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## **Franco Modigliani [Ideological Profiles of the Economics Laureates]**

Daniel B. Klein and Ryan Daza, with Viviana Di Giovinazzo

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### **Abstract**

Franco Modigliani is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called “The Ideological Migration of the Economics Laureates,” which fills [the September 2013 issue of \*Econ Journal Watch\*](#).

### **Keywords**

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

### **JEL classification**

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### **Link to this document**

[http://econjwatch.org/file\\_download/750/ModiglianiIPEL.pdf](http://econjwatch.org/file_download/750/ModiglianiIPEL.pdf)

**Mirrlees, James A.** 1997b. Information and Incentives: The Economics of Carrots and Sticks. *Economic Journal* 107(444): 1311-1329.

**Mirrlees, James A.** 2004. Interview by Marika Griehsel. *NobelPrize.org*, September. [Link](#)

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## Franco Modigliani

by Daniel B. Klein and Ryan Daza

Franco Modigliani (1918–2003) was awarded the Nobel Prize in 1985 for his analyses of saving and financial markets. His two most illustrious contributions are his life-cycle theory of savings (Modigliani 1949) and the Modigliani-Miller theorem, which shows that under certain assumptions the value of a firm would be independent of its ratio of debt to equity (Modigliani and Miller 1958; 1963). His professional accomplishments were prodigious and are nicely treated by Richard Sutch (2008) in *The New Palgrave Dictionary of Economics*.

As for Modigliani’s ideological character, Sutch (2008) describes Modigliani as a “life-long Keynesian.” And if one were to review only Modigliani’s English-language writings, beginning with “Liquidity Preference and the Theory of Interest and Money” (1944) and proceeding to “The Keynesian Gospel According to Modigliani” (2003), including his autobiographical book (Modigliani 2001) and essays and interviews (e.g., Modigliani 1984; 1986; 1995), one indeed would see an oeuvre befitting a mainstream social-democratic Keynesian economist.

What is often missed—and, frankly, it would seem deliberately misrepresented in his own autobiographical works—is that in Italy, Modigliani, by age 20, was a well published fascist wunderkind, having received in 1936 an award for economics writing from the hand of Benito Mussolini himself. Further, in 1947, at age 29, Modigliani published a 75-page article whose title in English translation would be “The Organization and Direction of Production in a Socialist Economy” (Modigliani 1947), an article that affirms socialist economics. In 2004 and 2005 there appeared English translations of five fascist works by Modigliani originally published during 1937 and 1938 (all five translations are collected by Daniela Parisi in Modigliani 2007b). The socialist paper of 1947 has never been translated in its

entirety, though the [Appendix](#) to this profile contains excerpts selected and newly translated by Viviana Di Giovinazzo, to whom we are very grateful.

Until recent years, then, these Italian works by Modigliani had been largely overlooked (by, for example, Kouri 1986; Merton 1987; Uchitelle 2003; Ramrattan and Szenberg 2004). Even some items published years after the appearance of the English translations of the fascist articles, items including Sutch (2008) and an intellectual biography of Modigliani by Michael Szenberg and Lall Ramrattan (2008), make mention of neither the 1937–1938 fascist writings nor of the 1947 socialist work. A “List of Life-Time Contributions of Franco Modigliani” in a volume edited by Karigirappa Puttaswamaiah (2009, 85-111) has the 1947 socialist paper but not the earlier fascist papers; in a critical essay from that volume, Andrea Micocci (2009, 48, 49, 53) makes veiled allusions to Modigliani’s early involvement in fascism.

A movement such as Modigliani’s from fascism or socialism to a more mainstream social-democratic Keynesianism represents a significant change in ideological outlook.

Franco Modigliani was born in Rome to a family of Jewish heritage. His mother was a voluntary social worker and his father a prominent pediatrician. He entered college at the age of seventeen. In his memoirs, *Adventures of an Economist*, Modigliani writes:

My mother and Fräulein Pabst had taught me a little German, and I was asked to translate some articles from German into Italian by the Traders’ Federation. In this way I made acquaintance with the economic problems dealt with in German publications: At that time, price control was the fashionable topic. (Modigliani 2001, 9)

In Italy at the time, interuniversity written competitive examinations—the *Littoriali della Cultura*—were under way. These competitions comprised a variety of scientific, literary, and artistic subjects—including economics, which was actually somewhat neglected in the universities. Though the competitions were organized by the regime, the cream of antifascist youth took part in them and scored very highly. That year’s economic subject was the price controls that had been imposed in Italy in 1935... After translating at least a score or so of articles on the matter, I felt sufficiently expert to enter the competition... To my astonishment, my essay scored the highest. The examiners intimated that I evidently had a certain bent toward economics. And I said to myself: Why not? From that moment, I began to think of myself as a potential economist. All this took place in

