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The Two Utopias of Economics: Human Freedom and the Mechanism of Competition

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1. Introduction

One thesis of this paper is that economic theories do not only make reference to a variety of utopian elements – such as optimality, community, progress etc. –, but that economic theory is fundamentally an endeavor to build bridges between *two utopias*: the utopia of an economic order based on human freedom (‘relation of persons’) and the utopia of a self-regulating system which works independent of human wishes and will. Both utopias were already present in classical political thought. Adam Smith’s idea of ‘an end which is no part of the individual’s intention’ provided a strong and resilient bridge which survived for more than a hundred years. It broke down only in the second half of the nineteenth century, undermined by the objection that an end which was not the expression of human intentions was not only a contradiction in terms, but also incompatible with the idea of human freedom.

The marginal revolution successfully erected new bridges. Leon Walras, the leading figure of the new approach, made the relationship between both utopias the starting point of his ‘Elements of Pure Economics’: “We may divide the facts of our universe into two categories: those which result from the play of the blind and ineluctable forces of nature and those which result from the exercise of the human will, a force that is free and cognitive” (Walras ⁴1926/54, §2.17, 61). For Walras, the operations of the forces of nature constitute the subject matter of the natural science, while the operations of the human will are related to pure moral science (ethics) and history. As I will show in the paper, the relation between natural science and ethics is, not only in the twentieth century, an indispensable part of every economic theory. The bridge on which Walras and

his followers crossed the river was the idea that the system of general equilibrium did show market exchange “to be the superior general rule. Freedom procures, within certain limits, the maximum of utility” (Walras ⁴1926/54, §22.222, 255). Superiority was demonstrated by science. Every free and rational actor should accept the scientific proof. Walras – following in the spirit of the Enlightenment – believed that with the system of general equilibrium, he had developed the *scientific* underpinning of an *ethical* maxim.

A relevant part of the contributions to the discussion about the significance of economic sciences in the 1920s and 1930s tried to deconstruct Walras’ bridge and build new ones. Take, for example, Frank Knight’s arguments directed against ‘scientific ethics of any kind’, against ethics as a ‘glorified economics’, Lionel Robbins’ definition of economics as a relationship between means and ends, John M. Keynes’ statement that ‘the postulates of the classical theory are applicable to a special case only’, or Gunnar Myrdal’s critique of the ‘communist fiction’: the point they have in common – notwithstanding all theoretical differences – is the idea that the building of the bridge has to start from the utopia that the economic order is formed, and can be modified, by human wishes and will.

This paper is not a study of the history of economic thought in the sense of searching for a convincing sequence of outstanding ideas. I am simply trying to enlighten the trend of mainstream economics during the 20th century using some representative contributions which are well-known to us all. I will start from Walras’ exposition of the general equilibrium approach and concentrate, in the following sections, on the relationship between the Chicago School of Economics and what we may call the ‘British Approach’, embracing equally the London School of Economics and Cambridge. Finally, I will come to what may be called ‘neo-liberalism’.

I will argue that the latter approaches are no less utopian than earlier ones. The ‘economic approach to human behavior’, ‘new institutionalism’, ‘public choice’ etc. provide the proof that economic theories do not and cannot live without utopia. Neo-liberal economics, too, has something to tell us about human choices and freedom. I will try to show that the belief in an objective science of economics itself is no less utopian than earlier visions of markets, man, and economics.

2. *The Two Utopias*

The core of economics as positive science and the first pole is formed by the utopia of the market competition as an automatic mechanism, as a self-regulating system which functions independent of human wish and will. This utopia is based on the analogy to the natural sciences and has as a precondition that the market produces phenomena which are objective in the sense that they are independent of human will and responsi-

bilities: the world of exchange value and prices, of supply and demand, of money-income, of capital etc. The ‘economic laws’ – if defined in terms of labor-value or marginal utility, of the fall of the rate of profits or of general equilibrium – are based on these seemingly objective phenomena which assume the shape of relations between things. Utopian is the idea of self-regulation and laws because it prescind from the fact that the economy is grounded in human relations (and in human relations alone) and that man has the capacity to reflect on and to decide how to organize these relations.

The second pole, utopia of social freedom, rests on the awareness that the economic relations – for the reason that they are relations between human beings – depend on our will and wish and, therefore, can be organized freely following only our values and ideas. This should not hold true for only the immediate and transparent relations within the small circles of our families or our friendships. The rise of modernity and the decline of the idea of a divine order, to which to conform, and – to use the words of Max Weber – the ‘disenchantment’ of the world had the consequence that the society as a whole could no longer be taken for granted and understood in terms of traditional canons but had to be regarded as created by free and responsible human beings. The core of the utopia of social freedom is the idea that the mode of the economic organization can be agreed upon freely and autonomously. The utopia of social freedom is an ethical-philosophical idea since human action is not regarded as a given but as a reflection of free and responsible decisions. It is a utopia because it prescind from the fact that the world cannot be created from nowhere, that no decision concerning our social order is without premise and that, therefore, our freedom of shaping society by human will and wish may be limited.

Both utopias are like two poles: they are incompatible but, at the same time, depend on each other. If choice is choice it is not determined from the outside. If it is determined from the outside it is not choice. Economics necessarily encompasses both poles. Mundell’s paradoxical definition, “Economics is the science of choice” hits the point: On the one hand, positive science presupposes a reality of economic facts which can be determined independent of human decisions. On the other hand, choice is choice only if it is free, not induced by the outer world, but decided upon by an individual who bears the responsibility for his decision.

Positive science is in search of facts or laws which are not influenced by human wish and will. The fundamental assumption that the truth of the laws is independent of human decisions is tantamount to the assertion that the world is not influenced by human volition. If this were true, any kind of reform would be unreal and impossible. There is no escape to the paradox that if we want to explain economic occurrences in terms of positive sciences we have to assume that the facts are independent of human wish and will, while if we accept that human decisions influence economic occurrences we admit that there is no place for a positive economic science. Or in the words of Frank Knight: “if the world is always the same there is no problem of prediction, while if it is not always the same prediction is impossible” (Knight 1927/35, 110).

