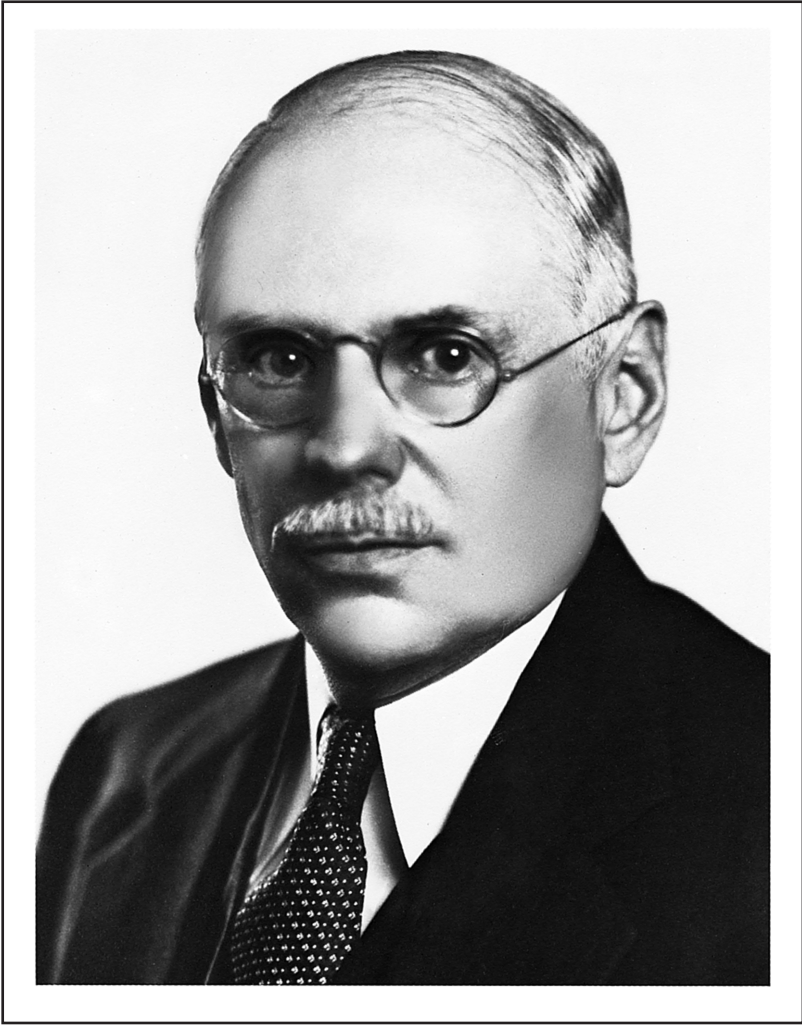

Freedom and Reform

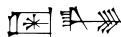


Frank H. Knight

Freedom and Reform

*Essays in Economics and
Social Philosophy*

FRANK H. KNIGHT



Liberty Fund

Indianapolis

This book is published by Liberty Fund, Inc., a foundation established to encourage study of the ideal of a society of free and responsible individuals.



The cuneiform inscription that serves as our logo and as the design motif for our endpapers is the earliest-known written appearance of the word “freedom” (*amagi*), or “liberty.” It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.

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Foreword

To those who may not know Frank H. Knight or his works, I can commence by making a “contribution to your education,” one of his own most familiar phrases. Frank Knight was born in 1885 on a farm in Illinois, and was variously educated in schools, colleges, and universities in Illinois and Tennessee (in chemistry, German drama, and philosophy) before settling down for a doctorate in Economics at Cornell (1916). His dissertation, *Risk, Uncertainty, and Profit*, published in 1921, quickly became and remains a classic in economy theory. His broader ranging interests were reflected early in essays written over the period 1921–1935 and published in *The Ethics of Competition* (1935), the first of his three volumes of collected papers.

Knight’s active teaching career included Cornell and the University of Iowa before the University of Chicago, which he joined in 1928 and where he became the primary intellectual source for the original, or pre-Friedman, “Chicago school”

of economics. At Chicago, Knight put his stamp on several generations of students who learned economics with philosophical overtones. After visiting stints at several universities in his post-retirement years, he died in Chicago in 1972 at the age of eighty-seven.

