

**DISCOVERY,
CAPITALISM,
AND
DISTRIBUTIVE
JUSTICE**

THE COLLECTED WORKS OF ISRAEL M. KIRZNER

Austrian Subjectivism and the Emergence of

Entrepreneurship Theory

Competition, Economic Planning, and the

Knowledge Problem

Competition and Entrepreneurship

Discovery, Capitalism, and Distributive Justice

The Economic Point of View

Essays on Capital and Interest

The Essence of Entrepreneurship and the Nature and

Significance of Market Process

Ludwig von Mises: The Man and His Economics

Market Theory and the Price System

Reflections on Ethics, Freedom, Welfare Economics, Policy,

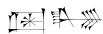
and the Legacy of Austrian Economics

ISRAEL M. KIRZNER

Discovery, Capitalism, and Distributive Justice

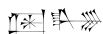
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PETER J. BOETTKE and FRÉDÉRIC SAUTET



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INTRODUCTION TO THE LIBERTY FUND EDITION

The great scientific contribution of the classical economists was the demonstration that within a system of private property rights and freedom of contract, individuals pursuing their self interest produce a peaceful and productive social order. The “invisible hand” proposition identified with Adam Smith set the stage for all subsequent developments of economic science. The great classical liberal political economists of the nineteenth century, such as J. B. Say and Frédéric Bastiat in France and David Ricardo and James Mill in England, refined Smith’s argument and claimed that the private property order with free and open trade resulted in the simultaneous achievement of individual autonomy, prosperity, and peace. The empirical record in the eighteenth and nineteenth centuries seemed to support this claim, as the relatively free economies of Europe, especially the United Kingdom, and of the new world, especially the United States, grew prosperous and the expansion of the rights of man was achieved.

But somehow, the late nineteenth century saw an increasing dissatisfaction with the capitalist order among intellectuals. The socialist critique of capitalism resonated with the youth and the literary class. James Buchanan argues that this was due to the fact that the classical liberal political economists had failed on the intuitive test of the justice of the distribution of resources, even though they had demonstrated the compatibility of individual autonomy with generalized prosperity.

The development of the marginal productivity theory of wages provided a rigorous answer to the question of the discrepancy of income in a capitalist system. The results, however, followed only under the highly restrictive assumptions of perfectly competitive equilibrium. The theory did not adequately address the moral intuitions of the social critics of capitalism. Furthermore, the “technical” defense of capitalist distribution did not adequately explain, let alone justify, the source of pure or speculative profit. This is where Israel Kirzner enters the discussion and seeks to contribute a better understanding of the nature of the capitalist economic process and the role of pure profit in the functioning of the system. To understand Kirzner’s contribution, one must go back to classical economics.

John Stuart Mill is taken to have argued that production and distribution could be treated separately.¹ A fair division of the social product could be determined without any concern for adverse incentives on the process of production or the efficient allocation of scarce resources. But thinkers who are more market-oriented, using the latest development of marginalist economics, emphasized that production and distribution could not be so neatly separated. The way the social pie was divided would have an impact on the size of the social pie produced. Incentives indeed matter. Thinkers who are more socialist oriented, on the other hand, thought the tools of marginal analysis could be marshaled to serve the ends of socialism more effectively. In other words, neoclassical economics could serve the distributional goals of socialism. This was a central idea behind Fabian socialism and the founding of the London School of Economics.

In spite of the major dispute in the 1920s and 1930s over the economic analysis of socialism, the sides never really engaged each other in a common language, and both walked away declaring themselves victors. Unfortunately, at the height of this debate the major modern world economies sank deeply into an economic crisis. The Great Depression had the consequence of not only ushering in a great growth in the size and responsibility of governments in the United States and United Kingdom, but it destroyed the “faith” in the efficacy of the capitalist order for more than a generation of intellectuals throughout the world. Capitalist distribution had been seen as unjust; now capitalism was seen as inefficient altogether, and it didn’t work as the classical theory had suggested. After the Great Depression, it became commonplace to argue that capitalism didn’t work and the distribution that resulted from it was unjustified on moral grounds. The “invisible hand” was revealed to be palsied, and the very “visible hand” of the government was required to fix, in addition to the injustice of the capitalist system, the inability of the market economy to self correct. In the 1940s and 1950s the dominant voices in economics declared loudly that unfettered capitalism suffered microeconomic inefficiencies and macroeconomic instability, and resulted in gross social injustice.

1. There is some controversy over whether J. S. Mill was actually committed to this separation, but subsequent discussions proceeded as if he was, and thus argued that questions of distribution should be treated separately from the laws of production.