The challenge for twentieth century economic theory was to explain why free human beings choose to organize their economic lives in the form of a market economy. In order to do so, they had to undertake the impossible task of giving human freedom a content which could be determined scientifically. The road which the economic theories of the twentieth century opted for resembles the attempt to develop a scientific underpinning of human choices, an endeavor which could have only one ending: If taken seriously, there was no escaping the conclusion that, finally, there is no choice at all.

3. Marginal Revolution and General Equilibrium

The marginal revolution is normally associated with the names of Karl Menger, W. Stanley Jevons and Leon Walras. The roots are much older. Indeed, Ricardo already had used this line of reasoning in his rent theory and Marx later followed in his footsteps. In the 1840s, the French engineer-economist Jules Dupuit employed a similar idea discussing the utility of public works and we shouldn't forget Augustin Cournot, Auguste Walras, and Hermann Heinrich Gossen. But all these treatises attracted no special attention and, for decades, have remained nearly unknown. What distinguishes the three above-named authors from their predecessors is that they consciously used the marginal approach to create a new foundation of the whole edifice of economics. This attempt not only included a fundamental change of the theory of value, but also a new bridge between the utopia of human freedom and the utopia of the self-regulating mechanism of competition.

The core of the edifice is a system of equations which we call the General Equilibrium Theory. The interesting point now is: how did the exponents of the new approach succeed in establishing economics as a mathematical and exact science, like astronomy and mechanics – an endeavour which included the necessity of finding an answer to the question of how it was possible 'to cast human liberty into equations'? For the reason that Leon Walras is the one who recognized the conflict between the utopia of self-regulation and the utopia of freedom – and the explicit necessity of building a bridge between both – I will refer mainly to his exposition.

In order to render economics an exact or physico-mathematical science, Walras needed numerical data upon which to build. And he found them in the exchange values and prices of goods and services determined by scarcity. 'The price of a good', he stated:

“does not result either from the will of the buyer or from the will of the seller or from any agreement between the two. ... Thus any value in exchange ... partakes of the character of a natural phenomenon, natural in its origins, natural in its manifestations and natural in essence. If wheat and silver have any value at all, it is because they are scarce, that is, useful and limited in quantity – both of these conditions being natural ... the pure theory of economics or the theory of exchange and value in exchange, that is, the theory

of social wealth considered by itself, ... a physico-mathematical science like mechanics or hydrodynamics" (Walras 1926⁴/54, §1.28, 69-71).

It is important here to recognize that the exchange values or prices were the starting point of the exact science of economics for the reason that the prices do not depend on the will or the wishes of the actors. The price system is self-regulating in the sense that in equilibrium the prices of all goods are independent of any human decision. Insofar as in equilibrium *all* actors are price-takers, the General Equilibrium Model is the *perfect* utopia of self-regulation. The independence of human volition is the reason why the model can be stated in terms of an exact and mathematical science. Scarcity became the key-concept. Science had to build on data, not on decisions. This indeed meant that human action was not regarded as action proper or as choice, but only as a *given* demand, or as a *given* supply, i.e. as data. The General Equilibrium Theory did and does not ask *why* somebody demands something, or *why* his or her demand changes, or *why* not. It is assumed that choices have taken place outside the system. Equilibrium theory starts once the utility or want curves of all traders have been determined. Human choices do not play any role within the system.

Now, the assumption of a system of equilibrium prices which are autonomous, self-regulating, and independent of human choices posed a serious problem: *Why at all would man choose a system in which he has nothing to choose?* Why should he desire to engage in exchange ratios he has no influence on? Why would he prefer a blind mechanism to an association of free men where economic relations can be determined according to their own judgment about personal and cultural well-being or a good life? Why would he choose market relations and private property? The postulate of a self-regulating system contradicted the idea of freedom and the insight that economic relations, fundamentally, are relations between persons. The marginal theorists had to explain why free human beings should choose to organize their economic lives in the form of a market economy.

It was a serious challenge because we cannot take the decision between different forms of social or economic organization simply as data. Walras had to tell us something about choice: he had to *explain choice*. But explaining choice is something which positive science is not able to do. Therefore, Walras had to leave the firm grounds of science and take off for the slippery realm of social freedom or – as he calls it – the realm of ethics or moral sciences.

"If men were nothing more than a superior species of animal ... the explanation of social phenomena in general and of production, distribution and consumption of wealth in particular would be a natural science. ... But this is not the case at all. Man is a creature endowed with reason and *freedom*, and possessed of a capacity for initiative and progress. In the production and distribution of wealth, and generally in *all matters pertaining to social organization*, man has the choice between better and worse" (Walras 1926⁴/54, § 1.7, 55). "The appropriation of scarce things or of social wealth ... has its origins in the *exercise of the human will* and in human behaviour and not in the play of natural forces. ... the appropriation of things by persons ... *is a relationship among persons* ... the mode of appropriation depends on human decisions, and according as those

decisions are good or bad, so will the mode of appropriation be good or bad. ... *Appropriation being in essence a moral phenomenon, the theory of property must be in essence a moral science*" (Walras 1926⁴/54, §4.36, 76-9; my emphasis).

The important point here is that Walras recognized that all questions pertaining to social organization could not be treated in terms of natural sciences. Since man is free to shape society by his own wish and will, Walras had to cross the borderline between the natural sciences and ethics. But Walras was not a philosopher. And he had nothing to say about how a 'good society' might look like. The only statement – at least in his 'Elements of Political Economy' – was that it should be a 'choice between better and worse'. But he did not tell us anything about good and bad. Therefore, Walras' ethics is the perfect utopia of social freedom. It is empty and absolute, undetermined and unconditional, unspecified and unrestricted. Man is *completely* free. He has the possibility to choose whatever kind of society or mode of appropriation he wants, but at the same time he does not know how to choose. Walras did not develop ethical norms which could be a guide to how to decide. His ethical or moral considerations did not tell us anything about what criteria man should adopt when he has to choose between different forms of social organization.

If we look at the General Equilibrium Model on the one hand and at Walras' ethics on the other, we have to admit that both, taken separately, do not amount to much. Walras' utopia of social freedom is empty and meaningless. It does not tell us anything about what kind of social or economic organization can be considered advantageous or desirable. The Equilibrium Model or the utopia of the self-regulating system has the character of an ideal-type construct, a hypotheses, which does not tell us anything about economic reality. Walras himself admitted that "absolute free competition is only a hypothesis. In reality, the working of free competition is obstructed by an infinite number of disturbing factors. It is, therefore, pointless, apart from the gratification of idle curiosity, to study free competition by itself" (Walras 1926⁴/54, §22. 222, 256).

