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IN ECONOMICS THERE IS MUCH TO LEARN AND LITTLE TO DO

INTRODUCTION

Get out of my light.

FOUR BASICS OF THE MARKET ECONOMY

Its core: voluntary exchange; its strength: use of knowledge; its ethical character: related to individual behavior per se not to the overall result of the market process; its empirical character: the growth of the knowledge economy.

TWO LIBERAL REFORMS FOR THE 21TH CENTURY

No stimulation of the general economy nor facilitation of individual industries. To state and guard the constitutional rules of the polity.

CONCLUSION: THE FUTURE FOR LIBERALISM

Keeping government in check and the path to the growth of the knowledge economy clear.

INTRODUCTION

The title of my presentation is: *In political economy, there is much to learn and little to do.* Frederic Bastiat, the French classical liberal theorist and member of the French assembly, said this, in the middle of the 19e century.

Or, in other words, as said too by Bastiat: *The request of industry to government is as modest as that of Diogenes (dī-ā-jə-nēz) to Alexander the Great: Get out of my light.*¹

If, however, we see around us, we do not see---the more familiar idea---*laissez faire*, **as the favorite government policy.** Government stimulus of the **total** economy and facilitation of **individual** industries we do see all around us. But what little the government should do---**we do not see.**

So, in view of **the first part of the title of this conference---liberal reforms for the 21e century---**at least *two* liberal reforms are necessary. **First, get out of my light.** In other

¹ As said by Jeremy Bentham in: F. Bastiat, *Economic Sophisms*, Foundation for economic Education: Irvington-on-Hudson, 1975, p. 3 and p. 127.

words: no politicization of daily economic activity. **Second, the important liberal reform: to do the little, but fundamental thing, there is for the government to do.** In other words: the---constitutional---politicization of the framework of daily economic activity.

FOUR BASICS OF THE MARKET ECONOMY

In order to get these two reforms on the right footing, we must in view of Bastiat start at the beginning: start learning.

What is our overall goal? Individual liberty; we all want to be free. As a liberal, we should at least believe that the majority of people are **capable and willing to be free**. So we can reach our goal in a peaceful way, without becoming dictators. Though of course it can take some time until the majority of the people do agree to this vision.

In daily life, **individual liberty means that we have exit options**: we can go to another shop; do our study at an university abroad; we can switch to another job; we can vote for another government; and we can even immigrate to another country. The power of exit is **also** one of the most **important disciplines of the marketplace**: firms that fail to meet consumers' demands will go bankrupt. As is said: "We are not running a 'no-failure' regime".²

Then it was the year: 1776! As we can read everyday at the *Wall Street Journal*, in the section *About us* on the Opinion section of the paper: "**We speak for free markets and free people, the principles, if you will, marked in the watershed year of 1776 by Thomas Jefferson's Declaration of Independence and Adam Smith's 'Wealth of Nations'**"."³ Since 1776, we do not only see it happening but also know why individual liberty does not lead to chaos but is possible within the institutions of a market economy.

How does the market economy work? What is, first, the core and, second, the strength of the market economy?

First, the core is voluntary exchange: buying and selling. This was Adam Smith great discovery in the 18e century. There is a simple and self-evident principle on which we can build on a society and that makes freedom possible. No matter of what culture we are of, or what sort of society we do live in, **we all want to improve our position if we act**: do make an exchange. Therefore, if costs go up; we do buy less. Some will no doubt still buy the good, but others, who before did found the good just worthwhile in view of the costs, do stop buying. For them there is no gain anymore in making the exchange. It was Smiths discovery that **these uniformities** in our behavior (the laws of demand and supply and the price mechanism) make possible the voluntary order of the market economy. **The market process is a nexus of relationships among separate decision takers.**

² Howard Davies, Managing Financial Crises, in: P. Booth and D. Carrie (eds), *The Regulation of Financial Markets*, Institute of Economic Affairs, London, 2003.

