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Austrian Economics and Value Judgements: A Critical Comparison with Neoclassical Economics

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ABSTRACT.
The article points out the limits of Austrian economics in so far as the passage from positive to normative economics is concerned. We propose a comparison with neoclassical economics and discuss the different theoretical solutions adopted by these two schools of thought in their legitimization of the normative discourse. The bridge from positive to normative economics is analyzed as resting upon two interdependent pillars, one of a technical nature, the other of an ethical one. In the case of neoclassical theory, these two pillars are, respectively, the "Pareto principle" and the so-called "minimal benevolence principle". In the case of Austrian economics, they are the "coordination principle" and the set of "quasi-universal" value judgements. A first problem for Austrian economics is that the coordination principle turns out to be incompatible with process analysis, the latter being a central theoretical tenet of the Austrian school. A second problem, which overwhelms both the schools of thought, has to do with distribution. Our thesis is that whereas the neoclassical solution of the distributive problem is formally consistent (although deeply unrealistic), the Austrian solution is theoretically untenable and based on strong, although implicit, value judgements.

1. Introduction

The intrusion of value judgements in economic analysis can take place at different levels. As Myrdal has pointed out, value judgements necessarily come into play at the decisive step of the choice of the problem to investigate (Myrdal 1969). At this level, the only thing to do in the attempt to separate ideological statements from scientific investigation is to explicitly state right from the beginning the motivations and the reasons that lead the choice of the field of investigation and the particular definition of the problem adopted. At a lower level, when the purpose is to define a body of normative economics to appraise the different policies of a capitalist state, some stronger value judgements are implicitly introduced, since capitalism as a system is taken as given: the value statement that is introduced is that remuneration should depend on performance. That remuneration depends on performance is a *fact* in capitalism and the value judgement in question is simply the *moral approval* of it (Harsanyi 1976). Finally, the approaches that build their positive frameworks on the assumptions of methodological individualism (which is the case of both Austrian and neoclassical economics) often espouses also some form of ideological individualism when passing to normative analysis: one thing is to say that economic processes and states of affairs must be explained starting from the individual, another thing is to say that the individual is the best judge of his own well-being. The former is a methodological position, the latter an ideological one (Blaug 1980).

In this paper, we do not focus on any of these levels of intrusion of value judgements in economics. Instead, with Myrdal, we concede that there is an inescapable *a priori* element in all scientific work and we also accept the ethical principle that remuneration should depend on performance, since we are interested in the legitimacy of different normative positions *within* capitalism and not in the moral legitimacy of capitalism. Finally, although with some greater reservation, we accept the ideological individualism that characterizes both Austrian and neoclassical normative economics.

Even with these concessions, however, we claim that the passage from positive to normative analysis is still problematic. The objective of the paper is to point out the limits of Austrian economics in such a passage to normative economics. To this aim, we propose a comparison with neoclassical economics, and discuss the different theoretical solutions adopted by these two schools of thought in their attempt to legitimize their normative discourse.

The positive question examined consists in the determination of the mechanisms of working of the market. The normative question that flows from it consists in appraising the desirability of such mechanisms. It is obvious that the passage from the positive sphere to the normative one implies the introduction of value judgements, even leaving apart the three levels of ideological intrusion mentioned above. The scientific problem is thus one of minimizing the introduction of such judgements, by leaning as much as possible on an efficiency criterion, which be neutral from the viewpoint of values. The bridge between positive and normative analysis rests in this way upon two interdependent pillars, one of a technical nature (the efficiency criterion), the other of an ethical nature (a set of value judgements). The legitimacy of the normative discourse is all the greater since the role of the first pillar is important and the role played by the second one is weak.

In the case of neoclassical theory, the efficiency criterion, considered ethically neutral, that is introduced in the passage from positive to normative analysis is the “Pareto principle”. Beside this criterion, the so-called “minimal benevolence principle” is introduced as ethical pillar. The latter is considered by the neoclassics as such an innocent value judgement to be largely shared.

In the case of the Austrian theory, the technical pillar is the “coordination principle”, beside which so-called “quasi-universal” value judgements are introduced. As for the neoclassics, the latter are considered by the Austrians as so innocent to be almost unanimously shared.

On the basis of their respective pillars, the two schools of thought derive their normative prescriptions starting from the results of their positive analyses. The aim of the paper is to examine the logical coherence of such a passage.

We proceed as follows. We commence in section 2 with a short investigation in the field of the history of economic thought aiming at clarifying the definition here adopted of the Austrian school and its main peculiarities with respect to the neoclassical one. This will lead us to characterize the positive analysis of neoclassical economics and Austrian economics as founded respectively on the concept of equilibrium and on the analysis of disequilibrium processes. In section 3, we present the pillars of the neoclassical and the Austrian bridges that sustain the passage from positive to normative analysis. A first problem for Austrian economics is that the adoption of the coordination principle turns out to be incompatible with process analysis. Such a problem is discussed in section 4. A second problem, which overwhelms both the schools of thought has to do with distribution. The discussion of the distributive issue is perhaps the hardest test for ethical neutrality, since it involves an explicit social appraisal of individual utilities and values. The theoretical solutions offered by the two schools of thought are presented in section 5. Our thesis is that whereas neoclassical economics formally passes the test, managing to preserve its theoretical consistency (although at a dear price on the ground of realism), Austrian economics does not pass it, its normative prescriptions resting upon strong, although implicit, value judgements, which go well beyond its set of quasi-universal values.