Do other students of Frank H. Knight experience reactions similar to mine when I reread one of his essays? Having struggled to develop a plausibly coherent intellectual position, and in one sense, feeling a bit of pride in my achievement, I find myself confronted time and again with Knight's much earlier and more sophisticated statement of the same thing. It is as if in rereading Knight I am retracing the sources of my own thoughts, which themselves have somehow emerged without conscious recognition that they are derived from him.

My own relationship to Frank Knight in this respect is, I think, quite different from the more straightforward teacher-disciple connection. When confronted with an intellectual-philosophical "puzzle," I do not go back to search out and see what the master may have written on the subject. For me, Knight's works are not reference materials. In response to a "puzzle," my own proclivities are those of Knight himself (which I surely got from him also), which are those of working out my own preliminary "solution," independent of *any* authority or *any* text.

This characteristic is central to everything Knight approached. The intellectual-moral courage to treat nothing as sacred shines through all his work, perhaps most notably in the philosophical essays of the sort included in *Freedom and Reform*. Honesty, sincerity, integrity—these are the qualities that mark the writings and the man. Frank Knight knew who he was and where he was. He possessed the elementary gumption to stake out his intellectual-moral position unawed by either the "wisdom of the ages" or the potential censure of his peers in the academy. He was willing

to acknowledge his own vulnerability to error, and when he was confused, he was not reluctant to say so.

Frank Knight did not preach a gospel (despite the old University of Chicago saying that “there is no God, but Frank Knight is his prophet”). There was, to him, no gospel to be preached. He made no effort to present the “truth according to Frank Knight.” He taught that “truth” was whatever emerged from the free discussion of reasonable men who approached the dialogue without prejudice and as good sports. The question as to the possible existence of something external to such a discussion-agreement process was not within his range of interest for the simple reason that it could never be answered.

Knight’s audience was made up of the other potential participants in the discussion process. He did not address his words to the agents who might hold positions of governmental-political power over others. Even in a remote conceptual sense, Knight was not an adviser to governments, a characteristic that, in itself, separates Knight from so many of his fellow economists, in his time and now.

As he himself acknowledged, and as many others have recognized, Frank Knight was essentially a critic. His work, aside from *Risk, Uncertainty, and Profit*, can be interpreted as a series of long book reviews. His “social function” was that of exposing the fallacies, nonsense, and absurdities in what was passed off as sophisticated-scientific discourse. He emphasized repeatedly that the problems we face in modern society are not problems of science and education in the standard meaning of these terms. “The main task of society . . . is *education*, but of the will more than the intellect; it is to develop a more critical attitude.”¹ I have personally heard Knight repeat many times the Josh Billings aphorism: “It

¹ *Intelligence and Democratic Action*, Harvard University Press, 1969. Page 14.

ain't what we don't know that hurts us. It's knowing so darned much that ain't so.''

Frank Knight was not pleased with developments in modern economics. He shared with the Austrians a highly skeptical attitude toward the value of empirical research. I recall sitting with him at the American Economic Association Presidential Address by Paul Douglas, during which Douglas paraded a panoply of charts and diagrams purporting to demonstrate relationships in aggregate production functions. At the close of the presentation, Knight muttered. "Proving water runs down hill," a comment that he would surely have found applicable to much of the empirical trivia that fills the journals of the 1980s.

He would have been particularly disturbed by the image of man that the modern emphasis on empirical testability forces on the economist as practitioner. To make hypotheses operational, arguments in utility functions must be specified. Old-fashioned *homo economicus*, man as net-wealth maximizer, reemerges as the actor on center stage. To Frank Knight this reemergence could only reflect retrogression into a simplistic and wrongheaded usage of the valuable insights that economic theory can offer. *Homo economicus* exists in every man, but one of Knight's most persistent themes through all his works is that there exist all sorts of other men (the romantic fool, the sportsman who enjoys the fray, the prejudiced ignoramus, the man who wants to be a "better" man) alongside the rational maximizer of economic interest.