The General Equilibrium Model could obtain acceptance only because Walras constructed a link and built a bridge between both poles, taking the physico-mathematical utopia, the utopia of self-regulation of the market mechanism, as an ethical maxim, i.e. reading the hypothesis of free competition in terms of a superior general rule, destined not to be confirmed but to be applied in reality. The bridge was constitutive not only for Walras' model, but for the success of the marginal revolution in general. Superiority should have been demonstrated by science. If it was true that man was a free and rational actor and that he could choose the mode of economic organization and appropriation he prefers, why should he have denied the scientific proof? Walras assumed that he had demonstrated the *scientific* proof of an *ethical* norm.

"The equations we have developed do show freedom of production to be the superior general rule. Freedom procures, within certain limits, the maximum of utility; and, since the factors which interfere with freedom are obstacles to the attainment of this maximum, they *should*, without exception, be eliminated as completely as possible" (Walras 1926⁴/54, §22. 222, 256).

Following Walras' understanding, the General Equilibrium Model was meaningful, not because it was a true description of reality, but because it constituted a utopia, an end in itself, which could be used as a model, as an ideal-type, for the reform of economic and social organization. Man was considered completely free to shape society by his will and wish. The market mechanism had the character of an artifact, of a human-made machinery, which could be described in mathematical terms. Man conforms his actions to the functioning conditions of the market mechanism because it is to his advantage, i.e. it generates a maximum of utility. The superior result was the justification of the market mechanism. Due to the outcome men decide in favor of market organization, even if prices do not result either from the will of the buyer or from the will of the seller and, therefore, contradict the principle of human freedom. The whole construction depends on the idea that the maximum of utility can be taken as a superior *general rule*, i.e. an *ethical* norm.

Now, it is exactly this link, the idea that the maximum of utility can be taken as an ethical norm which was the Achilles' heel of the edifice. Walras did not recognize the weakness, the fragility, and the vulnerability of the bridge he had erected. But, inevitably, Walras' belief in a scientific definition of human freedom was an illusion. There is no scientific proof, and there can be no such proof, of the validity of an ethical norm. At best, the maximum of utility can be accepted as one principle beneath other maxims. Why should a free man choose the maximum of utility as the highest maxim? What about freedom itself? What about conflicting ideas concerning social efficiency? What about personal well-being? Why should man abandon the idea of the good life? Even if the model is taken as scientifically correct this does not mean that it is ethically binding.

4. Deconstructing Walras' Bridge

It is not a surprise that not the General Equilibrium Theory as such, but the bridge between both utopias, came under fire. A relevant part of the discussion about the significance of economic sciences in the 1920s and 1930s aimed at the deconstruction of Walras' bridge and the rebuilding of new ones. The strongest attacks came from the other side of the Atlantic (if we limit our study to the tradition of economic liberalism). Frank Knight, one of the fathers of the Chicago School of Economics focused on the weak point of Walras' edifice: the bridge does not hold. Economic sciences and normative-ethical consideration operate on different levels and cannot be mixed up. Between science and ethics there is no bridge. In his article 'Ethics and the Economic Interpretation', published in 1922, he argued "against 'scientific' ethics of any kind, against any view which sets out from the assumption that human wants are objective and measurable magnitudes ... and which proceeds on the basis of this assumption to reduce ethics

to a sort of glorified economics” (Knight 1923/35, 41-3). Knight got precisely to the core of the question: human action could not be treated scientifically, i.e. as data, without misconceiving the essence of action and choice.

“The only possible ‘science’ of conduct ... necessarily takes the form that under given conditions certain things can be counted upon to happen; in the field of conduct the given conditions are the desires or ends and the rationale or technique for achieving them. The objections raised to the notion of the economic man ... reduce to the proposition *that there is no such man*, and this is literally true. Human beings do not in their conscious behaviour act according to laws, and in the concrete sense a science of conduct is an impossibility. ... wants are not ultimately data and the individual more or less completely recognizes that they are not. ... The definition of economics must, therefore, be revised to state that it treats of conduct *in so far* as conduct is amenable to scientific treatment, in so far as it is controlled by definable conditions and can be reduced to law. But, this, measured by the standard of natural science, is not very far. *There are no data* for a science of conduct in a sense analogous to natural science. ... A science of conduct is, therefore, possible only if its subject-matter is made abstract to the point of telling us little or nothing about actual behaviour” (Knight 1922/35, 34-6).

Knight did not argue against the General Equilibrium Theory as such. He was not opposed to science. He accepted – or better, he was convinced – that the General Equilibrium Theory was the only possible economic theory. His skepticism was directed against the relevance of the approach of positive science in a sphere which fundamentally is based on human action. In his eyes there was and had to be a fundamental difference between social and natural sciences. “The root fallacy is that social science should be or can be a science in the same sense as the natural sciences ... man, in positivistic terms, could not act at all” (Knight 1942/47, 227).

Knight did not, in principle, disapprove the attempt to analyze human preferences scientifically, i.e. as data. But, so his objection, we had to bear in mind that the possible results of such an endeavor were predetermined by the method of positive science. For the simple reason that the “abstract economic principles are universally valid” (Knight 1944/47, 329) they do not tell us anything specific about market relations. The equilibrium theory is in his reading a perfect model of *all* possible modes of appropriation. It is unable not only to discriminate between different social arrangements, but also between economics and ‘life’. “In so far as the ends are viewed as given, as data, then all activity is economic. ... the problem of life becomes simply the economic problem ... The assumption that wants are ends are data reduces life to economics” (Knight 1922/35, 34). Any kind of action can be described in economic terms, a result which, indeed, does not bring us very far. The insights of positive science simply do not – and cannot – do justice to the freedom of choice, the freedom of action, and the freedom of human will. Thus, in Knight’s eyes the scientific analysis of economic relations remained a (negative) utopia which – to use Walras’ words – may gratify our ‘idle curiosity’, but it remained without direct practical significance. In any case, it did not tell us anything concerning the understanding of the modes in which social and economic life was organized.