³ <http://online.wsj.com/public/page/news-opinion-commentary.html>

Within a framework of rules and institutions, as Smith said too, mainly about private property and a government that act as a referee if conflicts do arise, the result of letting this propensity run its course is **freedom, prosperity and peace**. However, it is important to be clear, in view of our moral evaluation of the market and possibilities for government policy, about the fact that the result of the market process is, **fundamentally**, in the hands of nobody. **I will come back to these two points later. As is said, the outcome of the market is the result of human action but not of human design.**

Second, the strength of the market economy is that by decentralized decision-making---every one buying and selling as he or she seems fit to do**---we make use of as much as possible of the existing knowledge in society and stimulate, because it is in the self interest of every buyer and seller---the fertility of freedom---the emergence of new knowledge.** The market uses and creates knowledge that without the market process we never would have known.⁴

See as an example how the late **Julian Simon**, in 1978, solved the problem of the bumped travelers when they find out that their plane is **overbooked**. In fact, he did solve it more than ten years before but no one thought it would work.⁵ Think of all the knowledge, not only scientific knowledge, but knowledge that is often unique and bound to the moment of decision, that is being used to make all passengers happy by letting the market solve the problem for those who fly and those he will take a later flight.

Scientifically, e.g., by the law of large numbers we do know that at a certain flight 4% of the passengers will not show up. Therefore, as a rule, we can book some extra people on a flight. **But what to do when everyone is there?** It was Simon's idea to organize an auction and pay people to take a later flight. In the bidding for the tickets, it is mainly the subjective knowledge of the bidders, unique to these participants in their separate decisions, which is impossible to centralize and to know by any government, that is used. No one knows the value of the time and money, at the moment of decision for every passenger. The "*central utilization of necessarily widely dispersed knowledge of particular and temporary circumstances must forever remain impossible.*"⁶

In short, **the main function of the market is spreading the information on which man e.g. passengers, can act. The West is richer** not only because it has more capital but especially because it uses more of the existing knowledge.⁷

To put it differently. It is our **incurable ignorance** of most of the particular circumstances which determine the outcome of the market process that is the central point of the scientific approach to the market economy. **Being scientific** involves a frank admission that we do not know, and fundamentally cannot know, what makes every

⁴ F.A. Hayek, Coping with Ignorance, *Imprimis*, July 1978, vol. 7, no. 2.

⁵ Julian L. Simon, "Origins of the Airline Oversales Auction System," *Regulation*, vol. 17, no. 2, Spring 1994. www.cato.org/pubs/regulation/regv17n2/reg17n2-simon.html.

⁶ Hayek, *op. cit.* 1978.

⁷ F.A. Hayek, *The Constitution of Liberty*, Routledge, London, 1960.

decision-making individual act as he or she does, based on their subjective knowledge.⁸ For sure we cannot predict the outcome of the market process since it is this knowledge of each and every participant in the market process, a nexus of relationships among separate decision takers, that informs the outcomes produced. **It follows that the market alone can utilize this knowledge.**⁹

This for the two basics of the market: the core and its strength. But what are the two most important basic characteristics of the market economy?

First, it is a highly moral system: you can only get rich by giving. You do have the freedom to make yourself useful. In every society, there are strong and weak people. In a market economy, strong people only can get rich by giving: making products that are in demand.

Consequently, if you are rich you do not have to give back to society later. You already did. But of course, if later in your life you let other people share, it is no problem. It is another thing, however, if the government is taking it by force from you, like a special millionaire's tax, a Warren Buffet rule. For that comes down to something quite different and unethical. It would come down to the fact that: *you can work but that you are not the owner of that what you produce*. The rewards of your work are taken from you, and that is, as we all know, **the definition of being a slave**: you work but you are not the owner of that what you produce.¹⁰

The morality of the market is located in human action *per se*. Do we treat each other with respect; do we play according to the rules of the game?¹¹ The way how the total market result is scattered over the people, **since it is in the hands of no one**, is neither moral or immoral--it is (ā-□mo□r-əl) amoral. It is a **category mistake** to look for the justice of the total outcome of the market process.

But that is not the characteristic I do want to focus on. The **second** question I want to ask is: **What is the great historical characteristic and trend of the market economy?** In this regard, Alan Greenspan, the former chairman of the Federal Reserve in the U.S., made a most important observation. He used to say, at the end of the last century: *in the last 50 years, the American economy has grown five times in real value but in weight, it has not added one ounce*. Compare what we see at those terminals at airports only used for the transportation of goods, almost an airport in a airport, with all the packages transported all over the world through the air. In weight less than 2% of the tons moved in international trade but in value more than 40 %.¹² In short, the big trend in history is:

⁸ Hayek, *op. cit.* 1978.