1936... In actual fact, what was taught was the theory and institutions of the so-called “Corporative State,” which had nothing to do with modern economic theory... I was awarded the *Diploma di Littore* at Palazzo Venezia by Mussolini in person, who shook my hand and presented me with a little gold badge with “M” for Mussolini that I still preserve (out of historical significance, not love). ... The competition entailed, immediately afterward, a trip to Palermo, where the winners were to meet, they being *ex officio* the secretaries of the commission for the following year. (ibid., 9-11)

Modigliani writes that he was gaining contact with antifascists, saying: “When I disembarked at Palermo my antifascism was no longer in doubt” (Modigliani 2001, 11; see also Modigliani 1984, 115; 1986). He says that all this took place in 1936. Yet of the five fascist articles, three are originally from 1937 and two are from January 1938. Daniela Parisi (2005, 555) notes that Modigliani graduated from the Faculty of Law at the University of Rome on July 22, 1939; Parisi says that in the five 1937–1938 articles Modigliani “had already dealt with some issues discussed in his final dissertation,” and that the dissertation was supervised by Professor Guglielmo Masci. In his autobiographical writings, Modigliani (1986; 1995; 2001) never mentions Masci, who favored corporatist economics (see Marget 1935, 561; Rothschild 2004, 258).

Historian Gene Bernardini (1977, 431) writes: “the Italian Fascist government unveiled its policy of racial anti-Semitism in 1938.” In his 2001 autobiography, Modigliani wrote, “we were surprised by the publication of the race laws that were to degrade the life of any Italian Jew who wished to remain in Italy. It was no longer possible for Jews to attend public schools or to hold public office, including university teaching” (Modigliani 2001, 13; see also 1995, 142).

So, unless we are to think that Modigliani was under ‘deep cover,’ falsifying his beliefs as he propounded fascist economics, throughout 1937, at least, at length in print, we must conclude that Modigliani, besides hiding his fascist past, back-dated his antifascism. Aside from Modigliani’s autobiographical testimony, all of the evidence suggests that it was the racial laws enacted in the autumn of 1938 that brought a sudden end to the fascist career of the 20-year-old of Jewish descent.

Whatever one might think of the actions of Modigliani from 1936 through 1938, these being the actions of a teenager in the tumult of Fascist Italy, it is understandable that when he moved to France and then the United States in 1939 (see Szenberg and Ramrattan 2008, 5-8), he would hide his fascist past, and then go on hiding it. In some respects, the providing of information in his 2001 autobiography, from which we quoted above, can be seen as a partial owning up.

The five articles of 1937–1938, as discussed briefly by Daniela Parisi (2005; 2007), vary in length and repeat material. They are now published in English translation, but, as they are not easily accessible, below we quote from four of them extensively.<sup>41</sup>

Excerpts from “General Concepts on Price Control” (Modigliani 2005a/1937):

How could one possibly believe that Fascism, which aims to coordinate individual interests and subordinate them to the national interest in every field and most specifically in the economic field, would leave a function of such elevated importance as that of price setting completely at the mercy of individual interests? ... [W]herever a price has been fixed not in such a way as to assure the maximum benefit of the collectivity combined with that of the individual, but only the advantage of the individual and the exploitation of the collectivity, then the State has not only the right but also the duty to intervene.

In conclusion, then, the intervention of the State in price formation and its action of control are not measures of a contingent nature but rather principles that are fundamental for the Fascist State. (Modigliani 2005a/1937, 563)

[T]he Fascist approach is expressed as incessant dynamism embodied in the formula of the *Revolution on the march*. By contrast, in order for control to be useful what must be ensured is not “anchoring” but instead “organic price formation”. This concept of “organic formation”, which must be the basis of price disciplining, is a very wide-ranging concept that includes many other conceptual frames and deserves careful attention. In a more elementary sense, control is organic, first and foremost, when it is applied in a complete manner, that is to say, when it follows and controls the development of prices of the greatest possible number of commodities, as well as in all the transitional stages that such commodities pass through from production to consumption. (ibid., 564)

Secondly, price control is organic when it is “constructive”, that is, when it does not simply involve taking note of a state of affairs that is to be maintained, but seeks instead, through continuous evolution, to

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41. The fifth is Modigliani (2005d/1938).