2. The Originality of the Austrian Tradition

Austrian economics is not constituted into a unified paradigm as neoclassical economics. It is thus necessary to first identify what the basic features of this tradition are in order to clarify who are the authors we are referring to.

Since its birth in the work of Carl Menger (Menger1871), the Austrian school has been facing the problem of positioning itself as distinct and perhaps complementary to neoclassical economics, fighting against the widespread view interpreting its contributions as mere verbal versions of the neoclassical theory. After a long period of ambiguities, the Austrian position is now clear (Vaughn 1994): Austrians do not adhere to the formalist program endorsed by neoclassical authors, which in general terms, aims at the determination of the conditions under which a competitive equilibrium is reached; the Austrian research program may be defined instead as an attempt to analyze the market mechanism from a dynamic perspective, by defining competition as a disequilibrium process rather than a state of affair.[1] Such a peculiarity directly flows from the specificity of the Austrian conception of subjectivism.

Austrian subjectivism is more radical than the neoclassical conception: it is not limited to preferences but is extended to expectations, costs, the conception of time and knowledge perception. We already find in Menger the germs of what was later called "dynamic subjectivism" (Menger 1871, 1883). According to O'Driscoll and Rizzo, dynamic subjectivism "[...]views the mind as an active, creative entity in which decision-making bears no determinate relationship to what went before", whereas static subjectivism is characterized by the fact that "[...] the mind is viewed as a passive filter through which data of decision-making are perceived. To the extent that the filter can be understood, the whole process of decision-making is perfectly determinate" (O'Driscoll and Rizzo 1985, p. 22).

In line with this conception, individual choice is the result of an active process of the mind consisting in the adoption of specific objectives and in the laying down of a plan of actions intended to realize them in the best manner. This scheme distances itself from the neoclassical one in which individual objectives are limited to the maximization of utility and individual choice results from a comparison within a closed set of alternatives. Austrian subjectivism challenges such a mechanist conception of human behavior, limited to mere calculation.

The contrast between the orthodox *homo oeconomicus* simply reacting to external stimuli and the Austrian *homo agens* conceived as a dynamic actor radically modifies the research agenda: within the Austrian logic, the market is viewed as a process of continuous change whose dynamics precisely results from the interaction between subjective individual plans.

It is now possible to answer the initial question, namely who are the Austrians we are considering in this paper. Basically, we refer in what follows to Mises (with his economic theory of human action), Hayek (with his knowledge-based theory of competition) and their modern followers, that is to say Rothbard (faithful to the

[1] The interest in process analysis as a tenet of Austrian economics has been clearly stated for the first time by Mayer: the author criticized the formalist approach, or "functional theories", aiming to describe the relation between already existing prices in an equilibrium situation. Mayer proposed to refocus on the process of price formation by adopting a "causal-genetic" approach (Mayer 1932).

praxeological logic of Mises) and Kirzner (at the junction of Mises's principle of human action and Hayek's problem of knowledge). We deliberately exclude Lachmann and his followers from this definition: as argued elsewhere by one of the authors (Gloria-Palermo 1999), Lachmann may well be considered, from an historiographical point of view, as the most faithful follower of Menger's principles, picking the subjectivist program up to its furthest implications. However the theoretical result to which this approach leads are indeed overwhelming, since it becomes impossible to prove that the market process is equilibrating (Lachmann 1969, 1986). This is perhaps the reason why Lachmann and his followers are considered by Rothbardians and Kirznerians as Austrian dissenters.

Even with these clarifications, however, it is clear that there exists no monolithic Austrian theory of the market process. All the authors agree in defining competition as a disequilibrium process in the sense that an equilibrium exists (at least as a theoretical reference), but the system is not generally in it. Beyond this general proposition, however, substantial differences remain among the authors, concerning in particular two aspects: (1) the content of the equilibrium reference that varies from one author to the other and even in the work of the same author from one period to the other and (2) the theoretical role played by this equilibrium reference.

Mises and Rothbard define equilibrium as an "imaginary construction" in which individuals have no reason to act; equilibrium is a state of affair in which there is no place for human action. Kirzner refers to the traditional meaning of equilibrium and places his analysis as complementary to mainstream economics; there is a sort of division of labor in the sense that neoclassics have been, from the 1930s onwards, progressively led astray into a more and more formalist analysis whose direct consequence was an overemphasis on the concept of equilibrium and the Austrian task may be viewed as an attempt to counterbalance this tendency by focusing rather on the process that leads to this equilibrium (Kirzner 1973, p. 1). Hayek has altered three times his conception of equilibrium throughout his career, passing from the traditional neoclassical idea that underlies his trade cycle theory and his first arguments in the planning debate, to the idea of mutual compatibility of plans since his famous 1937 paper "Economics and Knowledge", and finally, in the 1970s, to the notion of order in his theory of cultural evolution.[2]