⁹ James M. Buchanan, *Why I, Too, Am Not a Conservative, The Normative Vision of Classical Liberalism*, Edward Elgar, Cheltenham, 2005, p. 87.

¹⁰ Walter E. Williams, *Do the Right Thing*, Hoover Institution Press, Stanford, 1995.

¹¹ Buchanan, *op. cit.*

¹² Frederick W. Smith, *Deregulation and the Global Market Revolution, Cato's Letter*, vol.4, no 4, 2006.

for all products, **knowledge is put in every product and labor and matter are got out.**¹³

So if we do speak of a **market economy**, we do, in fact, speak of a **knowledge economy**. The last word looks modern but is, since 1776, the essence of a market economy. Therefore, as Smith spoke of **the system of natural liberty**, instead of a market economy, he could just as well have spoken of the knowledge economy. **All are synonyms.**

TWO LIBERAL REFORMS FOR THE 21TH CENTURY

This for the four basics of a market economy: the core, its strength, and its two overall characteristics. We now come to the role of the government: our two liberal reforms for the 21e century.

First, the market goes up and down. Is there anything else we can expect, as it is the result of all those separate exchanges? The miracle of the market is its order, the upwards trend in living conditions, the freedom it makes possible and the peace it gives. A continues growth rate, however, of, let us say, four percent **every year** is not to be expected. Though on average it has been the historical result of the market process.

Sometimes, we must correct our mistakes. We were overly optimistic or pessimistic. Moreover, sometimes even the most of us got it wrong, especially when self-confident politicians did dominate over economics by monetary and fiscal policy and tried to play God and steer results. Politicians still do have to learn that it is impossible to have the results of the market without the market process. So when we see a down turn in the economy, a recession, we do see a solution at work: we are making some necessary corrections. Nothing to worry about. **And certainly no policy is needed of keeping bubbles going and making un-sustainability the standard policy.**

Before the 1930s, the time afterwards, especially in the U.S., governments started with fiscal and monetary policy to stimulate the economy and guard the value money, **no one had ever had heard of a double dip or long-term inflation**. Since the time of Smith to the thirties of the 19e century inflation on average was zero. Of course, inflation went up and down, but there was no upward trend. Since the thirties, however, until now, of the value of a dollar remains only a few cents.¹⁴ Recessions, also, are quite natural. The difference on average between recessions then and now is not that they now last shorter, only that since the thirties of the last century after the recession is over, governments do have a high debt burden---which are mostly paid by inflation. Stimulus money is just wasted money.¹⁵ Stimulus is, as is said by, e.g., Gary Becker and Robert Barro, as

¹³ Walter B. Wriston, *The Twilight of Sovereignty. How the information revolution is transforming our world*, Scibners, New York, 1992.

¹⁴ Milton Friedman, *Money Mischief, Episodes in Monetary History*, Harcourt Brace, New York, 1992.

¹⁵ Gary Becker, The Great Recession and Government Failure. When comparing the performance of markets to government, markets look pretty darn good, *The Wall Street Journal*, September 2, 2011.

recently as last month, **the macroeconomic equivalent of bloodletting; there is zero evidence** that deficit-financed transfers raise GDP and employment.¹⁶

Also, to guard and stimulate the total economy cannot be the role of the state. So may be specific help, facilities to individual sectors in the economy, can be a role of the state.

At this moment, e.g., it is fashionable to stimulate the knowledge economy. But how does the government know what sectors to stimulate? *“Governments are good at governing matter but everywhere misrule mind, especially the best and most productive minds, minds that are frustrated and demoralized by the pretensions of the merely powerful.”*¹⁷

And what are the real costs? It needs a bureaucracy and a lot of paper work by the industry too, to get a subsidy. And since there is money involved, there is a long list of industries that come to government for help. Murray Weidenbaum, chairman of the *Council of Economic Advisors* of president Reagan, recalls that the word ‘**but**’ is the most important word of the English language. Every entrepreneur who visited him, was on principle for competition and a small government, ---**but**--- for the unique position of the own industry an exception should be made. **The list of industries who visited him for help was much and much longer than the list of industries that did not visit him.**¹⁸

But of course, we do have, at the present, this worldwide trend of stimulation of innovative industries. The Netherlands is no exception. So the point is that, at least in the Netherlands, corporate income tax, at present 25%, **can be almost halved for every industry** if we do not give special favors, subsidies, tax deductions, to some industries. Of course in Lithuania the corporate income tax is already much lower, with 15 %. But no doubt, there is also the option: lower for every industry or giving special favors to some industries.