To Knight the task for economists (and for social philosophers) is not to be located at the extensive margin of "science." The task is to be located squarely at the level of elementary common sense. No sophisticated analysis is required to recognize that legally-enforced wage floors cause unemployment or that inflation cannot increase production in any long-term sense. But many men are prejudiced and romantic fools.

The job is to cut through the cant of the professional and tackle the intellectual prejudice where it exists. In staking his own effort toward some ultimate attainment of common sense by ordinary citizens, Frank Knight categorically rejected the elitism too often met in the academy and at the same time reaffirmed his own faith in a society of free men. While he remained always pessimistic as to its potential realization, such a society was, for Knight, the only one worthy of serious consideration.

I am especially pleased that Liberty Fund is republishing *Freedom and Reform*. Over and beyond the desirability of insuring that the essays here will now be available again to potential readers, there are particular reasons that make Liberty Fund's republication appropriate. Pierre Goodrich, whose works made Liberty Fund possible, shared with Frank Knight more than membership in the same age cohort. These men shared a respect for ideas and a love of individual liberty. They were also men of mid-America, and the location of the source of the republication is itself of value. Frank Knight personified the mid-American scholar-skeptic-critic of his age. The man and his mind could never have emerged from the culture of either Europe or the American seaboard. And, sad to say, such a man could probably not emerge anywhere in the culture of the late twentieth century.

In this connection, I shall conclude by recalling a conversation with Professor Ronald H. Coase when he and I were colleagues at the University of Virginia, where Frank Knight had visited for an extended period. Coase and I were walking along Mr. Jefferson's Lawn, and we had been discussing famous economists. Ronald said something like the following to me. "I can think of almost any famous economist, like _____, _____, _____, or _____," naming the obvious world-renowned figures in our discipline as evaluated from the perspective of the early 1960s, "and I can sort of imagine

Foreword

myself in their position of fame with a bit of luck, persistence, and effort. But I simply cannot imagine myself to be like Frank Knight. I guess that amounts to saying that Knight is a genius.” I have always remembered that conversation because Coase put so well what so many of us feel when we think of the professor from whom we learned so much.

JAMES M. BUCHANAN

James M. Buchanan is the author of many books and articles, including The Calculus of Consent (with Gordon Tullock), The Limits of Liberty: Between Anarchy and Leviathan, and What Should Economists Do?

Preface to the First Edition

F*reedom and Reform* is in a sense a sequel to the volume, *Ethics of Competition*, published in 1935. The content is chiefly papers of a philosophical or interpretive character that have appeared in various journals and symposium volumes since that time; two earlier items and an expanded version of a lecture not hitherto printed are also included, but nothing belonging to the field of technical economic theory.

The assembly and publication of these papers is due to the initiative of certain of Professor Knight's students and junior colleagues, and the selection has been made in consultation with the author. The material has been brought together and presented in book form because of its significance in relation to serious problems that have been prominent in public discussion—both in and outside of academic circles—in recent years. It seems unlikely that these problems will lose their importance or their interest in the near future.

The papers deal with the nature of social science and its relation to social problems, the place of the methods and

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concepts of natural science, the interrelations of the several disciplines, and the interpretation of conspicuous features—many of them recognized as ominous—in the trend of events in the western world during our generation. It is hoped that these essays will contribute something to historical understanding and to the clarification of the values and procedures involved in social action in a free society.

We wish to thank the various publishers who have so kindly given us permission to reprint the selections included in this volume.

The University of Chicago
December, 1946

HUBERT BONNER
WILLIAM GRAMPP
MILTON SINGER
BERNARD WEINBERG

Freedom and Reform

Freedom as Fact and Criterion

Students of ethics or social science hardly need to be reminded that one of the leading modern schools of ethical thought has been dominated by economists. The English-speaking world in particular has been utilitarian in its theory and its folk-mind from the age of the Enlightenment. Hence some reflections by an economist on utilitarianism and ethics generally may be worth consideration.

For present purposes, it is the political rather than the properly ethical aspect of utilitarianism, and especially the separation of the two, which is of interest. It is one thing to ask what is Good, and another to inquire as to what social policy is to be carried out, and by what agencies, in order to realize the Good as far as possible. There might, indeed, be such a connection between the two questions that the answer to one would largely involve an answer to the other; but it is

an essential feature of utilitarian theory that it makes the separation complete.