As regards the role played by the reference to equilibrium, Kirznerians, Hayekians and Misesians propose three distinct approaches: to Kirzner, the equilibrating tendency of the market process is so powerful that the system can eventually reach a final state of equilibrium.[3] According to Hayek, the continuous occurrence of unexpected changes prevents the economy from reaching any final state of affair; notwithstanding this, it is possible to define a continually moving equilibrium reference supposed to attract the system.[4] The approach of Mises and Rothbard consists in starting from the imaginary construction of equilibrium; the dynamic effects of human action are precisely derived from the hypothetical consequences of the absence of action, allowing to grasp the direction the economy would necessarily take.[5]

Notwithstanding all these distinctions, it is possible to accept, for the purpose of this paper, the following characterization of Austrian economics: the economic actor is the propeller of change, the dynamic force of the market process; the market process is the outcome of the interaction of individual subjective plans and the analytical issue consists in appraising the ability of the market to achieve an efficient coordination of these plans. Neoclassical economics, by contrast, directly starts from an equilibrium configuration and examines the relationships between economic variables that characterize such a configuration. It is in these two distinct frameworks that Austrians and neoclassics face the problem of value judgements as defined in the next section.

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[2] Notwithstanding all these successive changes in the meaning of equilibrium, the idea of an equilibrating tendency of the market remains a constant of the Hayekian thought (Gloria-Palermo 2001).

[3] Although it is out of the purposes of this paper to criticize the positive contents of the theories of convergence toward equilibrium of the Austrian authors considered, we must notice that they all present theoretical problems. In the case of Kirzner, the analysis is subject to the same problem of stability as the general equilibrium theory; Kirzner, however, seems to conceal the issue or, in any case, does not bring any decisive contribution to it (Palermo 1997).

[4] The problem with Hayek is that he does not provide any theory explaining the movements in time of the equilibrium attracting the system. The problem is serious since these movements are not put in relation with the incompatibility of plans realized during the disequilibrium process, but are considered as completely exogenous. On the matter, Ioannides has elaborated an example showing that continuous changes, as conceptualized by Hayek, may mean nothing more than the constant repetition of the same motion (Ioannides 1992).

[5] Cf. Cowen and Fink 1985 for a destructive criticism of the Mises-Rothbard imaginary construction of equilibrium. They show that there is no explanation for the convergence path toward equilibrium: all that the theory implies is that if disequilibrium forces are frozen (income effects, non-convexities, strategic behaviors, …), then the equilibrating forces will prevail. Moreover, the authors show that the institution of monetary prices cannot logically exist in the Mises-Rothbard framework.

3. The Bridge Between Positive and Normative Analysis

The necessity for eliminating value judgements from economic theory is an old idea whose origin goes back to Hume's postulate according to which it is not scientifically correct to deduce *what ought to be* from *what is*. Facts and values should be rigorously separated; science should concentrate on facts and be value-free, whereas value judgements should enter the domain of art, which focuses on what should be. This idea has been advocated in economics through the distinction between positive economics, which should be value-free, and normative economics in which value judgements should be explicitly introduced. The persistence of this position during the twentieth century finds its greatest systematization in the doctrine of "wertfreiheit" (value-freedom) developed by Max Weber. According to Weber, the social scientist should remain value-free and, parallel to this, the moral scientist should develop a coherent discourse on ethical values ("wertungsdiskussionen").

The neoclassical response to the problem of value judgements, has been the development, in the 1930s, of the so-called new welfare economics, based on the efficiency principle of "Pareto" and the ethical principle of "minimal benevolence". Austrian economics has remained attached to the Humean guillotine by proposing, for its part, the "coordination principle" and the so-called "quasi-universal value judgements" as technical and ethical pillars of its bridge to normative analysis.

Pareto Principle and Minimal Benevolence

A first influential criticism against the epistemological basis of Pigouvian welfare economics, based on interpersonal comparisons, was raised by Robbins, who defended the objectivity of economic analysis by proposing to exclude not only value judgements, but also the discussion of value judgements, from economics (Robbins 1932).

The idea that Paretian welfare economics is value-free was then defended by Archibald and Hennipman (Archibald 1959; Hennipman 1976). The argument is that Paretian welfare economics simply studies the effectiveness of alternative configurations, by comparing the utilities of each individual taken separately. No value judgement is required to establish a comparison according to the Pareto principle. Value judgements enter only at the crucial step of normative prescription. To put it differently, to say that *B* is Pareto superior to *A* involves no value judgement; to prescribe *B* when *A* and *B* are both feasible necessarily involves value judgements. But if prescriptions are left apart, the propositions of Paretian welfare economics are susceptible to be empirically tested like any other positive proposition. In this sense, according to Archibald, welfare theorems must be considered theorems of positive economics. For instance, propositions like "perfectly competitive equilibria imply Pareto optimality" or "monopoly equilibria imply a welfare loss" are true or false independently from any value judgement or ideological position. They are thus positive statements. If, however, prescriptions are to be derived from these positive statements, then value judgements must be introduced in a form or another: what is needed is in fact a simple value-judgement according to which it is desirable to eliminate the inefficiency stemming from the existence of a potential Pareto improvement. Such a value judgement flows from the apparently innocuous moral principle of *minimal benevolence*: other things being equal, it is a morally good thing if people are better off.[6]

This principle, according to the neoclassics, contains the minimal ethical position necessary to translate the positive statements of the new welfare economics in normative terms. If one accepts minimal benevolence, then, other things being equal, Pareto improvements are moral improvements and Pareto optima are morally desirable.[7]

Coordination Principle and Quasi-Universal Value Judgements

Despite the homogeneity of the normative discourse in favor of the free market, there is hardly such a thing as an Austrian welfare economics.[8]

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[6] For a critical discussion on the role of minimal benevolence in the passage from positive to normative economics, cf. Hausman and McPherson 1996, chap. 4.