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“construct”, to “form” the situation that is deemed best suited to the current movement. (ibid., 564)

It should however be borne in mind that at this point in time, and especially in connection with the contingent facts that led to the re-organization of the price control system as described earlier, price control sets itself not only the general aims laid out in Fascist doctrine but also a specific aim, which calls particular attention. This aim is the maintenance of the domestic value of the Lira. That is to say, the aim is to make sure that the alignment carried out to facilitate Italian exportation does not have any effect from the domestic point of view, so that a pointless, unfair and harmful redistribution of wealth can be avoided. (ibid., 565)

Excerpts from “Political Price and Corporative Price” (Modigliani 2005b/1937):

In contrast to the rigid fatalistic conception of so-called classical economy, corporative economics proposes a strongly voluntaristic conception. General equilibrium does not “take shape”: rather, it must be constructed and shaped. The balance between supply and demand and the price level that expresses this balance does not exist outside of man himself but it *can* and *must* be created by the will of man. (Modigliani 2005b/1937, 570)

[Corporative price control] is a logical consequence of logical principles; not an isolated intervention, but the crowning result of a system of interventions; not an external action designed to impose a different price compared to that indefinable entity that is the market price, but a quintessentially internal action, eminently self-regulating, which aims—through direct cooperation with the categories involved that operate first and foremost in the framework of the Corporation, and then in the Provincial Council of the Corporation—to influence not just the price but also, insofar as is possible, the quantities supplied and even the demand for such quantities. (ibid., 570-571)

But now that control has passed into the hands of the Corporations... price control will cease to be...a source of imbalances, and will become a source of greater justice and collective wellbeing. (ibid., 571)

Excerpts from “The Role of the Party in Controlling Prices” (Modigliani 2007a/1937):

This is the course of action that liberal Governments have always followed by adopting non-intervention as a dogma, which, in this as in many other cases, results in the exploitation of the weak by the strong. But the Fascist regime, whose avowed goal is the advent “of a higher social justice”, could certainly not accept this approach simply because it was the easier solution. (Modigliani 2007a/1937, 31-32)

It is precisely at this point that the specific task entrusted at this time to the Party—the contingent tasks of price control—becomes clear. For if, as we have seen, sacrifices are required in order to protect the value of the lira, in the Nation’s interest, then it will be the duty of the Party to ensure that these sacrifices are borne equally, or in other words to guarantee what we could term distributive justice. (ibid., 32)

Excerpts from “The Crisis of Capitalistic Economic System: The International Division of Labor” (Modigliani 2005c/1938):

This study thus aims to assess the economic value (in the technical sense) of autarky and to demonstrate that the autarkic principle is the *new economic principle* that is called upon to regulate international exchange, replacing the unenforced and unenforceable principle of the *international division of labor*. (Modigliani 2005c/1938, 573)

[W]hat we associate with the term “classical political economy” is that complex of schools which start out from the individualistic viewpoint: that is to say, schools that not only assume as their model a man who pursues no other end than an economic end (*homo oeconomicus*) but a man who, moreover, is an end in his own right. Such a man lives for none other than himself and views himself as the first and last end of every action; he is an individual for whom the community holds no meaning whatsoever and who himself has no meaning for the community. In short, an individual who is entirely contained within himself. (ibid., 573)

It is precisely for this reason that the judgment of “pure economic theory” is of little interest to us, and indeed is devoid of meaning; “pure economic theory” positions itself no[t] so much outside of, but against, reality. And therefore it cannot claim to judge either autarky or ninety

percent of concrete human actions, simply because they are not purely economic “real situations” but also “spiritual” and consequently political situations. The science of “pure economics” either ignores the State or considers it as an element of disturbance: how then can such a science issue a judgment on the activity of an existence that hinges entirely on the State? (ibid., 574)

Rather, it is a different point of view that offers a more pertinent starting point for an examination of autarky: namely the *new economy*, the economy that is based not on the individual but on the community and which, in referring to the concept of “utility”, has in mind that which satisfies not the individual but the entire collectivity as a unit considered over time (*corpus perenne*). (ibid., 574)

We believe that at this point the task of economic science has run its full course and it is time to hand over the task to politics; by forging a broad unitary synthesis which will include both the political and the moral factor, the political sphere will then judge, as the “Science of the State” ... (ibid., 574-575)

According to the “classical” school, one sure system would be that of absolute freedom of trade, since this solution would set the productive activities of the different countries in opposition to one another without any support whatsoever and thus in equal conditions. The outcome would then demonstrate which of these was the most economical. As can be seen, the theory expressed one of those characteristic libertarian and egalitarian conceptions that economic liberalism and political liberalism were replete with, according to which freedom and equality were concepts devoid of concrete value, being instead abstract and formal juridical dogmas. These conceptions were crystallized as the famous constitutional equality and the associated freedom of contract between the rich and powerful employer and the poverty-stricken worker who had no chance to resist. In other words, an equality that amounted to the absence of any superior force that could rectify the condition of the two conflicting parties. By the same token, the freedom of international trade was a freedom that setup a contest under “juridically” equal conditions between a rich, powerful and well organized industry and an economically weak industry barely in its infancy!