The counterargument of the 1960s and 1970s associated not only with the Chicago School but also with the various strands of a resurgent classical liberal political economy in Law and Economics, Property Rights Economics, Public Choice, New Economic History, Market Process, and New Institutionalism focused their analytical and empirical attention on demonstrating that the claims of market failure theory were flawed. In other words, upon close examination, the market economy was indeed a self-regulating system that generated social cooperation and wealth creation. In short, the market worked and the “invisible hand” thesis proved to be more robust to deviations from ideal conditions than former theory had led us to believe.

But the economists of that generation largely left the questions of justice and the moral assessment of capitalism alone. The economist *qua* economist, it was argued, had nothing to say on such questions. The position held is not intellectually unjustified. Economics is after all a “positive” science in that it seeks to understand what is and not necessarily what should be. But it is important to stress that economics is not rendered completely silent by such a position. Indeed, economic theory may not be able to tell you whether profits are deserved or not, but it can specify the consequences of your answer to those questions of just desert. And that knowledge is essential for the task of moral and social philosophy. Perhaps nothing is as dangerous as an economist who knows only economics except a moral philosopher who knows no economics at all.

Robert Nozick’s *Anarchy, State, and Utopia* put the fundamental question of justice in distribution at the center of discussion in modern political theory. Nozick basically defended the style of reasoning associated with “invisible hand” explanations that raises doubts about aggregate and end-state ideals of just distributions. He laid out the case for individual rights and fairness in the processes of exchange and production, and thus the resulting distribution. Nozick legitimated the classical argument that the market economy works and the resulting distribution is morally just. The critical debate between John Rawls (the two principles of justice: [1] maximum equal liberty, and [2] maximize the minimum position of anyone in society) and Nozick (rights as trumps and process versus end-state ethics) became the centerpiece of every discussion in modern political theory. It is not an exaggeration to say that Nozick impressed with his wit and analytical skill but did not persuade, and Rawls came to define modern political liberalism.

This was a debate of political theory that touched on political economy, but many of the core economic issues, such as pure profit, remained unexamined. Marginal productivity theory of distribution could hardly be used in understanding the role that speculation and pure profit play in a market economy, let alone in justifying the pursuit and grasping of those pure entrepreneurial profits. Israel Kirzner's *Discovery, Capitalism, and Distributive Justice* sought to make those unexamined economic issues more widely understood in the hope that the positive science of economics could contribute greatly to our understanding of the justice in capitalist distribution.

Kirzner argues that standard criticisms of the justice of capitalist income distribution are not correct because they fail to see capitalism as a "discovery procedure" in which the way the social pie is created and distributed is never fully known prior to its distribution. He argues that the capitalist system consists of innumerable acts of entrepreneurial discovery by all market participants. These acts must be sharply distinguished from acts of deliberate search and deliberate production. On the basis of these insights, Kirzner argues for what he calls a "finders-keepers" rule as a commonsense ethical rule that has moral weight. In a fundamental sense, Kirzner argues that the society that does not accept the finders-keepers rule will be unable to enjoy the fruits of capitalism in terms of technological innovation and wealth creation that we are too often led to take for granted. Economists' theory of the market generally ignores or underappreciates entrepreneurial discovery and the institutional conditions and moral prerequisites that make possible a vibrant entrepreneurial society.

Discovery, Capitalism, and Distributive Justice is Kirzner's work that comes the closest to normative political economy, but reading the book in such a way would do the work a disservice. Kirzner goes to great lengths to avoid being a normative economist. He is, instead, limited to laying out the implications of the positive analysis of entrepreneurial market process for arguments concerning the role of pure profit and the capitalist distribution of resources.²

2. For more discussion of the main themes of the book, see Charles Baird's, Richard Ebeling's, and David Gordon's reviews of the book. See also two articles that discuss Kirzner's book: David Schmitz's "Finders, keepers?" and Martin Rickett's "Kirzner's theory of entrepreneurship: A critique."

The arguments contained in *Discovery, Capitalism, and Distributive Justice* are particularly timely given the turmoil of the global financial crisis that started in 2008. Those events are this generation's "Great Depression," and the old Keynesian arguments about capitalist instability, market failure, and ill-gotten market gains have been resurrected with a vengeance. The story of the financial crisis, just as the story of the Great Depression of the 1930s, is not a simple one. But the larger debate over the capitalist system needs to be reengaged in light of the arguments that logically follow from an economic analysis that sees entrepreneurship as the driving force.