[7] In light of the limited applicability of the Pareto criterion, neoclassical economics has developed along two alternative paths: (1) the definition of a social welfare function, which explicitly introduces value judgements and is, among other things, subject to the Arrow's impossibility theorem if one tries to build it as an aggregation of individual preferences (Bergson 1938; Samuelson 1947; Arrow 1951); (2) the elaboration of compensation criteria *à la* Kaldor and Hicks, which, however, may be subject to theoretical paradoxes (Kaldor 1939; Hicks 1940; Scitovsky 1941; Little 1950; Samuelson 1950).

[8] On the difficulty of identifying an Austrian welfare economics, cf. Cowen 1991, 1994.

It is however possible to single out some common features among the authors, in particular their reliance upon the principle of coordination as efficiency criterion (if this principle is to be understood in a very general sense) and their reliance upon a set of value judgements that displays their adhesion to the liberal doctrine.

Mises characterizes the Austrian position as a formal system: the *praxeological system* (Mises 1949). Praxeology is "the general theory of human action" (Mises 1949, p. 3). It concerns the set of implications logically deduced from the sole axiom of *human action* according to which *action is purposeful*. The whole set of praxeological sciences is built upon this subjectivist dimension according to which human choice must be distinguished from passive response to the environment. Praxeological propositions are made up of universally valid statements, completely independent of the personal values of the scientist for individuals' goals and means are not the object of investigation. Economics is a component part of praxeology that focuses on a particular type of human action: market interactions.

According to praxeology, the criterion used to appraise the efficiency of an economic configuration should meet two requirements, namely subjectivism and value freedom. An economic system is efficient insofar as it allows individuals to follow their subjective plans with no incursion from the theorist on the nature of their goals and of the chosen means. Accordingly, an efficient situation is one in which individual plans are fully compatible, namely, a situation of coordination.

As Rothbard underlies, praxeology (and thus economics) is not sufficient by itself to enable the theorist to make any normative statement (Rothbard 1956, 1976). The passage to policy pronouncements needs the previous establishment of an explicit ethics. According to Rothbard, Mises introduced the minimal possible degree of value judgement in his application of the results of praxeology to politics: "[…] his value judgement is the desirability of fulfilling the subjectively desired goals of the bulk of the populace" (Rothbard 1976, p. 105). This statement plays the same role as the minimal benevolence principle in the neoclassical framework. It simply means that it is desirable that people could act according to their will. This is nothing else than the classical liberal doctrine that morally enhances the values of liberty, of individual sovereignty and promotes the voluntarism of choices.[9] These values are presented as being so innocuous that almost nobody would question them and are in this sense defined as "quasi-universal".[10]

Though discarding the praxeological framework, Kirzner and Hayek reach similar results. In line with Austrian subjectivism, these authors develop an analytical framework that preserves the individuality of the purposes of the separate individuals. In this perspective, the Pareto principle is replaced by the coordination criterion that strictly respects "the individuality of individual purposes" (Kirzner 1976, p. 85). The notion of coordination is simply understood as the fulfillment of the unaggregated preference structure of the individuals and refers to a situation in which there is full compatibility among individual plans.[11] What is the set of value judgements associated with this efficiency criterion? According to the authors, what is good is the efficiency criterion itself, or, in other words, coordination is good *per se*. This ethical position is very close to the neoclassical minimal benevolence principle: it is a morally good thing if people realize their subjective plans of action.

At a strict positive level, Hayek and Kirzner analyze the market process as a procedure that is more efficient than alternative arrangements in discovering and spreading new knowledge that can be used by all the members of the system to modify their plans toward a better fulfillment of their respective ends (Hayek 1978, p. 180;

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[9] This is particularly clear in Mises: "Liberalism (i.e. *laissez-faire* liberalism) is a political doctrine.[…] As a political doctrine liberalism (in contrast to economic science) is not neutral with regard to values and ultimate ends sought by action. It assumes that all men or at least the majority of people are intent upon attaining certain goals. It gives them information about the means suitable for the realization of their plans. The champions of liberal doctrines are fully aware of the fact that their teachings are valid only for people who are committed to their valuational principles. While praxeology, and therefore economics too, uses the terms happiness and removal of uneasiness in a purely formal sense, liberalism attaches to them a concrete meaning. It presupposes that people prefer life to death, health to sickness, nourishment to starvation, abundance to poverty. It teaches man how to act in accordance with these valuations" (Mises 1949, pp. 153-4). The values underlying the liberal doctrine are presented in such a way of being hardly questionable. It is in this sense that they are quasi-universal. Blaug's comment on this characterization of value judgement is straightforward: "This is a silly characterization of value-judgements for, by definition, value judgements are ethical prescriptions that are much debated!" (Blaug 1980, chap. 5).