The protectionists therefore argued that in order to bring about the division of labor in the best manner, it was necessary for productive activities to compete with one another under conditions of *genuine equality*, i.e. of equal development. ...

The protectionist objection, the exactness of which cannot be doubted, struck a severe blow to the classical theories on international trade and in particular free trade. But what was even more serious was that it also opened up the first cracks in the very system of individualistic and automatic economy. This came about in a twofold manner: 1) because it showed that the spontaneous and free contest among “individual” interests did not necessarily lead to the maximum “collective” interest. Thus as opposed to the “being” deified by the classical economists there now arose a “becoming” through the individual’s forsaking of maximum immediate individual utility; 2) because it confirmed that the intervention of the State is not always, as was fondly believed, a disturbing and anti-economic element. Rather the State, by intervening alongside and not against the individual, can contribute to acting as the driving force of a more economic result than the individual himself could obtain if the unbridled forces of egoistic instinct were given free rein. (ibid., 581-582)

Instead of continuing to theorize and trying to give advice based on abstract, or fictitious, principles, what is needed is to move closer to reality. It is vital to interpret the new demands, in order to design a principle that is truly capable of eliminating the infinite, adverse effects of the current system of international trade, which still clings doggedly, but only formally, to non-applied and inapplicable concepts.

Such a principle is that embodied in autarky, as a theoretical and practical principle of economic organization. (ibid., 588)

Modigliani earned his Ph.D. in economics in 1944 from the New School of Social Research. “The crucial figure for me at the New School was Jacob Marschak” (Modigliani 2001, 19). At this time Modigliani began building his illustrious career in modern Keynesian macroeconomics, beginning with the publication in *Econometrica* of “Liquidity Preference and the Theory of Interest and Money,” which was the basis of his dissertation.

Shortly thereafter, Modigliani published in Italian the aforementioned article on “The Organization and Direction of Production in a Socialist Economy” (Modigliani 1947), from which we provide some newly translated passages in the

Appendix. Gary Mongiovi, in an unpublished paper on “Keynesian Economics and Socialism,” tells of the article:

The article was written in Italian; Modigliani never published an English version of it, and indeed appears never to have referred to it until the publication of his autobiography shortly before his death. The paper, which runs to 75 pages, argues the case for socialism, along lines laid out by earlier market socialists like Abba Lerner and Oskar Lange. Modigliani’s aim appears to have been to lay out a practical guide to implementing a socialist program that could actually work; such a program would have to make use of the coordinating properties of the price system. At the outset Modigliani remarks that the economics of socialism—the literature initiated by Enrico Barone’s “classic study” on “The Ministry of Production in a Collectivist State” (1908)—is among “the most interesting and promising” developments in economic theory. He indicates in an opening footnote that “The present study is part of an unpublished work whose purpose is to lay out the fundamental principles of the modern economic theory of a socialist state” (1947, p. 441); yet nowhere else in his subsequent work did Modigliani address these issues: the project appears to have been abandoned. The 1947 paper contains few references to the literature, and it is perhaps worth noting that most of the literature cited by Modigliani is on the socialist side of the debate—Lange, Lerner, H. D. Dickinson, James Meade and Pigou; there is no discussion of Hayek, von Mises or any other critic from the Austrian camp. (Mongiovi 2011, 13-14, quoted with permission)

Modigliani writes about the 1947 article in his 2001 memoirs:

In retrospect, we know that socialism failed because it was unable to carry out the task of creating a mechanism for formulating prices. At that time, however, we were more interested in the limitations and failings of a capitalistic-style economy ... [T]he absence of a capitalist-style price system means that economic resources cannot be used intelligently or efficiently to satisfy the needs of society. This is because prices offer the only objective criterion for evaluating the economic requirements of society and for establishing the most economical way of satisfying them.

Over the years, we have often seen price controls applied in market economies. They have nearly always been catastrophic ex-

periences. This is not because they were necessarily morally wrong but simply because they obstructed the price-formation mechanism. And that is the only way so far discovered by humans to allocate the resources of society efficiently. This is why I have never tired of suggesting solutions that, while letting the market determine its own prices, enable governments to reallocate resources throughout society by fiscal means. (Modigliani 2001, 166-167)

Modigliani then speaks of events in 1948, personal conversations and reflections, that led him at that time to “distance” himself from “whatever sympathy I had entertained for socialist theories” and to “embrace democratic liberalism unreservedly” (2001, 167). Once again, one might view the 2001 memoirs as Modigliani opening up about his past.