“It is a fallacy to think of the problems of large-scale social organization – and specifically of large-scale economic organization – in terms of the relations between given individuals. Stating it in positive form, the problem is rather that of creating or producing the right kind of individuals ...the general principle that freedom is the only basis of ethically defensible relationships among men and the essential condition of all moral or personal life calls for leaving such individuals to work out and establish such relations as they themselves deem most conducive to economic efficiency, to personal and cultural well-being, and in general to their mutual advantage in their pursuit of the good life” (Knight 1940/47, 160-2). “The individual cannot be a datum for the purposes of social policy, because he is largely formed in and by the social process, and the nature of the individual must be affected by any social action. Consequently, social policy must be judged by the kind of individuals that are produced by or under it” (Knight 1939/47, 69).

If we acknowledge that Walras’ bridge does not hold, the question of social management, the ‘discussion of the merits of free competition, or laissez-faire ’ (Knight 1923/35, 47) remains a question which exclusively has to be discussed in the realm of ethics and philosophy. “Economic theory, as such, involves no disproof or rejection of socialism. ...The economist, as economist, has nothing to say about any of these questions” (Knight 1940/47, 134). Consequently, Knight’s interests parted more and more with economic theory proper and concentrated on the ethical foundations of the market economy. For the reason that “any judgment passed upon a social order is a value judgment” (Knight 1923/35, 74), questions of social philosophy came to the fore of his studies.

Now it is interesting to recognize that Knight accepted Walras’ utopia of social freedom completely. For Knight too, economic relations had the character of a ‘relationship among persons’ and therefore they needed an ethical or moral justification. The difference between both authors was that the latter rejected the idea of substituting the ethical for a scientific foundation. “If there is to be a real ethics it cannot be a science” (Knight 1922/35, 38). But at the same time he had to recognize that it was difficult to find an ethical justification of the market mechanism. At the end of his famous article ‘The Ethics of Competition’ he summarized: “We appear to search in vain for any really ethical basis of approval for competition as a basis for an ideal type of human relations ... Its only justification is that it is effective in getting things done; but any candid answer to the question, ‘what things’, compels the admission that they leave much to be desired” (Knight 1923/35, 74).

Only at the end of the 1930s, during World War II, he comes to the conclusion, that the market society could be made legitimate because of its more equal distribution of power. Nonetheless he stuck to the principle that the market mechanism in practice had serious weaknesses which asked for public interventions: the tendency for economic activity to expand and contract in more or less regular ‘cycles’ of prosperity and depression, the formation of monopoly, ‘distributive’ injustices, corruption of popular taste. The justification of market society, which drew exclusively upon ethical reasons, remained weak. At the end, Knight was unsuccessful in his effort to overcome the crises of economic liberalism which resulted from the breakdown of Walras’ bridge.

Frank Knight's criticism – and we will return to this point later – had a strong influence on and gave direction to the development of economic sciences in the United States. Till today there is a fundamental skepticism not only towards the significance of the models of pure economic theory for practical and socio-political purposes but also towards the building of bridges between the realm of science and the realm of ethics. Even if they set off from the same starting point, the direction in which economic reasoning not only on the European continent, but also in Great Britain proceeded was significantly different.

5. *The Distinction between Ends and Means*

Was the General Equilibrium Theory no more than a mathematical fiction which may serve as a gratification of our idle curiosity? Were we able to save the economic sciences from losing practical significance? Is it possible to demonstrate the importance of economic sciences? The most influential treatise which pretended to give a positive answer to these questions was without doubt Lionel Robbins' 'Essay on the Nature and Significance of Economic Science', published by the London School of Economics in 1932. Robbins acknowledged that Walras' identification of the result of his scientific model and an ethical maxim was unsustainable and that he could save the significance of economic science only if he succeeded in building a new bridge.

The core idea of his proposal was to separate means and ends. We may split the economic process into 1) a *given* initial situation, 2) *given* purposes or ends, and 3) alternative relationships between ends and means. That was exactly what Robbins tried to explain in his famous definition of economics as "the science which studies human behavior as a relationship between ends and scarce means which have alternative uses" (Robbins 1932/35, 16). Taking the initial situation as being determined by scarcity and concentrating all ethical judgments on the second link, i.e. the ends, the means-ends relationship could be discussed in purely scientific terms. Ethical considerations were attached to the ends only, and the means-ends relationship was supposed to be neutral and independent of moral or ethical valuations. In other words: positive economic science had found a new significance because it provided the rational apparatus to decide about the means which could be used to achieve the desired ends.

In order to arrive at this conclusion, Robbins' disapproval of Walras' bridge was more cautious than Knight's opposition. He did not object to the idea that human action could be treated as data, but narrowed his criticism to Walras' misleadingly scientific interpretation of the term 'maximum of utility'. The main fallacy, from Robbins' point of view, was the assumption of interpersonal comparisons of utility. The comparison of utility between different persons was not achievable on purely scientific grounds because it necessarily involved some kind of ethical judgment concerning the relationship

between different persons. Therefore, the result of the scientific model, equilibrium, was not an ethical maxim, and the ethical norm, the maximum of utility, was not a result of economic science.

“The pure theory of equilibrium ... does not by itself provide any ethical sanctions. To show that, under certain conditions, demand is satisfied more adequately than under any alternative set of conditions, does not prove that that set of conditions is desirable ... *Equilibrium is just equilibrium*” (Robbins 1932/35, 143).

The maximum of utility was considered a purely ethical norm and, therefore, had to compete with other ethical maxims. Positive science had nothing to say about all this. It had to limit itself to the discussion of the means-ends relationship.

“Economics is entirely neutral between ends” (Robbins 1932/35, 24). “Economics is not concerned at all with any ends as such. It is concerned with ends in so far as they affect the disposition of means. It takes the ends as given in scales of relative valuation, and enquires what consequences follow in regard to certain aspects of behaviour” (Robbins 1932/35, (30). That aspect of behaviour which is the subject-matter of Economics is ... conditioned by the scarcity of given means for the attainment of given ends” (Robbins 1932/35, 46).