[10] At a more precise scrutiny however, the praxeologically-based defense of the free market turns out to be built on a tautology: if the unhampered market is defined as a system in which people interact peacefully, without violence through voluntary agreements (Rothbard 1962) and if voluntarism is ethically good for it enables individuals to fulfil their goals whatever they be (Mises's minimal value judgement) then *by definition* the unhampered market is desirable.

[11] Kirzner affirms that "Modern Austrians have converged on the notion of *coordination* as the key to normative discussion" (Kirzner 1987, p. 11, emphasis in original); this concept can already be found in Hayek's paper "Economics and Knowledge" (Hayek 1937) and is made explicit in particular in Kirzner's main book (Kirzner 1973).

Kirzner 1992, p. 60). To put it differently, competition is successful in spreading new knowledge and leads to increasing degrees of coordination. According to the authors, this positive result provides a scientific support to those who promote a society of unhampered markets as soon as one espouses the liberal doctrine that overrides the values of individual sovereignty and voluntarism of action (Kirzner 1976; Hayek 1979).[12]

To recap, all modern Austrians here examined agree to replace the Pareto criterion with the coordination principle if this principle is understood in a very general sense as the fulfillment of individual plans. The associated ethics is made up of a set of value judgements derived from the liberal doctrine and presented as arousing quasi-unanimous consent. The combination of these two pillars is the ultimate theoretical support of the Austrian normative defense of the free market.

4. Coordination Principle and Disequilibrium Analysis

The problem of convergence of the market process concerns the effects of market interactions on the compatibility of individual plans: the market process is said to be convergent if it generates processes of revision of individual plans that lead to the eliminate all the (eventual) incompatibilities.[13] For the market process to converge, it is necessary that (1) by interacting in the market, individuals modify their plans according to the signals provided by market interactions and that (2) such signals be sufficient to lead individuals to formulate more and more compatible plans.

[12] The difference however between Mises and Rothbard on the one hand and Hayek and Kirzner on the other hand, is that praxeology maintains that *by definition* when a person acts, his *ex ante* utility increases (Rothbard 1976, p. 98); in other words, the very fact of being engaged in a transaction means that a more coordinated situation is *expected* by the participants. This however does not prove that this will effectively occur, putting some doubt on the coherence of their pro-market normative stance. Hayek and Kirzner on the contrary make the case for the free market on the basis of the positive results of their theories of convergence of the market process, by articulating the idea of convergence toward coordination with the knowledge problem.

[13] In the Austrian terminology, expressions such as "convergence of knowledge", "convergence of expectations", etc. are used to mean that in the market process, knowledge, expectation, etc. are modified in such a way to eliminate plans incompatibilities.

Hayek and Kirzner analyze the process of convergence by focusing on the effects of market interactions on individual knowledge. Their idea is that market interactions spread knowledge among individuals leading them to modify their plans in such a way to progressively eliminate the existing incompatibilities.

According to Hayek, knowledge is time and place specific and the potentiality of the market process lies in the possibility to exploit such a specificity instead of eliminating it (Hayek 1945, 1949, 1978). Indeed, the convergence of the market process does not imply at all that individuals end up with a common knowledge; on the contrary, it is their different knowledge that allows them to formulate plans that, in the course of the market process, become more and more compatible.

The process of convergence is specified in more details in Kirzner's theory of entrepreneurship (Kirzner 1973). It is the *alertness* of individuals (entrepreneurs in particular) that assures the convergence of the market process: alert entrepreneurs perceive the existing profit opportunities and by exploiting them, progressively eliminate all the manifestations of disequilibrium.

The objective here is not to criticize the relevance of the Austrian theory of the market process.[14] Let us proceed instead *as if* this theory were analytically satisfactory and let us focus on the relation between the theory of convergence and the use of the principle of coordination as technical pillar of the bridge to normative analysis.

Remember that in the Austrian framework, the market process is by definition a process in which individuals *do not* realize their plans. Indeed, the analysis is coherent only to the extent that equilibrium (or full coordination) is not reached, otherwise there would be no market *process*: if plans became compatible during the market process, the process itself would end. The market process is instead characterized by continuous unexpected changes, which prevents full coordination from being obtained.

[14] Elsewhere we have criticized the ability of the Austrian market process theory to guarantee, under general conditions, the convergence of individual plans (Palermo 1997; Gloria-Palermo 1999).

But now, if the positive framework is developed to analyze the *process*, the normative evaluation too should refer to the *process* and not to an hypothetical (never reached) *final state*.[15]

The contradiction is thus straightforward: on the one hand, the Austrian theory rests on the necessary assumption that individuals act in a situation of lack of coordination, whereas, on the other hand, the market is considered efficient (and desirable). But, if the normative criterion is *coordination*, how could one argue for the desirability of a system that, by assumption, is *dis-coordinated*?

The hypothesis that full coordination is never reached considerably question the internal consistency of the coordination principle as technical pillar of the bridge between positive and normative analysis and casts doubts on the overall argumentation in favor of the desirability of the free market. To be rigorous, the Austrian theory only allows to deduce a negative evaluation of the free market system: conceded that the working of free competition be correctly represented by the Austrian theory and accepted the coordination principle as efficiency criterion, then the free market system is inefficient (and, thus, according to the Austrian second pillar, undesirable).