Modigliani joined the faculty at the New School in 1944 and then moved to Chicago in 1949 as a Research Consultant to the Cowles Commission, and he held a position at the University of Illinois until 1952. Subsequently, he taught at Carnegie Institute of Technology and Northwestern University before moving to MIT in 1961 where he “remained ever since” (Modigliani 1986).

Like many leftist economists of his day, Modigliani was interested in econometric models of the economy. Sutch speaks of an “important direction for Modigliani’s research”:

He was asked to construct an econometric model of the US economy by the Federal Reserve. The model would be an empirically estimated system of simultaneous equations that would be used by the Federal Reserve to make and guide policy and forecast future developments. He asked Albert Ando to join him on the project and they created what was first known as the “MIT model” and, after Ando moved to the University of Pennsylvania, as the “Federal Reserve-MIT-University of Pennsylvania Model”... (Sutch 2008)

Sutch cites Modigliani (1975) and adds: “The model proved sufficiently valuable that the Federal Reserve continued to use it into the 1980s.”

In the 2001 memoirs Modigliani writes of his visit to Sweden in 1973 and his enthusiasm for “the Swedish success story”:

The brilliant results...have been achieved by keeping the system of free enterprise intact... Here, socialism is not about the sterile nationalization of the means of production inspired by some abstract ideology. It is about being pragmatic; thus, it exploits the efficiency and flexibility of the profit-making private enterprise system by making

judicious use of incentives to guide production in socially useful ways. In addition, it takes the form of a gradual reduction of economic inequality via redistribution of income in a complex, advanced social security system. (Modigliani 2001, 171-172)

In the 1960s Modigliani began to take part in public debate in Italy (see Modigliani 2001, 170-262). Based on the treatment offered in Andrea Micocci's chapter "Modigliani, Economics, Italy," it seems that Modigliani's policy advice consisted of such reforms as denationalizing certain enterprises, making labor markets more flexible, and encouraging private investment (Micocci 2009). Micocci writes, with apparent dissatisfaction, that "Modigliani's proposals are certainly part of the conventional economic wisdom" (2009, 52). Modigliani later described himself as having "participated actively in the debate over economic policies both in Italy and the U.S., concentrating lately on the deleterious effects of the huge public deficits" (Modigliani 1986).

Modigliani was interviewed by Arjo Klamer (1984). When asked whether he was aware of the clash between between Chicago people and MIT people, Modigliani responded:

I was very aware of the problems with the Chicago people. In some sense I have become more understanding of what Milton Friedman has been arguing. Friedman is driven by the idea that whatever the government does is bad. He has a mission and seems to be willing to sacrifice some intellectual honesty for that. (Modigliani 1984, 120)

In a 1976 Presidential address before the meeting of the American Economic Association, Modigliani said: "We must, therefore, categorically reject the monetarist appeal to turn back the clock forty years by discarding the basic message of *The General Theory*. We should instead concentrate our efforts in an endeavor to make stabilization policies even more effective in the future than they have been in the past" (Modigliani 1977, 17-18). Elsewhere, Modigliani (1979, 40) wrote: "Mr. Friedman has a profound disbelief in the ability and honesty of government. I think he would therefore be inclined to argue that, even if the government could stabilize the economy, it should not be trusted with the power, because it could always be used for evil. Fortunately this advice was never heeded, and on the whole, during the period before 1970, stabilization policies were pursued." He continues: "Whether stabilization worked is not a question that can be answered so easily, but the record of the period seems to indicate that it was fairly successful."

In 2003 Modigliani signed a petition against the tax cuts of the George W. Bush administration (Hedengren et al. 2010). He also spoke out against proposals

to privatize Social Security, which he believed would disproportionately hurt the poor (Uchitelle 2003).

## Appendix: Passages from Franco Modigliani's “L’organizzazione e la direzione della produzione in un’economia socialista” (1947)

selected and translated by Viviana Di Giovinazzo<sup>42</sup>

(p. 441)

### **The Organization and Direction of Production in a Socialist Economy**

(p. 442) *I – 1 – Problem Setting*

[...]

In carrying out this task we will be able to show that the socialist system is not only economically possible, but also that such a system should possibly work much better than the private enterprise system.

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(p. 446) *I – 5 – The Four Rules in a private enterprise system.*

[...]

There is no doubt that the First Rule<sup>43</sup> is generally fully applied. As for the Second,<sup>44</sup> we can notice that use to which the factors of production are put can be chosen freely (1); however the private enterprise system is usually unable to ensure the utilization of the entire available quantity. And, indeed, cyclical unemployment is without doubt the most serious shortcoming of such system. The Third<sup>45</sup> and Fourth<sup>46</sup> Rules tend to be satisfied *when and only when* the production and market

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42. University of Milano Bicocca, 20126 Milan, Italy.