It is worth mentioning that Robbins did not speak any more of ‘superior general rule’ (Walras) or ‘value judgment’ (Knight) but used the more neutral term ‘ends’. Man – as the society as a whole – was, in Robbins view, free to determine the ends following their wishes and will alone. The utopia of social freedom assumed the shape of the freedom to choose whatever ends man prefers. Here again, we were in the realm of complete liberty. The choice of an end was, from the point of view of positive science, arbitrary. Science had nothing to contribute to the choice of ends. Only when the ends were determined would science step in and tell us how to achieve them. Only at this point did the utopia of self-regulation and the General Equilibrium Model become significant. Myrdals’ early warnings that the bridge would not hold, that “it is quite obvious that values are attached not only to ‘ends’ but also to ‘means’”, that “means are not ethically neutral”, and that “value judgments thus refer always to whole sequences, not merely to the anticipated final outcome” (Myrdal 1933/58, 210-1), were not considered seriously by the scientific community. The ends-means scheme was the new bridge which Robbins proposed and which became the cornerstone for the development of economic sciences in the following decades.

If we have a closer look on Robbins’ essay we find that the separation between ends and means on the one hand, and ethics and science on the other, is not as unambiguous as it seems. It is true that in the first chapters of his essay he makes this distinction. And, following this logic, he came to the conclusion that “applied Economics consists of propositions of the form, ‘If you want to do this, then you must do that’” (Robbins 1932/35, 149), i.e. depending on the concrete ends economic science should determine the adequate means. But in the last pages of the last chapter of the essay entitled ‘The Significance of Economic Science’, Robbins discusses the meaning of Pure Science: He clearly goes one step further and demands a voice in the definition of ends. Even if the

ends lie outside the realm of positive science, the latter should play a central role in the discussion of the *coherence* of a system of ends.

“There is nothing in any kind of science which can decide the ultimate problem of preferences. But, to be completely rational, we must be aware of the *implications* of the alternatives. ...Economics ...can make clear to us the implications of the different ends we may choose. ...It makes it possible for us to select a *system of ends* which are mutually *consistent* with each other ...a consistency of achievement, not a consistency of ends” (Robbins 1932/235, 152). “Without economic analysis it is not possible rationally to choose between alternative systems of society” (Robbins 1932/235, 154) “It does make it possible for us to bring our different choices into harmony. ... It does make it possible within these limitations to act consistently” (Robbins 1932/235, 156).

Therefore, in Robbins’ reasoning the idea that economic theory is needed to decide which *sets of ends* are compatible with each other and which are not, restituted the greater part of the significance which science had lost due to the deconstruction of the bridge between the two utopias. Science felt authorized to invade the realm of freedom and ethical choices. We were, at least half the way, back to Walras: Once more, every rational choice of a set of ends, if taken by a single person or the “society acting as a body of political citizens” (Robbins 1932/235, 144), required the blessing of positive science.

6. *The Macroeconomic Revolution*

If we accept that the utopia of social freedom assumes the shape of the freedom to choose purposes, or ends, two questions arise: *who* decides on the purposes? And *what kind* of ends should be considered? Concerning the first question: Should there be a democratic decision of society as a whole? What should be the role of ethics or philosophy in defining ends? Myrdal proposed that other social sciences, like socio-psychology or sociology, should play a part. Robbins himself did not say anything about the question. He referred to the personal preferences, the ‘outside interests’ of the economist but, apart from the necessity to introduce scientific reasoning for rational decision-making, he left the door completely open to further considerations.

Indeed, it was the second question which became more important for the development of the whole subject in the following decades. Progress in the field of quantitative and monetary analysis opened new ground. Economic statistics had made huge advances, time series of prices, of production, and of incomes had been published. Wesley Mitchell’s grandiose study ‘Business Cycles’, for example, which contained a vast collection of quantitative economic data had an important influence on the scientific community. Wouldn’t that mean that Frank Knight’s statement ‘there are no data for a science of conduct in a sense analogous to natural science’ was no longer true? W. Stanley Jevons, already half a century earlier, had declared: “my numerical data are more abundant and precise than those possessed by any other science ... There is not a clerk nor

book-keeper in the country who is not engaged in recording numerical facts for the economist. ... Thousands of folio volumes of statistical, parliamentary, or other publications await the labour of the investigator” (Jevons 1871/⁵1957, 11). In the 1930s, book-keeping for the society as a whole was within reach. Was there any reason *not* to consider, from the point of view of ‘society acting as a body of political citizens’, the increase of social product or of national income as an *end*?

The answer to this question is not a problem of practicability, but *of principle*. Economic quantities are aggregates of prices. Prices over a period of time and a variety of goods are added up. The question arises: what is the meaning of this procedure? Value is a relation, not a sum. We may say that at a certain moment in time the price of one good is twice as high as the price of another good because the scarcity of the latter is less. But in the logic of the marginal approach a good has not a value in itself, without reference to other goods which are scarce. The categories exchange value or price are meaningful only *in relation* to other values or prices. Therefore, Robbins was in doubt about the significance of economic quantities.

“The addition of prices or individual incomes to form social aggregates is an operation with a very limited meaning. ... As quantities of money expended, particular prices and incomes are capable of addition ... But as expressions of an order of preferences, a relative scale, they are incapable of addition. Their aggregate has no meaning. They are only significant in relation to each other. Estimates of the social income may have a quite definite meaning for monetary theory. But beyond this they have only *conventional* significance” (Robbins 1932/²35, 57).

In other words: statistical science may sum up prices but it is never able to add up values. The mathematical operation of adding up prices doesn’t make the difference, but rather the distinct features of the sphere of utility and value on the one and the sphere of prices and exchange values on the other hand. We are back to Walras’ distinction between value and price: value is an expression of human choice, of human preferences, desires and will. Prices, in contrast, do ‘not result either from the will of the buyer or from the will of the seller’. Man acts in order to satisfy his desires. We may assume that want satisfaction is the end of his action. But it does not make sense to suppose that he acts in order to produce a certain social product or national income. It even does not seem sensible to say that he aims at a specific money price. All we can say is that the seller may try to increase the price as high as possible while the buyer strives for a price as low as possible. But, in the end, in equilibrium it is scarcity, not the will of the actors that determines the price. That is why Robbins can state about the misconception of the significance of money: “Money-making in the normal sense of the term is merely the intermediate stage between a sale and a purchase. The procuring of a flow of money from the sale of one’s services ... is not an end *per se*” (Robbins 1932/²35, 31). Like Walras, like the Austrians, like Knight and like many others, Robbins regarded the idea as a misleading and confusing fallacy that prices, or aggregates of prices produced by statistical calculation, should be considered human ends.