The good, according to the utilitarians, is pleasure, which is a purely individual matter. We shall not stop to criticize this conception of the good. The issue regarding it is in fact largely verbal. Utilitarians expressly define the term “pleasure” in an all-inclusive sense; it covers high pleasures and low pleasures, the pleasure of being good and that of being bad, the pleasure of peace and also that of strife, even the “pleasure” of martyrdom. If pleasure is defined as identical with motivation in general, there naturally can be no motive but pleasure—and if it is defined in any other way, there will necessarily be other motives. And that is all that appears to be worth saying on that point, with the possible exception of questioning whether it is an economical use of language to take two perfectly good words to mean the same thing when there are significantly different ideas which they might be used to distinguish with less departure from their ordinary meaning in speech and writing. The important point, however, is that for utilitarianism good is individual, and the individual is the ultimate judge of it; what is good is that the individual shall get what he wants. To Bentham especially, the particular beauty of the theory was that it definitely removed the ethical question from the domain of practical politics and set up an “objective criterion” of public policy.¹

The actual goal of political action then became the essentially negative ideal of *freedom*, i.e., the “greatest good” will be realized through “maximum freedom.”² Details were worked

¹ We need not pause to consider expressly the now familiar fact of a contradiction between two aspects of the pleasure theory, psychological and ethical hedonism. If every individual universally and necessarily seeks his own maximum pleasure, it is hard to see sense in saying that he ought to do so.

² Dean Pound derives the doctrine of maximum freedom in legal theory from the “metaphysical” foundations of Kant (*Law and Morals*, p. 103, etc.); but he elsewhere admits that all the modern schools of jurisprudence come out at

out by the British laissez-faire economists, beginning with Bentham's older contemporary, Adam Smith, and culminating in Herbert Spencer, a biological sociologist rather than an economist of technical competence. In practical application, the doctrine of maximum individual freedom necessitates a further assumption, namely that the individual is the final judge of the *means* to his own happiness, as well as of the result. The utilitarian-economic position on both points is, however, relativistic. It need not be assumed that the individual's knowledge is perfect, or even very good, but only that it is *better* than that of the outside agency of control, practically speaking a political bureaucracy. Smith and his followers notoriously placed their emphasis on the stupidity of governments rather than the competence of individuals, and the modern reader must keep in mind the character of the governments which formed the basis of their judgments.³

Sharply definite formulation of the principle of freedom waited for Herbert Spencer. In contrast with Smith, who mixed genial humanity with his hard common sense, Spencer was the cold, passionately dispassionate thinker. He explicitly defined pleasure as any mental state men strive to get or keep, and pain as the opposite. He traced conflicts of interest to

essentially the same practical conclusion. It seems to be the only kind of political ideal which has meaning for the modern mind, especially the Anglo-American mind.

³ In England it was, of course, the period of the "rotten-borough" Parliament and the Hanoverian Kings whom Thackeray rhymed so spicily:

"Vile George the First was reckoned;
Viler still was George the Second;
And what mortal ever heard
Any good of George the Third!
When George the Fourth to Hell descended,
Thank the Lord the George's ended."

It is not clear just how much of a theoretical hedonist Smith was when he wrote the *Wealth of Nations*. His views seem to reflect rather "hard common sense" than rigorous analysis, and undoubtedly contain an element of the Puritan conviction that it is good for the soul as well as conducive to happiness for the individual to make his own decisions and take the consequences of his own acts.

biological-economic roots in the distribution of the material means of individual enjoyment and gave the freedom theory its classical, quantitative expression as the right of each to the maximum freedom compatible with equal freedom for all others. He also supported it with a deduction from an evolutionary-biological law that life is necessarily increased and improved by making each individual free to act and to reap the consequences of his acts, since pleasure-giving and life-sustaining acts are “necessarily” identical. The good in life is its balance of pleasure over pain, and Spencer was unconscious of the absurdity involved in combining ethical with psychological hedonism.