43. (p. 445) *First Rule* — Each individual must be free to spend his own income as he pleases and the market price of each good must be decided so that the quantity demanded equals the quantity available.

44. (p. 445) *Second Rule* — Each individual must have the full freedom to choose his own occupation, naturally, within the limits of his objective capacities. The price that the firms must pay for the use of every factor of production must be determined according to the principle that demand equals supply.

45. (p. 445) *Third Rule* — Any good must be produced adopting that method which, applied with the maximal efficiency, leads to the minimal total production cost.

46. (p. 446) *Fourth Rule* — The person in charge of organization and management of production must fix and adjust the level of production so that the marginal cost of the marginal quantity produced equals the value of the market price.

conditions lead to *perfect competition*. Under imperfect competition (that is, when one firm is able to influence significantly the market price) the Fourth Rule is never satisfied: seeking the maximum profit, the private entrepreneur tends to (consciously or unconsciously) equalize marginal cost and marginal revenue, which is always inferior to the price. Finally, the Third Rule tends to be satisfied under monopoly but not under imperfect competition in the broad sense. The competition of new firms has the effect of containing profits to a normal level, but only by generating an excessive number of firms of non-economic dimension and with high cost of production.

From what we have said so far, it is clear that, if the purpose of the socialist State is to maximize collective welfare, the socialization of firms *is not necessary* under perfect competition. If nonetheless it shall be considered reasonable to socialize the firms, the best thing that can be done is to order the company managers to manage “as if” they were private entrepreneurs. On the contrary, in general, under imperfect competition it is necessary to socialize firms and order to the managers to apply the Four Rules.

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(p. 447)

[...]

Given what we said so far, it is clear that if the purpose of the socialist State is to maximize the common welfare, the socialization of the firms under perfect competition *is not necessary*. Should it nonetheless be deemed worthwhile, the best thing to do is to order the company managers to manage production “as if” they were private entrepreneurs.

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(p. 447) II – 1 – *Problem Setting*.

The previous section demonstrates the vital contribution that economic theory is able to bring to political Socialism.

The same old aphorisms that are usually repeated from many sides, such as “production for consumption and not for profit” or “the firm must be run in the general interest” are completely empty if they are not made concrete in precise, objective and verifiable rules. The capitalist system works, even if with many inefficiencies, because the company manager has a precise task to accomplish: to maximize company profits.

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(p. 448) II – 2 – *The function of the productive factors prices in a socialized system*.

The prices of *consumption goods* have essentially the same function in a private capitalist system as in a socialized system. They help to ensure that the goods

produced are assigned precisely to those individuals that desire them more intensively. In a private enterprise system this important function of the prices of consumption goods is considerably compromised by the fact that the capacity of each consumer to realize his own desire depends on his income, and that such income is distributed highly unequally among consumers; so that a secondary need of a “rich” individual carries greater weight than the more urgent needs of a “poor” individual. This shortcoming will be considerably reduced, if not completely eliminated, in a socialist system, as we shall show in the chapter on income distribution.

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(p. 463)

[...]

The Fifth Rule<sup>47</sup> is clearly the one that allows the private entrepreneur to decide whether or not it is reasonable to engage in a new production initiative. It should be noticed that such decision is always based on an uncertain hypothesis about consumers’ tastes, reinforced by some previous experiment. In this respect, the major difference between a private system and a socialized one is that in the former decisions are made by a “potential entrepreneur” who has capital or access to credit: in the latter, on the contrary, the decision must necessarily be taken by some community’s administrative authority. Well, one should admit that, in this field, there is a serious danger that the socialist system will prove to be considerably inferior to a private enterprise system.

The prospect of large profits and the risk of possible losses constitutes, without doubt, an extremely efficient mechanism to induce the entrepreneurs to be open to new ideas and, at the same time, prudent in introducing them.

On the contrary, in a socialist system one alternates between two opposite and equally serious dangers: on the one hand there is the danger that, lacking the profit incentive, the one who administrates the social wealth will shrink from the novelty and remain stuck in the routine; on the other hand, there is the danger that using capital that is not his, he embarks on senseless undertakings, wasting the resources of the community.

[...]

B) [...]

We should notice that as far as large-scale decisions are concerned, it is likely that, in the final analysis, there won’t be a big difference between the socialist system and the current one, because in the latter also large investments are made

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47. (p. 463) Fifth Rule: The production of a new good is always justified when the price that consumers are willing to pay for one of the possibly producible quantities is adequate to cover the total cost of production.

with public capital more than with that of the private entrepreneur and carried out on the basis of previous consultation with various type of production and market specialists.