It is true, from the point of view of human action, that the quantitative aggregates are *artificial* theoretical constructions, invented by statistical sciences, without any real meaning. In order to become significant there had to be *actors* who considered prices as ends. But human beings, as Walras had stressed, do not regard prices as ends. Only inhuman entities may develop the capacity to do so. If these inhuman entities do not exist they have to be created. This very simple but revolutionary idea prepared the ground for progress in the direction of macroeconomics. John M. Keynes became one of the most important economists of the 20th century not because of his theoretical work in itself but because he developed the theoretical foundations for the transformation of existing *institutions* and the creation of new ones. Quantitative categories like price level, national income, domestic product, employment, and external balance became significant because *artificial actors*, such as Central Banks, Ministries of Finance, and international organizations (IMF) were enabled to act *as if quantitative aggregates were ends*.

Macroeconomics in the modern sense would have been impossible without this shift. The vision of the economic process in terms of a circular flow of goods and services, the ideas of aggregate supply and demand, national accounting, econometrics, macroeconomic policies etc. are rooted here. Only from these ideas could economics really become an empirical science, producing such macroeconomic data that could be used for ex-post calculations and for prediction.

In a certain sense it seems justified to regard the development of macroeconomics as a *progressive* theoretical revolution. Results which are not result of our intentions, ‘incidental outcomes’, or ‘by-effects’ of human action develop into the objects of human will and turn into ends. New ends and new responsibilities which before the revolution were inconceivable and unthinkable can now be established. Until the beginning of the 20th century it was beyond belief to regulate categories like price stability, full employment, or the growth of GDP in a purposeful manner. The change is progressive in so far as it enlarges the domain of human freedom. We can choose objectives, decide upon ends, make decisions and consider responsibilities which, before the revolution were completely out of reach.

The revolution also means that the ends have changed their character. They no longer have the quality of a ‘summum bonum’ but are rather defined in objective, scientific, and measurable terms. And they no longer belong to the realm of ethics but are rather streamlined and rationalized (rendered rational) by economic sciences. There are only loose and vague links between macroeconomic objectives and human ends, between full employment on the one and working and living conditions on the other hand, between price stability and distributive justice, between external equilibrium and peace. In other words: the revolution presupposes what we may call *the acceptance of the reality of the market mechanism*, i.e. the recognition or insight that in the modern, complex societies of the twentieth century exchange values, prices, supply and demand, money incomes etc. are real, and that they are an indispensable part of social reality, even if they cannot

be explained by human will and decisions.¹ Although we know that economic relations are relations between persons we have to concede “that it was an illusion to assume a society shaped by man’s will and wish alone” (Polanyi 1944, 157-8). From a purely theoretical point of view it was the end of what Joseph Schumpeter at the beginning of the century in his ‘Wesen and Hauptinhalt der Nationalökonomie’ had introduced as ‘methodological individualism’. Prices and price aggregates form a reality, a sphere of human relations which has to be regarded as final, last, and ultimate. Prices and price aggregates cannot be explained further by referring directly to human wish and will. Therefore, it was only consequent if, for example, John M. Keynes in the ‘General Theory’ took the 20th century economic arrangement for granted and did not try to tell us anything about its origins. The market mechanism existed, it was the result of history. If we want to have a deeper understanding of *why* our economy is what it is we have to ask history, and not economic sciences.

Yet, there is not only progress but also a danger of regression in what I have called the acceptance of the reality of the market mechanism. The danger is that if we take the market relations simply for granted, we run the risk of reducing the utopia of social freedom to the fulfillment of artificial theoretical objectives, of ends which are defined in objective, scientific, and, therefore, inhuman terms. If price stability, full employment and external equilibrium become the principal ends of our actions in order to progress in the direction of greater freedom we are losing sight of the fundamentally human dimension of social freedom. It may be appealing to construct a new bridge between the utopia of social freedom and the utopia of self-regulation by reducing social freedom to the implementation of macroeconomic objectives. The fathers of the post-Keynesian IS-LM model got caught in this trap. When the utopia of social freedom is reduced to an idea which resembles the utopia of a perfect self-regulating mechanism, supported by monetary and fiscal policy, *human wishes and will are lost*. The result is an objectified, reified and alienated vision of the world where man loses the capacity to express his wishes and to take over his part of responsibilities for the society as a whole. Man is regarded as – and, in the end, becomes – an embodiment of economic functions or, as Marx stated, a ‘personification of economic categories’. The fact that in the 1950s and 1960s economic policy in the western world was, actually, successfully concentrated on the implementation of what was called the ‘magic triangle’ showed the relevance of the danger *in practice*.

The danger of being caught in the trap of alienation augmented when it became evident that the human content of economic policy could only be protected and defended by increasing democratic decision-making in the realm of economic relations. The polarity between social freedom and self-regulation rose to a new level. It became un-

¹ I have borrowed this term from Karl Polanyi who – concerned not only with economics but with society as a whole – uses the expression “acceptance of the reality of society” in the last chapter of the ‘Great Transformation’.

avoidable because the pursuit of human ends and the strengthening of economic democracy reduced necessarily the self-regulating capacity of the market mechanism. The campaigns in favor of workers' councils, workers' participation, and industrial democracy in general which peaked not only in theory but also in practice at the end of the 1960s were an expression of the efforts to protect the human content of social freedom not only against the identification of freedom with objective, scientific, and inhuman ends but also against the utopia of the self-regulation market process.

It is the polarity between the utopia of social freedom and the utopia of self-regulation where the neo-liberal attack against the post-Keynesian bridge started out. Both, post-Keynesians and neo-liberals stick to the self-regulating capacities of the market mechanism. But when the conflict between the utopia of social freedom and the utopia of self-regulation became evident the post-Keynesians were destined to find themselves in a more difficult position. The weakness of the post-Keynesian bridge was that it was an unsustainable compromise: it was committed to the idea that ends should be pursued, but at the same time it rejected the ends which are human and supported ends which are not human. When, at the beginning of the 1970s, the struggle for democratization impaired the self-regulating capacities of the market mechanism – with the consequence of increasing inflation rates on the national level and the break down of the exchange rate system on the international level – the moment for the counterrevolution had come.