This volume comprises two sections. The first section contains Kirzner's book *Discovery, Capitalism, and Distributive Justice*. Section 2 offers three important articles by Israel Kirzner on the subject of economic justice. The first one dates back to 1973 and was written at the time *Competition and Entrepreneurship* was published. The second paper was written in 1978 and presents an assessment of Robert Nozick's entitlement theory of justice, including an insightful discussion of the Lockean proviso. Kirzner saw very early on the importance of the entrepreneurial framework for the subject of economic justice, and one can find in those two papers the themes that Kirzner will develop further in his 1989 book. After his book came out, Kirzner was concerned that his ideas on justice were neglected, which led to the publication of the third paper in 1992. That paper offers refined insights into the issue of discovery and economic justice. Section 2 also includes a critique of Kirzner's theory by Theodore Burczak published in 2002 and Kirzner's reply.

ACKNOWLEDGMENTS

We would first like to thank wholeheartedly Israel Kirzner for his unparalleled contribution to economic science. Kirzner's research program has deeply enriched the discipline and has shed light on some of economics' most difficult puzzles. Economists owe him an immense intellectual debt.

The publication of the Collected Works of Israel M. Kirzner would not be a reality without the participation of Liberty Fund, Inc. We are extremely grateful to Liberty Fund, and especially Emilio Pacheco, for making this project possible. To republish Kirzner's unique oeuvre has been on our minds since our time spent at New York University in the 1990s—where one of us was a professor (Peter) and the other a post-doctoral student

(Frédéric). We are thrilled at the idea that current and future generations of economists and other scholars will have easy access to Kirzner's works.

Finally, we wish to thank Emily Washington for her invaluable help in the publication of this volume.

Peter J. Boettke and Frédéric Sautet

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PREFACE

For a number of years my work has emphasized the importance of the entrepreneurial role in market processes. The bulk of this work has focused on understanding the way in which market processes depend on entrepreneurial alertness and discovery for any systematic equilibrative properties they display. In this work in positive economics, insights concerning entrepreneurial discovery were able to illuminate the Austrian tradition in economics, as developed in recent decades by Mises and Hayek. This tradition, while overlapping on key elements of economic understanding with the dominant, neoclassical tradition, differs from it in significant respects. Grasping the entrepreneurial role turned out to be crucial for an appreciation of how the Austrian theory transcended the scope of mainstream equilibrium formulations. While at work on these matters, it was difficult to avoid noticing how profoundly important the entrepreneurial role is, not only for positive economics, but also for the philosophical and ethical evaluation of market processes. This little book develops some simple but important ideas along these lines. It argues that criticisms of the justice of capitalist income distribution suffer severely as a result of failure to see capitalism as (to employ Hayek's felicitous phrase) a "discovery procedure."

It turns out that when equilibrium economics treats economic gains as being *either* the fully expected results of deliberate plans, *or* the fortuitous expression of pure luck, it is excluding consideration of a third, morally significant possibility, namely, that gain may emerge as a result of the alert grasping of a hitherto unnoticed opportunity. Such gain, I maintain, must be seen as *discovered* gain—a category with a moral character entirely of its own. This book pursues this idea at some length, and reaches, as a result, some radically novel conclusions concerning capitalist distributive justice.

Many of the matters discussed in the book have been debated around the colloquium table of the Austrian Economics Program at New York University. Portions of the book were also presented at seminars at the Center for the Study of Market Processes, George Mason

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University, and under the auspices of the Social Philosophy and Policy Center, Bowling Green State University. Appreciation is gratefully expressed to participants in these seminars, especially to Mario Rizzo, Lawrence H. White, Jack High, James Buchanan, Karen Vaughn, Robert Tollison, Don Boudreaux, Richard Epstein, Alec Nove, John Roemer, Loren Lomasky, and John Gray. Financial support from Sarah Scaife Foundation and Moorman Fund is gratefully acknowledged. Theorists of distributive justice may differ on the degree of credit to which these friends and supporters are respectively entitled. All of them will agree, I believe, that only the undersigned deserves censure for remaining errors.

Israel M. Kirzner

1. INTRODUCTION

This book aims to clarify an aspect of the morality of the capitalist system—the idea of *justice* as it relates to the market economy. Probably no other moral dimension of capitalism has sparked such bitter controversies and aroused such fierce emotions. Critics of capitalism have denounced this system as one of exploitation; they have condemned it as generating a pattern of income distribution that is unjustified and unfair. Sometimes these denunciations have focused on the economic *inequality* that is inseparable from capitalism. But it is the charge of *injustice* that almost invariably supplies the moral fuel for these and similar criticisms.