Contemporary with Spencer, the subjective-value school of economists worked out the implicit rationale of the economic utilitarian political philosophy of maximum freedom or *laissez faire*. The result may be summed up in a series of propositions: (1) The good is pleasure (or happiness, the substitution of terms being largely an evasive effort to soften the position). (2) Each pleasure has its specific desire or motive, which impels conduct with a force proportional to the magnitude of the pleasure. (3) The intensity of any pleasure and the force of the desire for it decrease together as more of any pleasure is enjoyed, in comparison with other pleasures sacrificed to obtain the first (law of diminishing utility). (4) Consequently, an individual if left “free to choose” must automatically proportion his activities in such a way as to secure the maximum total of pleasure from the available means. (5) Interrelations between individuals work automatically, so as to bring about a maximum of pleasure all around, if such relations are also “free,” or voluntary, on both sides (free exchange), including the freedom of each individual to bargain with whichever opposing party offers the best terms (free competition). Hence the field of group control is restricted to the prevention of relations other than those of competitive

free exchange, specifically the protection of property and enforcement of contract.

Passing over various mechanical implications or hidden assumptions which still trouble economic theory,⁴ our purpose here is to show that the very notion of freedom as a “criterion” is illusory. The theory of maximum freedom if really followed through, ends in a question-begging justification of whatever human relations happen to exist, and the only way to escape this result and arrive at any ethical judgment is to appeal to an ethical judgment as such. If the notion of freedom has any ethical significance, it is derived from prior ethical norms.

The fatal defect in the utilitarian doctrine of maximum freedom as a goal of social policy is its confusion of freedom and power. Its advocates overlook the fact that freedom to perform an act is meaningless unless the subject is in possession of the requisite means of action, and that the practical question is one of power rather than of formal freedom.⁵ As its actual test of equality of freedom, the utilitarians set up voluntary exchange. That is, no individual is to be asked to make a sacrifice or render a service at the behest of another unless he receives in return what he himself considers a full equivalent. Plausible this argument undoubtedly is, but there is a gaping

⁴ Such as the tendency of freedom to eventuate in monopoly rather than competition, the fact that bargains between individuals usually have effects, good or bad, for persons other than the immediate parties, the further fact that many wants like culture and a beautiful environment must practically be provided for on a local group basis if at all, etc. See Pigou, *Economics of Welfare*.

⁵ Another deficiency of utilitarianism on the side of ethics proper is its restriction of the notion of the Good to values realized through conduct and use of material means. It has nothing to say about purely internal problems of appreciation or attitude such as are the chief concern of religion in its esthetic and mystical aspects.

In our opinion it is unwise to attempt to vindicate freedom as an ideal by defining it to include power. Thus Graham Wallas calls freedom the capacity for continuous initiative, and others distinguish between positive and negative freedom. It is surely better to work out clearly the relation between freedom and power as distinct factors in conduct.

hole in the logic. An “equivalent” to the choosing individual himself is simply the maximum that the other party will pay, a standard of force with no flavor of fairness. An ostensible provision for “fair” equivalence comes in only through the workings of the competitive market, establishing a general scale of prices. Thus the *most* that exchange relations can do is to assure that each individual shall keep, quantitatively unimpaired, the stock of values originally possessed, as measured by free exchange among persons whose original stocks were whatever they happened to be. The principle merely settles the ethical problem by decreeing fixity for all eternity of the *existing* distribution of means of enjoyment, as measured by a process the results of which also depend on the starting point. By a twofold *petitio principii* it sanctifies the *status quo*. The result rests on an ethical judgment, and on an ethically indefensible one. Its ethic is in the first place the right to keep what one has. But it does not stop there, as will presently be pointed out more in detail; it also sets up the right to use what one has to get more, without limit!

The weakness of this theory of maximum benefit through maximum freedom defined by voluntary exchange could not go entirely unnoticed. Theorists of the subjective-value school were accused of bringing forth their doctrine as an answer to the socialistic labor theory of value. But if it might be used apologetically in that connection, its net significance was clearly against the fairness of the established value scale rather than in its favor. For the principle of diminishing utility seems to lead at once to the conclusion that total utility can always be increased through one-sided transfers from persons who have more to those who have less, and hence establishes an equalitarian ideal of society. Early in the history of the subjective-value movement, one of the leaders of the Austrian school wrote a book to deal with this difficulty. He got around it theoretically by admitting that value or price does not