There is however one possible way out consisting in giving a soft interpretation of Austrian positive results: one might argue that, among all institutional systems, the free market is perhaps the less worse.

But, is it possible to set such an institutional comparison within the Austrian framework? As said above, the principle of coordination is useless, since it is inconsistent with one of the methodological tenets of the Austrian theory (in the Austrian dynamic framework, individuals, at least partly, do not realize their plans). The only way out should be to measure the *degree of dis-coordination* in order to compare different systems from the viewpoint of their relative ability in making individual plans compatible. In that perspective, what the Austrians should prove is that the unhampered market process produces *less dis-coordination* than other processes of social interaction (planning for instance). Such a project, however, encounters a serious obstacle. The

[15] From an analytical viewpoint, this contradiction is the result of the assumption of a dynamic positive framework and of an efficiency principle for normative analysis that resembles too much the static concept of equilibrium. As a matter of fact, if coordination might ever be reached, i.e., if plans might effectively become fully compatible, the concept of coordination would coincide with that of equilibrium. On the other hand, if the concept of coordination is defined in such a way to contemplate some forms of plans incompatibilities, then it can no longer be accepted as a purely efficiency pillar of the bridge to normative analysis.

attempt to compare different institutional settings within the Austrian disequilibrium framework and identify the less dis-coordinated one raises two problems: (1) the problem of specifying who are the agents whose plans can remain unfulfilled without, because of this, questioning the overall desirability of the system (or, symmetrically, who are the agents whose plans must be fulfilled in order that the system be considered desirable); (2) the problem of determining a critical measure of plans inconsistency marking the formal passage from coordination to dis-coordination. These problems cannot be handled without introducing (1) a criterion for interpersonal comparisons and (2) value judgements about the content of individual plans necessarily stronger than the innocent quasi-universal ones. In any case, all this would put a weight over the bridge between positive and normative analysis that the coordination principle and the quasi-universal value judgements cannot evidently sustain.

5. The Problem of Distribution

One of the main fields of normative analysis in which ethical positions can hardly be left aside is the discussion of distribution. In capitalism, production and distribution are two interdependent processes. Private property of the means of production implies that owners can claim a reward for the services of their production factors. The participation to the production process is thus itself based on the conditions that rule the distribution of the product. Particular cases apart, interventions in the sphere of production have distributive effects and interventions in the sphere of distribution have effects on production, so that production and distribution cannot in general be analyzed separately.

At an intuitive level, the interdependence of production and distribution may create problems as far as value-neutrality is concerned, since even apparently technical issues, such as the determination of the conditions for efficient production, have in fact distributive implications. This means that even normative prescriptions at the production level might in fact not be neutral in terms of distributive justice.

The solutions offered to this problem by neoclassical economics and Austrian economics are different: neoclassical economics has managed to determine the conditions under which production and distribution can be analytically separated and, in such a way, has found a formal solution to the problem of value judgements; such a solution however is obtained at a dear price on the ground of realism. Austrian economics, on the contrary, has developed a theory based precisely on the interdependence between production and distribution; this approach, however, surreptitiously introduces strong value judgements.

Production and Distribution in the General Equilibrium Model

Consider the general equilibrium model. Here production and distribution are interdependent: the equilibrium allocation determined by the initial conditions concerning technology, individual endowments and preferences simultaneously solves both production and distribution problems.

The fact that production and distribution take place simultaneously (and instantaneously) in the general equilibrium model might create ethical problems in case the production solution (which, under opportune conditions, is proven to be Pareto efficient) were not also ethically acceptable as far as its distributive consequences are concerned. But here, thanks to the two fundamental theorems of welfare, neoclassical economics can formally separate the questions of production and distribution. Let us see how.

The two fundamental theorems of welfare economics state that (1) general equilibrium is Pareto efficient and (2) every Pareto efficient allocation can be obtained as a solution of a general equilibrium model.

If the minimal benevolence principle is accepted, these theorems have direct normative implications: the first theorem implies that, other things being equal, perfectly competitive equilibria are morally desirable and market imperfections that interfere with their achievement are morally undesirable;[16] among the "other things that must be equal"

[16] This is, of course, a theoretical defense of *perfect competition*, not a defense of actual markets or of *laissez-faire* policies and it is only a defense of perfect competition, *other things being equal* (cf. Hausman and McPherson 1996, pp. 42-3).

in order to translate the Pareto principle into a moral principle, there are however things which are more ethically controversial than minimal benevolence, like justice and, more specifically, distributive justice: a Pareto improvement that leads to distributive injustice might be morally undesirable. Here, however, the second welfare theorem enters the scene: all moral concerns about distributive justice can be solved by adjusting initial endowments (by means of lump-sum taxes/transfers) and letting perfect competition do the rest.