Is it not---we must ask ourselves---the natural thing **to see as the task of the businessmen** to create products that have a future. If helping some, what should others think? I am doing something that has no future. **Without support for some sectors** of industry, however, the government creates, with low taxation, freedom for everyone.

John Sloan, a socialist artist in the U.S., already said in 1944, when in the U.S. they wanted to create a department of culture and he was asked what he thought of the plan: **“I am wholly in favor of it, he said, for than at least we do know were the enemy is.** So it all comes down to the answer to the question---**who to trust more**: the politician who with the money of someone else tries to secure his reelection or the businessman who with his own money tries to make a profit.

¹⁶ Robert J. Barro, Keynesian Economics vs. Regular Economics. Food stamps and other transfers aren’t necessarily bad ideas, but there’s no evidence they spur growth, *The Wall Street Journal*, Augusts 23, 2011.

¹⁷ Wriston, *op. cit.*, p. 35.

¹⁸ Murray L. Weidenbaum, ‘Reaganomics: How Can Resources Be Shifted to the Private Sector?’ in: Craig E. Aronoff, *The Future of Private Enterprise*, CBA, Atlanta, 1986, pp. 109-110.

Or, another favorite policy of government policy, **to save the banking sector**. Why should we help this sector? We must not forget that it is **one of the most politically well-connected sectors in the whole industry**. Former or future government employees, like a minister of finance, are often recruited from the financial sector and the other way around. So they do know, by personal friendships, how **to shape their special interest as the general interest**. Still, it is speculation if the world will come down if banks, even the big bank ones, go bankrupt. May be the banking sector has grown to big. Who knows? But what is sure is that if a sector knows it will **not** be helped, it will be forced to become creative. Would not the chairman of *Lehmann Brothers*, **Richard Fuld** behaved differently if he had known that, in the end, he would not be saved. And look how overnight when *Lehmann Brothers* went broke, the business was broken up in viable and unviable viable parts. A bank that goes broke does not disappear in a **black whole**, it still has value that is worthwhile to preserve

What is the real price of the present regulation the banking sector? We do stifle the discovery process of the market, the growth of knowledge: we never get any wiser **than we are now** by all the rules **based on current wisdom** to prevent a future collapse. But the point is just, that later it must be possible to say: *if I had only known what I do know now, I would never have done it*. We do not, by definition, know our future knowledge, and without the market process of discovery, we will never know.

Besides that, current proposed regulation of the banking sector in the U.S. is already in retreat because of its unforeseen effects.¹⁹ Contrary to what is often supposed, the more complicated a sector is, the less an industry can be managed from above.

In short, the medicine is worse than the sickness it tries to cure. The cure will be a spontaneous process, which must run its course without the government playing the planner of it all. The government can only, as we will see in a moment, prepare the constitutional rules of the discovery process.

The banking sector, in fact, is a **prime example of the knowledge economy we want. It is making new innovative pure knowledge products with all those new financial innovations like credit default swaps**. Of which some indeed did fail, and others certainly did increase the efficiency of the market in a transfer of credit risk.²⁰ Failure can only be a problem if industries are only confronted with the gains but not with the losses.

Now we do know why and what it means to **get out of the light, so we come to our second and last question: What little is there for the government to do?**

The most important thing without which the market economy would be impossible is for **the government to state the rules of the game and be the empire in case of conflicts**.

¹⁹ Alan Greenspan, Dodd-Frank fails to meet test of our times, *Financial Times*, March 29, 2011.

²⁰ Alan Greenspan, *The Age of Turbulence*, Penguin Press, New York, 2007, p. 371.

The subject of what James Buchanan, the winner of the Nobel prize in economic science in 1986, calls **constitutional economics**.²¹

But what do we see? No hard and fast constitutional rules, like in the Eurozone the rules of an annual budget deficit no higher than 3% of Gross Domestic Product (GDP) and a national debt lower than 60% of GDP of **the Stability and Growth Pact**.