[...]

(p. 465)

E) [...]

Lastly, managing directors should be repeatedly reminded that their job is to pursue the welfare of consumers, and that this task requires not only prudence but also intelligence and courage. The originality and success of the experiments must be one of the main criteria of the economic bureaucracy's progress.

It is to be desired that with these, or similar, measures, the socialist system will be able to hold its ground, in terms of dynamism, against the current capitalist system. Indeed, it should be noted that also in the modern capitalist system, the business direction is frequently in the hands of "employees" paid in fixed wages and bonuses, and that firms in conditions of more or less perfect monopoly, do not always distinguish themselves by their dynamism.

There is no reason to fear the possibility that the Research Commissions could be heavy and expensive bureaucratic organizations. Economic research is currently managed, partly by the firms themselves, partly by some offices financed by the employers' organizations. Thanks to the immediate diffusion of every technical and organizational progress, entrusting the coordination of research to a single central organization will reduce the cost and increase the practical results.

In addition to the function described above, the Research Commissions shall have a thoroughly important and delicate task: that of deciding about the opportunity to open new firms or to reduce the number of the pre-existing ones. In a capitalist system this problem is resolved by way of the profit mechanism. (p. 466) High profits attract new firms, whereas losses tend to reduce the number of existing firms. On the other hand, in a socialist system, high profits do not *ipso facto* attract new firms because there are not potential entrepreneurs, ready to exploit the opportunity. As for the reduction of firms, this shall occur only in the case where the price falls to the point where it prevents one or more firms from covering also the direct costs.

Thus, the profit mechanism must be replaced in the socialist system with this final and following Rule, which we will call the Sixth Rule.

*Sixth Rule* — The number of the firms must be determined by the principle that the total cost of the quantity produced by all firms must be at a minimum. That is, in the absence of changes in demand, the total number of firms must be increased or diminished if and only if this provokes a diminution of the total production cost. The application of this rule clearly exceeds the concern of the

managing directors, because it requires the knowledge of the state of the entire branch of production.

[...]

(p. 467)

It is clear that the Sixth Rule must be applied with extreme caution and that the state outcome it pursues can never be fully realized, mainly because the economic conditions change continuously. Still, it has to be envisaged that in a system of private enterprise, it is not only the case that such a condition (optimal firm number and dimension) is not always satisfied but, in fact, it *cannot be satisfied*. In a socialist system there will be at least a continuous effort in the right direction, even if the results can never be perfect.

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(p. 480)

[...]

Incidentally, we notice that various fascist economic systems (particularly the Nazi and Japanese ones) accumulate the shortcomings of the capitalist system and the communist one. Indeed, current production is in the hands of private enterprises and, consequently, aims at earning a profit and not at realizing the common welfare. Investments are made in accordance with a plan, but the scope of this plan is not the common welfare, but rather the military strengthening of the nation. Furthermore, the centralization of political and economic power in a social class gives rise to unprecedented exploitation of the working class.

On the other hand, it is clear that the socialist system combines the advantages of the capitalist system (economic decentralization, consumer sovereignty) with the advantages of the Soviet system (investment coordination and production for consumption).

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(p. 482)

[...]

While the job of an engineer or a doctor isn't necessarily more tiring than that of the unskilled worker or subordinate employee, the income of the former nonetheless considerably exceeds that of the latter. This is clearly due to the circumstance that the former require particular natural abilities and long technical training. Given that this is true for a socialist system as well as for a capitalist system, it is easy to expect that such difference will remain.

However, in a capitalist system some professions are accessible only to those who, having a minimum of skills, possess adequate financial means. In this way, those who belong to wealthy families have easier access to differential wages so that

income inequalities tend to be perpetuated and to increase. This manifest injustice can and must be abolished, not by arbitrarily removing the wage difference, but rather by guaranteeing to everyone the same means, regardless of family income. Concretely, this means that in the socialist system technical secondary education also must be supplied free of charge to anyone who shows a natural inclination, by means of scholarship programs.

[...]

However one may ask if it is actually justifiable to accept (p. 483) differential incomes for individuals who differ only in natural inclination. To answer this question, one should notice that the general interest requires that an individual, able to perform different tasks, be induced to choose precisely that economic activity whose productivity, and consequently price, is higher; otherwise, he will produce goods or services of an inferior value in comparison to what he is able to produce, resulting in a general loss.

Therefore, the difference in income should be considered not as a reward for a natural skill, but as the necessary mechanism to stimulate the supply of services that have the greatest economic value for the community.

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(p. 488)

[...]

