exchange and therefore the existing distribution of income, wealth and power. This implies that, not only the existing distribution but also ‘the right to use what one has to get more, without limit’, is ethically defensible (1929, p. 8).

The result is dogmatic acceptance of an existing distribution of power, which is an ethical proposition, a value judgment in disguise, and an ethically indefensible one. Moreover, it involves logical contradictions. Freedom means freedom to use power, and the only possible limitation on the use of power is intrinsically ethical . . . Freedom and coercion are ethical categories (1929, p. 19).

Knight therefore argues that the naïve faith in the benevolence of *laissez-faire* individualism is ‘untenable’ (1939, p. 86). Its main weakness ‘as compared with an ideal system . . . lies in the natural, cumulative tendency toward inequality in status, through the use of power to get more power’ (1934, p. 296).

In a 'free' social-economic system there is every presumption that movement will be away from and not toward fundamental human equality . . . Freedom, again, means the right to do what one is able to do, i.e., to use power, and has content only in so far as one possesses power. Equal right to use unequal power is not equality but the opposite (1939, p. 87).

Knight (1923, p. 71) contrasts this 'ethics of scientific naturalism' or psychological hedonism, expressed in the utilitarian political philosophy of *laissez-faire*, with ethical hedonism in which happiness depends upon cooperation and affection for others rather than on getting ahead of others 'in a rivalry for things about whose significance, beyond furnishing objectives for the competition itself, little question is asked' (1923, p. 47). There is no justification of competition in Aristotle or Plato. In the Christian view, happiness depends upon spiritual matters: competitive values are not admitted into Christian thought. Christ's participation in competitive sport 'is not to be imagined': the last should be first (1923, p. 71). Knight concludes that he has searched in vain for any really ethical basis of approval for competition as a basis for an ideal type of social order or as a motive to action. 'Its only justification is that it is effective in getting things done' (1923, p. 74).

In principle democracy is political individualism so that 'one man one vote' would seem to ensure a more equal distribution. However in practice it is 'competitive politics, somewhat as free enterprise is competitive economics (though inherently a competition for a monopolistic position)' (1934, p. 295). For both economics and politics, the reality is that the drive for action is the competitive interest in the sense of emulation or rivalry (1934, p. 296). 'One of the most fundamental weaknesses of the market system is the use of persuasive influence by sellers upon buyers and a general excessive tendency to produce wants for goods rather than goods for the satisfaction of wants' (1934a, p. 39). However, persuasive influence is 'almost the essence of democratic political process, and is definitely more sinister where the advocate appeals to men in the mass, and they decide in the mass, rather than individually' (1934a, p. 39). Thus, while the main weakness in both economics and politics is the tendency towards inequality in status through the use of power to get more power, liberal politics is worse than liberal economics in this regard (1934, p. 296). ('The fundamental fact in both is the moral fact of rivalry, competitiveness, and the interest in power' (1934, p. 297).) Thus the jump to politics 'is no cure for the self-defeating tendencies of economic competition, but is rather a jump "from the frying pan into the fire"' (1934, p. 298; see also 1934b, p. 39).

Conclusion

As Burgin (2009) has pointed out, when Knight set out 'The Case for Communism' in his 1932 lecture, he was not giving it 'tongue in cheek' or as a joke. Unlike the postwar Chicago School economists headed by Friedman and Stigler, he all too clearly recognized the substantial limitations of liberalism. Knight seemed to argue that the way economics was set up overemphasized the individualist aspects of liberalism. Knight warned in 1922 and 1923 that liberalism's defect in taking the individual as given, exacerbated by economists' support for the utilitarian political philosophy of *laissez-faire*, was leading to a social order for which he could find no ethical basis for approval – at least on an ideal

level. 'If wants are data [the place of ethical theory] must be taken by economics. . . . the great majority of economists . . . have not really believed in ethics in any other sense than that of a more or less "glorified" economics' (1922, pp. 20-21).

Knight argues that the defect in liberalism (of taking the individual as given) led in economics to the mistaken notion that values were the same as, or indeed given by, individual desires. Yet, Knight argues, values are social entities. They are derived from the interaction of individuals in a society. In this society, because individual interests clash, the outcome represents both the solution of a social problem as well as a value. These values reflect a system of ethics adopted by a society. Knight describes the kind of life that arises in liberalism, or the organization of life on a competitive basis. He points out that it is possible, if the individuals in a society choose a different system of ethics, to choose other kinds of life. If there is no real ethics, that is, if the only ethics is economics, then we may become trapped in the kind of life that stems from liberalism. Knight then, seems to warn us of the danger of continuing to follow the liberal road. In this light, he would view, for example, the rapidly increasing levels of inequality associated with today's neoliberalism as only to be expected.

Knight also seems to argue that it is the way in which the discipline of economics has been set up that has contributed to its 'ethical' underwriting of this defect of liberalism. That is, economics has been set up as a science and as such is predisposed towards the proposition that there are absolute values. This predisposition has contributed towards its viewing of individual desires as absolutes. In order to combat this view, Knight emphasizes the importance of not conducting social science in a scientific manner i.e. as attempting to apply to it the methods of a natural science. This is why he emphasizes the 'the pluralism of categories required in the realistic treatment of human-social subject matter'. Consideration of his fifth and six categories shows that (ethical) values are not really absolute because the ideals 'are never cut loose entirely from the real world and its possibilities of growth and transformation' (1923, p. 44). It is possible – at least in the ideal -- for individuals by social discussion, in Knight's view, to choose a kind of life not based on the competitive order associated with liberalism.

In closing it should be mentioned that Knight (1923) was concerned that his essay might be seen as an 'attack' on orthodox economics and its ties to liberalism. He therefore stressed that he was 'not advocating or proposing change'. In other words, he was concerned with ideals, rather than policy. For Knight, 'while the competitive system is better than any available substitute, a clear view of its shortcomings in comparison with conceivable ideals must be of the highest value in making it better than it is' (1923, p. 45). Knight 'was a specialist who emphasized the constricted boundaries of his profession, a philosopher who declared the impotence of truths, a liberal appalled by the effects of laissez-faire, and a democrat who pronounced his peers incapable of governing themselves. His readers find constancy on the bedrock of paradox' (Burgin 2009, p. 537). In the light of this, Knight would hardly have been an unexpected critic of today's enthusiasm for free-market economics.

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