And referees like the European Commission, who do not only judge but are players too in applying the principle of, e.g., subsidiarity. The principle, as embedded in the EU treaty, states that policies are decided at the most effective level, whether local, national or supra national. So European **localism** is constitutionally underpinned by the principle of subsidiarity. In practice, however, the principle is hardly a drive for localism so the EU can concentrate on core activities. There is an **Impact Assessment** to consider whether a given proposal breaches the subsidiarity principle. **“In practice, however, the Commission is effectively responsible for both drafting the proposal and producing the Impact Assessment.” So---unsurprisingly---the Commission “consistently produces Impact Assessments with a bias for the Commission’s preferred options”.**²² The situation is the same as kids playing football on the street and one of them is, next to playing football, also functioning as the arbiter.

This is all opposite to **the old constitutional wisdom** to split, in these cases, the functions over two independently chosen chambers of parliament. A fundamental separation over different authorities could be the answer of, e.g., the competences regarding the determination of fiscal rules and the power to make policy within the boundaries of those rules.²³

So we can be happy, from a constitutional point of view, that there are some **outside checks for the European Union---like is sometimes done by the German Constitutional Court**. This court has stated this year that *a still closer union* is, within constitutional German law, hardly possible anymore.²⁴

We must, however, never forget that **the great gain of the European Union is the one, integrated, internal market**. This for the overriding reason that consumers do have more choice and, **of the utmost importance**, hence producers do have more competition. That means, producers have, without the possibility of curtailing it, to be entrepreneurial: the main spring of all our growing wealth. **“Vested interests of firms and politicians, however, for sure would, after World War II, not have been in favor of the one internal market. Arguments based on the economic efficiency of the enlarged market nexus would never have carried the day. It was fortuitous ... it fit so well**

²¹ James M. Buchanan, *The Logical Foundations of Constitutional Liberty*, Liberty Fund, Indianapolis, 1999.

²² Anthony Browne and Mats Persson, The case for European localism, *Open Europe*, 2011; cf. John Fonte, *Sovereignty or Submission*, Encounter Books, New York, 2011, pp. 146-147.

²³ Auke R. Leen, “Pushing Limits, Limiting the Budget of the European Union,” in: *Evolution and Revolution in the Global Knowledge Economy*, eds. L. Fuxmann a.o., New York: GBATA, pp. 572-577.

²⁴ Mehr Europa lasst das Grundgesetz kaum zu, *Frankfurter Allgemeine Zeitung*, September 25, 2011; cp. Fonte, *op. cit.*, pp. 157-158.

within the overriding thrust toward Europeanization as a means of securing guarantees against armed conflict”.²⁵

CONCLUSION: THE FUTURE FOR LIBERALISM

To conclude, and come back to the second part of the title of this conference: is there a future for liberalism?

The answer is Yes, if the liberal does what he is good at doing: curtailing the role of the state, in order to create individual freedom. In other words, keeping government in check and the path to growth clear.

Often, however, he is forced to play on the field of daily politics, a field he does not want to play on in the first place. Though of course he can play. Mostly by stating why a proposed policy will not work because it is unethical and hampers the growth of knowledge; the proposal is against the economic laws of Adam Smith: the liberals' unique selling point.

We should be proud of saying as a former governor of the state of New Mexico, and present candidate for the Republican nomination for the President of the United States, Gary Johnson said: “*The fact is, I can unequivocally (ən-i-kwi-və-kəly) say that I did not create a single job while I was governor---entrepreneurs did.*”²⁶ Otherwise, the liberal is just a social engineer and an adherent of the social market economy who tries to give guidance to the economic process.

²⁵ James M. Buchanan, “Constitutional Efficiency and the European Central Bank,” *Cato Journal*, vol. 24, no. 1-2, 2004; cp. ,e.g., A.R. Leen with M.C. Huang, '[How a free market system resulted in hegemony and a magnificent era: the case of Nobunga oda, 16th century, Japan](#)', in: *Archives of Economic History*, vol. XIX, no.1, pp. 5-16. It does not matter if this one internal market is brought by peaceful means or the sword. In 16th century Japan, the local lord Oda fought his neighbors and established peace with the slogan: *Free trade and free guilds*. The two thing he demanded of the inhabitants of the conquered countries was, **first**, free entry of his goods and allowing also the goods of the conquered country freely in his country, and, **second**, that, without any fee or tax, everyone could start up a business. Great wealth was the result of the free exchange market system.

²⁶ <http://www.outsidethebeltway.com/gary-johnson-i-didnt-create-a-single-job-entrepreneurs-did/>