What I will be dealing with is, therefore, certainly not the full gamut of ethical and moral concerns arising from capitalism. The morality of the capitalist system depends not only on its justice or injustice, but also upon the extent to which it promotes or obscures human freedom, the extent to which it can succeed in efficiently serving the needs and promoting the goals of its members, the extent to which it promotes the emergence of noble or ignoble qualities among its members, and on and on. As I shall be emphasizing, clarity in regard to the idea of justice in capitalism requires that we be careful to treat this idea separately from all other moral aspects of capitalism. Lack of compassion is not the same as the perpetration of injustice; moral criticisms of capitalism that claim that it promotes heartlessness and selfishness have not—even were these criticisms to be accepted—thereby established that capitalism is an inherently unjust system. Conversely, the defense of capitalism against the charge of injustice does not by itself invest the system with overall moral worthiness.

Yet, while I freely acknowledge that my topic is relatively modest in the scope of its ethical concerns, we must not underestimate its importance. It is because capitalism is seen as at least permitting rank injustice that many of its defenders feel compelled to couch their defenses in apologetic terms: it is true, they concede, that exploitation and injustice are rampant under capitalism, but, after all, the system promotes prosperity and/or individual liberty, and so on. It is because capitalism is seen by millions as being built on injustice as one of its essential and defining characteristics, that the system is despised and even hated in much of the world. It is largely because of this violent antipathy to capitalism on

the grounds of its alleged injustice that no modern country has permitted unrestricted capitalism to flourish within its borders. To claim, as this book will claim, that virtually all of these criticisms of capitalism as being unjust, are themselves deeply flawed and are even, perhaps, in principle invalid, is to make a counter-intuitive and iconoclastic claim concerning a vitally important issue. Whether my claim is itself persuasive will be for the reader to decide; but the intrinsic importance of the issue as being at the very forefront of moral and ethical debate regarding capitalism, should not be a matter of dispute.

DISAGREEMENT WITH THE LITERATURE

My thesis is to charge that existing discussions of economic justice under capitalism have—whether they attack or defend capitalism—seriously misperceived the issue. Considering the substantial volume of work which has been devoted, during the recent decade, to economic justice, and considering the unquestioned competence and eminence of many of the philosophers and economists who have addressed this theme, the charge will properly be met by skeptically raised eyebrows. It will be necessary, in subsequent chapters, to identify with great care the lapse in vision I wish to attribute to the existing literature, and to seek to persuade the reader that this lapse is indeed crucial for a proper evaluation of the justice or injustice of the capitalist system. In this introductory chapter I can only outline the basic insights that I wish to introduce into the discussion, to sketch their significance, and briefly show how existing discussions have consistently failed to incorporate these insights.

I should emphasize at the outset that my disagreement with the existing literature is not, at the core, a disagreement on ethics. In fact very little in what I shall be arguing anywhere in this book depends on proposing any novelties in the moral evaluation of economic phenomena. My contention will be that the ethical assessments of capitalism have failed primarily because these assessments have misperceived the nature and the mode of operation of the capitalist system. My disagreement with the existing literature will, then, turn out to be not a disagreement in ethics but a disagreement in economics—but an economics disagreement with direct implications for the ethical assessment of capitalism. Some further remarks on this aspect of the problem may be of help.

ON THE INTERFACE BETWEEN ETHICS AND ECONOMICS

To judge adequately any aspect of social reality from the ethical perspective calls, of course, for a valid framework of ethical criteria to serve as the evaluative yardstick. But such judgment also requires, perhaps even more importantly, a valid positive understanding of the particular slice of social reality being ethically appraised. The same is true, after all, for all kinds of moral appraisal: that which is being appraised must, first of all, be properly identified and understood. To condemn the bad manners of someone creating an unruly disturbance in a concert hall during the course of a sublime artistic performance, requires that one should correctly identify the nature of the disturbance. One's moral condemnation might be softened if the noisemaker turns out to have noticed an unsecured ceiling girder dangling precariously over a portion of the audience. Two observers who are equally outraged by rude interruptions of orchestral performances will react differently if one of them does and the other does not, understand what has motivated the horrified girder-discoverer.

To judge the morality of a particular economic transaction requires that we fully understand the motives and the likely consequences of that transaction. To judge the justice of a market system requires that we fully understand the workings of that system. Two judges who share the same set of ethical values may judge the morality of the market system quite differently from each other, if one does and the other does not, understand how markets work.