7. Neo-Liberalism and Positive Economics

The neo-liberal counterattack originated from the awareness that the post-Keynesian macro-economic quantities such as employment, GDP-growth, external equilibrium, and price stability were not human ends proper. The exponents of neo-liberalism saw the deficits of post-Keynesian macroeconomics. They picked up on the uneasiness and the worries over the status of the discipline which in the 1960s and 1970s were felt as much by students as by scholars of economics. But instead of substituting human ideas, desires, and wishes for the artificial objectives neo-liberalism took the opposite direction and aspired to eliminate social or macroeconomic ends from the research program of economics altogether. That is what the neo-liberal version of 'positive economics' is all about: social freedom should be excluded from economic science completely, so that economics can become a discipline similar to the natural sciences.

Once again, and not by chance, the Chicago School of Economics took the lead. Had not Frank Knight demonstrated that there was no bridge between the two utopias? That economic science – qua science – had to regard human action as data? And that there was no link between science and ethical maxims, between positive and normative statements? Milton Friedman's proclamation, published already in the first half of the

1950s, that “Positive economics is, or can be, an ‘objective’ science, in precisely the same sense as any of the physical sciences ... positive economics is in principle independent of any particular ethical position or normative judgments” (Friedman 1953, 4), prepared the ground. Friedman and other exponents of the Chicago School of Economics II took over Frank Knight’s idea that there was no bridge between the two utopias – but only in order to turn upside down Knight’s thoughts and to draw the opposite conclusions! If Knight had told us, “If there is to be a real ethics it cannot be a science” (Knight 1922/35, 38), Friedman answered, “If there is to be a real science it cannot be an ethics”.

This turnaround would not have been possible if the progress of macroeconomics had not produced the data. The advancement of empirical research, of economical statistics, of national account, of macroeconomics, and of econometrics had delivered whatever data was necessary to transform economics into a ‘real’ science. Knight’s reservation towards economics qua science fell victim to the progress of the discipline. Knight had anticipated the consequence: “If human wants are data in the ultimate sense for scientific purposes, it will appear that there is no place for ethical theory” (Knight 1922/35, 20). The attitude of Chicago School of Economics II was a mirror image of Chicago I and Frank Knight’s reasoning. In Knight’s approach it was ethics which got in the lead because the market system could only be explained and legitimated by ethical considerations. For Friedman it was the science which broke new ground and assumed leadership. The rapport between science and ethics was reversed.² The immediate attack was directed against post-Keynesian theory and political proposals.

The macroeconomic world was divided into a ‘real’ and a ‘monetary’ sphere. Monetarism regarded all quantities in the realm of the real economy essentially as results which, according to the assumption, in the long run could not – and, because of time-lags, adverse side-effects etc., in the short run should not – be influenced by purposeful political intervention. The opposite was declared true for monetary economics. Because of the particular features of money in a fiduciary currency system – according to Friedman – government had to play an indispensable role. Both sides were brought together by the policy advice that government intervention had to focus on one objective only: to strengthen the self-regulating capacities of the market mechanism. In the real economy that meant reducing the activities of government; in the monetary sphere it required that central banks follow some kind of monetary rule.

Both proposals were directed against the post-Keynesian idea of government institutions which actively took the initiative in order to achieve predetermined macroeconomic ends. The real economy, according to the monetarist assumption, could be described in its essential features by the General Equilibrium Model. The disapproval of

² It is interesting to see that Friedman, even if he is not interested in ethics at all, publishes several influential popular writings (books, interviews, TV-productions etc.), definitely propagandistic in character, which he keeps clearly distinct from his scientific work.

such a crude interpretation which came from reputable scholars of the Equilibrium Theory was brushed aside,³ while the quantity theory of money was retrieved to explain price development.

In the attack on post-Keynesianism the discussion over the (slope of the) Phillips-curve played a crucial role because – to use Friedman’s words – “it was said that what the Phillips curve means is that we are faced with a choice. If we choose a low level of inflation ... we shall have to reconcile ourselves to a high level of unemployment. If we choose a low level of unemployment, we shall have to reconcile ourselves to a high rate of inflation” (Friedman 1975, 18). From the monetarist point of view the possibility of a choice had to be denied. Consequently Friedman and others “argued that the long-run Phillips curve was vertical” (Friedman 1975, 23). In the 1970s the monetarists successfully exploited stagflation, i.e. the simultaneous occurrence of unemployment and inflation, as a convenient opportunity to argue against the idea of a choice between different policy priorities.

However, the dispute over macroeconomics was only the first step. The real challenge which neo-liberal theory had to face was the task of overcoming reification and to reintroduce in some way the ‘human dimension’ into economic theory. With the attack against post-Keynesian thinking alone this task had not been accomplished. How could neo-liberal reasoning cope with the mission of rejuvenating freedom, human will, and choice? How could the positive theory do justice to the consciousness that economics is concerned with human action? How could it deal with the insight that the economy is essentially a relationship between human beings? Criticism of the inhuman features of the IS-LM model had been a constitutive part for the attractiveness of neo-liberalism.

The neo-liberal answer was the call for micro-foundation of macro-categories. In search of a theory of human behavior, neo-liberal economists turned to the General Equilibrium model. Yet, the attempt was destined to fail from the very beginning. Within the General Equilibrium model “the consumer is not a human being but a consistent set of preferences. The firm to an economist, ... ‘is effectively defined as a cost curve and a demand curve, and the theory is simply the logic of optimal pricing and input combination’” (Coase 1988, 3-4). The micro-foundation of macro-categories turned out to be a false promise. Human choice is human choice only as long as it is not treated as data and freedom is jeopardized when *given* preferences are substituted for human

³ Frank Hahn, for example, expressed his incredulity towards the neo-liberal understanding of the General Equilibrium Theory unmistakably in his famous lecture ‘Why I am not a Monetarist’ in the following words: “One of the mysteries which future historians of thought will surely wish to unravel is how it came about that the Arrow-Debreu model came to be taken descriptively; that is, as sufficient in itself for the study and perhaps control of actual economies. Having spent most of my life as an economist on this theory I confess that such an interpretation never occurred to me. ... If ever a theory was straightforwardly falsified it is the theory of the American economy in Arrow-Debreu equilibrium. But it was never meant to be so obviously falsified; it was designed as both a reference point and a starting point” (Hahn 1982/84, 309).

will and wish. The request for the micro-foundation of macroeconomics, relying on homo oeconomicus, could not bring back the lost human dimension since the preferences ascribed to consumers, firms etc. were already reified categories.