These theorems constitute a powerful apolitical shield against potential ethical attacks: there exist two separated problems, the production of a big pie and the distribution of the pie. The second fundamental theorem of welfare states that for each ethical judgement about the criterion for the distribution of the pie, the market mechanism allows to obtain the greatest possible pie. If we are not satisfied with the existing distribution, the neoclassical economist argues, let us change it, but, after that, it would be silly (immoral) to be satisfied with a pie which is not the greatest possible one. Although production and distribution processes are interdependent, the two fundamental theorems of welfare allow in this way to analyze them separately.[17]

It is appropriate at this point to draw attention to some of the necessary conditions under which the two theorems of welfare hold: there are (1) no increasing returns to scale, (2) no externalities and (3) no public goods. Notwithstanding the lack of realism of these conditions (the problem is not simply that there exist markets which do not respect these conditions, but rather that there is practically no market in which the three conditions hold), neoclassical economics formally solves the problem of distribution.

To recap then, the passage from the positive interpretation of Paretian welfare economics to the normative one is based on the acceptance of a relatively weak value judgement (the minimal benevolence principle). This implies that Paretian welfare economics cannot be considered rigorously value-free. However, thanks to the analytical results contained in the two welfare theorems, neoclassical economics can go much

[17] One manifestation of the possibility of separating production and distribution can be found in the so-called Coase theorem – formulated by Stigler (Stigler 1989), who draws inspiration from the work of Coase (Coase 1960) – in which it is asserted that the initial distribution of (private) property rights do not influence the production configuration of the system. Notice however that Coase himself, in his 1960 article, insists upon the paradoxical character of such a result, which depends on the highly unrealistic assumption of the absence of transaction costs.

further in the normative ground, overcoming one of the main normative problem of welfare economics: the problem of distribution.[18]

Some caution should instead be paid to the effective value-freedom of the approaches aiming at more realistic analyses developed as extensions of the pure Walrasian model. Here, we do not refer only to the neoclassical literature on the second best, but also to the works of the New Keynesian and the New Institutional Economics, in which imperfect information, bounded rationality or other imperfections of the Walrasian model prevents Pareto efficiency from being obtained. In these conditions, the prescription of Pareto improvement cannot be considered neutral because its distributive implications have to be taken as they come. If we do not like distribution, the argument "let us change it, but, after that, it would be silly (immoral) to be satisfied with a pie which is not the greatest possible one" no longer works. In this case, there is thus a contradiction, since, on the one hand, these approaches define a problematic theoretical context in which the two welfare theorems do not hold, but, on the other hand, they still insist on the Pareto criterion as efficiency criterion for their normative prescriptions.

Production and Distribution in the Austrian Theory

The interdependence of the processes of production and distribution is at the core of Austrian normative economics. Let us examine, in this respect, the leading contributions of Mises and Hayek.

In line with the coordination principle, Mises defines the efficiency of an economic system as depending on the possibility for individuals to freely pursue their goals, both in the sphere of consumption and in that of production. Individual sovereignty is thus not limited to consumers, but is extended to the whole set of

[18] If the first and second welfare theorems provide a solution to the problem of analytically separating production and distribution, the so-called impossibility theorem (Arrow 1951) affirms that there is no logically infallible way to aggregate the preferences of diverse individuals and there is thus no logically infallible way to solve the problem of distribution by means of democratically voting. This result (known also as the third welfare theorem) invalidates the message of the first two welfare theorems about the supposed desirability of the free market and *laissez-faire* in capitalist democracies: it is true that the market mechanism does not raise distributive problems if the two welfare theorems hold, but it is also true that because of the third theorem, such a mechanism is incompatible with the principles of democracy.

economic agents and in particular, to producers. Consumers' ability to achieve their goals depends on the ability of producers to offer the appropriate goods. The efficient entrepreneurs are those who best anticipate the wishes of consumers and find the best means to realize them. In this way, the efficiency of the overall system is amount to the efficiency of production. The efficiency of production, in turn, is the result of a process of competition among entrepreneurs motivated by the prospect of making profits.

> The more successfully [the entrepreneur] speculates the more the means of production are at his disposal, the greater becomes his influence on the business of society. The less successfully he speculates the smaller becomes his property, the less becomes his influence on business. If he loses everything by speculation he disappears from the ranks of those who are called to the direction of economic affairs. (Mises 1936, p. 206)

The crucial aspect here does not concern the justification of the appropriation of profits, an aspect that we have deliberately excluded from the inquiry of this paper, but rather the fact that, contrary to the neoclassical position synthesized in the second welfare theorem, Mises rejects any kind of redistribution, i.e., any distribution different from that which directly flows from the production process. The production process, in its (supposed) efficient working, determines income distribution too. In other words, Mises considers efficient production as an indisputable social objective, which implies that its consequences in the sphere of distribution must be accepted as they come. In this way, the *wertfreiheit* principle assumes a very particular form in the Misesian comparative analysis: it leads to the neglect of any autonomous relevance of the distributive issue.[19]

According to Hayek, the efficiency of an economic system depends on the solution it can offer to two general problems: the problem of incentives and the problem of knowledge. In the Hayekian theory these problems are strictly interrelated: an efficient economic system should display a mechanism that allows individuals to discover the most relevant bits of knowledge and an efficient incentive device should ensure that scarce resources be allocated to the most competent agents with respect to their ability in discovering, diffusing and using the relevant specific knowledge.