These are rather obvious observations, but are often overlooked. It is frequently assumed that in order to defend the market system against its ethical detractors, it is necessary that the defender should disagree with his adversaries more or less profoundly on ethical standards. Of course such disagreements on standards *may* be responsible for quarrels about the morality of the market. But very frequently this is not the case. The quarrels over the morality of markets merely reflect different views concerning economic reality.

So sound "positive" economic reasoning is important, in the most simple and direct way, for arriving at sound ethical judgment concerning economic reality. It will be my contention that a fairly subtle flaw in the standard economic understanding of the function and operation of markets is in fact responsible for much that is inappropriate in contemporary discussions of economic justice under capitalism.

ON THE DEFINITION OF CAPITALISM

I have been using the term “market system” synonymously with “capitalism.” This means I am defining capitalism, for my purposes, as a “pure” system, one in which all economic activity proceeds through laissez-faire markets. I do not, in other words, wish to comment directly on real-world modern day capitalism, in which a large, often enormous, volume of government regulation modifies the operation of otherwise free markets. For present purposes it is important to disentangle the market elements in modern capitalism from those other elements in it which circumscribe and constrain the market elements. My concern is with the justice of the market system; with the justice of real-world capitalism only insofar as relates to its market elements.

More specifically, I conceive of pure capitalism, for purposes of appraising its justice or injustice, as a system of *decentralized decision making*. Such a system, as we shall see, presumes a legal framework defining individual private property rights. Given this framework each individual is free to decide for himself what to do with each item that he owns. The individual may use it for consumption, may use it in productive processes, or may sell it to anyone able and willing to buy it from him at an agreed price. No one finds that his power to determine the use to be made of an item of property that he rightfully owns, has been arbitrarily interrupted by the decision of someone—legislator, central economic planner, criminal, or whomever—other than himself. No one finds that his ability to sell his property to a willing buyer has been obstructed by laws declaring the agreed price to be illegally too low or too high, or by laws declaring his sale to be harmful to the physical well-being or the morals of the purchaser. Notice that the postulation, in capitalism, of a system of individual rights is merely an alternative way of identifying capitalism as a system of decentralized decision making. To be able to make a decision with regard to the disposition of a unit of resource or product *is* to have rights over the entity the disposition of which is being considered. Decentralized, individual decision making *is* nothing but a system of inviolate individual rights. Centralized decision making, involving one or other form of central planning, implies, at the very least, significant limitations on the extent to which individuals may exercise economic decision rights. The system I wish to examine is the pure, decentralized decision-making system. Such a system is described as a market system because, typically, decentralized

decision-making systems tend to generate active and complex markets and systems of markets, and these markets are defined as exempt from outside regulation. Questions concerning economic justice under pure capitalism relate, therefore, to the operation of and outcomes generated by unregulated markets, for land, for labor, for capital goods—as well as for financial capital, and for intermediate and final consumer products of all kinds. But, at least conceptually, we must distinguish sharply between two different kinds of questions that may be asked concerning the justice of a system based strictly on individual rights. Only one of these two kinds of questions is our direct concern in this book.

One kind of question—the kind we are *not* directly concerned with—has to do with the justice of the specific pattern upon which individual rights are initially assigned, *before* the market process gets under way. Conceptually this question is prior to that of the justice of the market. This first question asks whether the property which individuals bring to market is justly theirs, that is, whether the legal system assigning such property rights to them is a just one.

The second kind of question begins only after the first has been satisfactorily answered. Given a just system of individual rights-assignment, the second kind of question then addresses the extent to which the *operation* and *outcomes* of the system—any just system—of individual rights conform to canons of justice. Admittedly in practice the property rights an individual enjoys in a given market economy are themselves the outcomes of earlier market economy processes, but conceptually we can distinguish between the assignment of existing rights at the moment when we begin our examination, and the subsequent market processes through which rights are exchanged and exercised.

It matters a great deal that I declare myself in this book, not to be directly addressing the first kind of question. The idea of capitalism, of a market economy, of a system of decentralized decision making, does not presuppose and is not dependent upon any one system of property law. One can imagine a wide range of alternative systems of private property, each one of which would satisfy the institutional prerequisites for capitalism. Clearly any given criteria of justice are unlikely to pronounce all these alternative systems of property law to be equally just—yet all could serve in a capitalist system. Full acceptance of the justice of one legal system specifying private property rights is entirely consistent with moral revulsion against a second legal system specifying a different mode of