The exponents of neo-liberalism were aware of the weaknesses of the post-Keynesian bridge, and they realized that in some way human wish and will had to be brought back into economic reasoning. But again they took the wrong track. They misinterpreted the weaknesses of the post-Keynesian approach. Its true flaw was not that it recognized macro-ends but that it relied on concepts without human content.

Neo-liberalism confounded the difference between the macro- and micro-level with the distinction between inhuman categories and human action, between artificial objectives and human ends. They ignored that the significant borderline is not that one between micro and macro but between choice, will and freedom on the one, and data, *given* ends, *assigned* motives, and *imputed* consciousness on the other. They did not recognize that freedom is lost when human beings are treated exclusively as objects, and they overlooked what already Leon Walras had shown: that prices and exchange-values are beyond human choice, both on a macro- *and* micro-level. The revival of methodological individualism was a fatal and fateful fallacy because it obstructed the passage to a true recovery of the human dimension. Its paradoxical consequence was that neo-liberal economics reified *all* actors without exception and treated *all* human beings as 'personifications of economic categories'. Thus, the claim for the micro-foundation, drawing on the categories of the General Equilibrium Theory, was the second and decisive part of the "wrong turn ... that economic thought took when it faced a crossroads in the early 1970s" (Heilbroner/Milberg 1995, 20) and which resulted in a fundamentally distorted vision of crucial theoretical categories.

One far-reaching fallacy which resulted from the futile micro-foundation was the assumption that utility maximization could be regarded not as one particular motive beneath other motives but rather as all-embracing. As Knight had predicted: "In so far as the ends are viewed as given, as data, then all activity is economic. ... The problem of life becomes simply the economic problem ... The assumption that wants and ends are data reduces life to economics" (Knight 1922/35, 34). Gary Becker, as all the other exponents of 'economic imperialism', got caught in the trap when he insisted "that the economic approach is a comprehensive one that is applicable to all human behavior, be it behavior involving money prices or imputed shadow-prices, repeated or infrequent decisions, large or minor decisions, emotional or mechanical ends, rich or poor persons, patients or therapists, businessmen or politicians, teachers or students" (Becker 1976, 9).

From the point of view of the utopia of social freedom neo-liberalism is a dangerous and poisonous type of the acceptance of the reality of the market mechanism. It is dangerous because it leaves no place for human feelings and, per definition, no possibility to express wishes and to take over responsibilities for the social organization as a whole. The dominance of the impersonal market mechanism is taken for granted, so that the

freedom of the property holder or of the sovereign consumer is regarded as the only true expression of human freedom. Freedom is reduced to the choice of a way of life *within* the social structure of a market society. This interpretation of freedom, which always had played a more or less important role within the tradition of economic liberalism now became all-encompassing. If man is unable to decide upon and carry the responsibility for his social organization, he at least may feel free when he is *free from* duty and responsibility for his part of the society as a whole. It is a kind of recognition of the reality of the market mechanism which promotes conformist behavior insofar as it means essentially the *unreflected* acceptance of reification, of the objectified and inhuman forms of the social life.

Neo-liberal economics represents a fundamental fracture, compared to all the earlier theories. For more than two centuries the utopia of social freedom has served as a guideline, a point of orientation and a compass for theoretical reasoning. Its importance rested, like the significance of all other fundamental values, on its meaning as a point of reference. The insight that it was impossible to realize social freedom *completely* had never cast doubt on its significance. The utopia of social freedom was regarded as indispensable in order to do justice to the human character of economic relations. Neo-liberal economics, in contrast, constitutes a rupture which is deeper and more radical than even the revolution of macroeconomics since it breaks with the whole tradition. The utopia of self-regulation became the only and exclusive point of reference while the utopia of social freedom was rejected as idealistic, misleading and obsolete.

8. *The end of utopia?*

So I come to the last question: Isn't it correct to state that neo-liberalism, at least, does provide the proof that our initial thesis was wrong, that in contrast to our initial view self-regulation can stand alone, that it can be dissociated from the utopia of social freedom? I doubt that this conclusion would be correct. Neo-liberalism, in fact, is not independent of the utopia of social freedom, but it is simply connected to its antipode, to the utopia that social relations should not be decided upon by human will. Even the belief of the unbeliever is a belief! The premise that the market mechanism exists independent of human will is just the other extreme – not less utopian than the original one. The assumption that we do not have a choice about how to organize society, that we have to take markets for granted, and that we have to adapt to this kind of reality is not a statement about facts but a fiction. The idea of an economic mechanism which works independent of human will is no less utopian than Walras' idea of a society shaped by man's will and wish alone. It is simply not true that we do not have ideas about what a more human society and a better world would look like. And even if we do not know how far we can go, it is not true that vital reform is impossible. We do have the option to reor-

ganize the institutional framework of society in the direction of more social justice, of less alienated human relations and increasing freedom.

The proof that self-regulation, even within the neo-liberal interpretation, is and remains a utopia is confirmed by the fact that neo-liberalism feels authorized to work out normative statements. Modern economics would never be able to give advice and to tell us anything about how to reform the social organization if self-regulation were not regarded as an *end*. Self-regulation and efficiency certainly do not amount to more than fairly poor ethics. But as already Frank Knight had noted: “It is impossible to form any concept of ‘social efficiency’ in the absence of some general measure of value. ... ‘Efficiency’ is strictly a value category” (Knight 1923/35, 42). It is, therefore, misleading to speak of the “‘non-ethical’ character of modern economics” (Sen 1987, 2). The real question is why neo-liberalism took the wrong turn and ended up with (sticking to) such a spectacularly narrow interpretation of human freedom which, without need, freezes our social fantasy.

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