[19] Rothbard puts it as follows: "There is no distributional process apart from the production and exchange processes of the market; hence the very concept of 'distribution' becomes meaningless in the free market" (Rothbard 1956 p. 251),.

According to Hayek, the market process, if not hampered, automatically transfers resources from the less competent individuals (with respect to their contribution to the knowledge problem) to the most competent ones, efficiently solving in this way the knowledge problem. This result is based on the twofold assumption of non-appropriability of knowledge and appropriability of profits: as soon as a new set of knowledge is made available, the whole society may enjoy its beneficial effects in terms of social coordination, but the discoverer alone enjoys the beneficial effects of the discovery in terms of generated profits. As for Mises, market incentives are efficient only if profits can be appropriated with no obstacles. In this way, Hayek's normative analysis of incentive and knowledge problems leads to the definition of the *production of a big pie* (or, rather perhaps, the *discovery of a big pie*) as a social objective and to the distributive prescription that scarce resources be allocated according to the contribution of each person (in terms of knowledge discovery) to the production of the pie.[20] Kirzner summarizes the whole Austrian position as follows:

> The market system is seen in this discussion as not only producing a social 'pie', but at the same time slicing up that pie and assigning the respective slices to the specific individuals who participate in the market process. […] In fact the size and composition of the pie are as much dependent upon the pattern of income 'distribution' as the latter depends on the size and composition of the pie. (Kirzner 1989, p. 8)

Differently from the neoclassical case, redistribution is considered, by definition, scientifically illegitimate. Although both neoclassical and Austrian economics accept the general principle that remuneration should depend on performance, the latter pushes the principle further, putting even the initial distribution of the endowments out of any ethical inquiry.

The fact that the only tolerated social objective is efficient production in a context in which distribution is just a consequence of production allows to clarify the Austrian position with respect to the distributive issue: Austrian economics does not

[20] According to Hayek, social justice is a harmful concept (Hayek 1976). For Hayek, it basically means one thing: the protection of (in the sense of maintaining or increasing) the material position of particular groups; any intervention of this kind leads to the destruction of the foundations of the market order, i.e., to be more precise, the destruction of the incentives that each person has to discover what is of value to others.

really neglect the distributive problem, it simply approves the free market solution and denies the legitimacy of any redistributive intervention.

6. Conclusion

Inasmuch as the Pareto principle and the coordination principle can be applied without the need of making interpersonal comparisons, some of their proponents have maintained that they are value-free. Such a position is however untenable.

At a general level, both neoclassical and Austrian economics rest on value-judgements at least because the principles that remuneration should depend on performance and that the individual is the best judge of his own well-being are themselves value-judgements. These general principles, however, are still insufficient to allow neoclassical and Austrian economics to build a legitimate normative theory.

In the attempt to introduce only the value judgements that are strictly necessary to support a normative position, the neoclassics and the Austrians have introduced respectively the minimal benevolence principle and the quasi-universal value judgements. Even with these explicit ethical positions, however, the normative discourse remains largely unfounded in both the approaches, although for different reasons. In the case of neoclassical economics the main problem is one of realism. In the case of Austrian economics it is one of internal consistency.

In order to point out these problems we have considered the ways in which the two approaches discuss the distributive issue, which constitutes in our view the field in which the problem of value judgements takes its most exacerbated form.

In capitalism, production and distribution are interdependent processes. In principle, such an interdependency is sufficient to create problems to the value-free economist in his attempt to provide a normative criterion at the production level (because it implies the acceptance of a determined distribution, the latter being the result of value judgements). Neoclassical economics, in order to overcome the obstacle, has determined the conditions under which production and distribution can be analyzed separately and, in doing so, has confined itself to an abstract world which has nothing to do with the real one (in which production and distribution continue to be interdependent) but, at the same time, has saved its formal integrity (which applies only to its abstract world). What is scientifically surprising, however, is that once affirmed the legitimacy of the Pareto principle in the particular abstract world in which the two welfare theorems hold, neoclassical economists have then pretended to apply it to the real world.

Austrian economics, on the contrary, has accepted the theoretical challenge by building its theory precisely on the interdependence of production and distribution. The problem is that it has then lost the challenge because its position on distribution cannot be coherently defended simply on the basis of the weak quasi-universal value judgements. The ethical pillar has so proven to be insufficient to support the Austrian normative position in favor of the free market and the result is a normative framework in which strong value judgements are indeed present, although awkwardly hidden.

However, it is probably the consequences of the fragility of the other pillar to be even more disastrous for the internal consistency of the Austrian theory. The coordination principle indeed ends up being logically inconsistent with the features of the Austrian positive analysis, which even impedes the appraisal of efficiency (which is the first step for the appraisal of desirability).

At the analytical level, what is interesting is that the Austrian normative criterion, if rigorously applied, ultimately leads to opposite results with respect to the liberal doctrine that it supports: all that can be deduced from the Austrian theory is a negative evaluation of free competition. Moreover, any attempt to go beyond this negative result needs the introduction of stronger value judgements and creates internal consistency problems to those who affirm that no such values should be introduced.

Our conclusion is thus that the normative engagement of Austrian economics in favor of the free market and *laissez-faire* is the result of a mix of strong ideological positions and weak theoretical elements and is ultimately untenable on a scientific ground.

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