In conclusion, we can certainly affirm that saving is socially useful, given that it allows one to increase the quantity and improve the quality of the means of production available to the community, and consequently, to make work more productive. However, if saving is not invested, it becomes not only useless, but also seriously dangerous because it gives rise to unemployment; and the capitalist system lacks an effective means of guaranteeing the investment of potential savings. Therefore, it is frequently incapable of avoiding large-scale unemployment.

With these points in mind we can now consider the solution of the savings and investment question in a socialist system.

The matter clearly has two aspects: a) who must be entrusted with the savings function in the socialist system? Must the savings function be considered a private, collective, or mixed function? b) how can an efficient coordination between savings and investment be assured, so as to eliminate unemployment?

The second question has been already partially answered in chapter II. Investment coordination is in fact a basic step towards solving the problem; other, different methods shall be recommended in the last section of this chapter. For the moment we shall concentrate our attention on the first problem.

(p. 489)

[...]

In our opinion, the problem of savings and the inheritability of wealth must be resolved in the socialist system according to the simple principle that *anybody has the right to increase his own income with his own sacrifice*.

Given that savings implies a sacrifice, there is no reason to prevent individuals from increasing their own income in such a way. Anyway, the transmission of other goods for free (either by legacy or donation) should be limited or subject to special regulation, because the person receiving such goods receives an increase in income with no corresponding sacrifice or performance.

Once individual saving is allowed, the conditions upon which such savings can be invested should be decided.

[...]

b) Savings may possibly be deposited in savings accounts or invested in government bonds. Of course, government bonds will be the only existing bonds, given that all the big industrial and banking publicly-quoted firms will be transformed into public firms and financed by the State.

[...]

(p. 490)

d) [...] In our view, the right to own a home should be acknowledged and so, therefore, should the right to use savings for this purpose. According to the above-mentioned principle, the property right acknowledged for certain types of goods shall not include the right to dispose of them as one wishes; the transmission of goods free of charge to private citizens should be prohibited, except for consumption goods. However, for several reasons, the strict application of this principle is not advisable. Firstly, it will remove any incentive for saving and for the maintenance of the material goods purchased thanks to those very savings. To this shortcoming that, as we will shortly see, is not essential, we must add another more serious one: the danger of tax evasion and fraud on a large scale.

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(p. 499)

[...]

We have similarly shown that the socialization of firms under perfect competition, to the extent that it is possible, is not necessary because, in such conditions, the private pursuit of maximal profit leads automatically to maximal common welfare. In fact, under such conditions, the rules that the private entrepreneur strives to follow (consciously or unconsciously) are precisely the same rules that the socialist State should prescribe to the socialist manager.

Consequently, a question should be raised: if the socialization of such firms is not necessary, is it opportune?

In the first place, we notice that, in the best possible situation, the socialist enterprise could not pursue the collective welfare better than the private one. On the other hand, it is possible, if not probable, that that socialist one, not having a direct and personal interest as strong as the private director, might, on average, be less “efficient” than the latter.

Finally, it should be added that when there are the conditions for free enterprise, the productive firms are numerous and relatively small and, consequently, the entrepreneur would require vast, expensive, and strict surveillance by the bureaucracy. These and similar conditions lead economists to conclude that the socialization of enterprises under perfect competition is inadvisable, because it would not be able to increase collective welfare, whereas, almost certainly, it would cause a significant reduction of the national income.

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(p. 503)

[...]

The private enterprises that will be able to face the competition will survive, and there is no reason to forcefully eliminate them, because they clearly serve the general interest. On the contrary, the other “inefficient” enterprises will be automatically eliminated.

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(p. 505)

[...] 2) In our opinion, a much more decisive issue is the fact that the task of the socialist director is considerably easier than that of the private one. In order to maximize profits, the private entrepreneur must match marginal cost and marginal revenue, whereas the task of the socialist director consists in equalizing marginal cost and price.

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(p. 506)

[...]

Therefore, “collective bargaining” in the socialist system has no purpose and might only be useful in illicitly protecting certain interests to the detriment of the general interest.

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(p. 514)

[...]

It remains only to conclude by repeating the words of Oskar Lange, written in 1937, "...there is but one economic policy that the economist may suggest to a socialist government with the hope of success: revolutionary courage."

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## Dale T. Mortensen

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Born and raised in Oregon, Dale Mortensen (1939–) went to Willamette University, studying economics and mathematics to “combine my interest in analytical problem solving with a concern for social issues” (Mortensen 2011). Mortensen reflects on his childhood:

My parents, as one of a few with any advanced education among the fruit growers and loggers of the [Hood River] valley, entertained the intellectuals of their community, their colleagues of like mind, the local school teachers, and a few eccentrics. I grew up listening to my father argue politics into the night and taking trips every Saturday to the