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In Memoriam
Foreword to
“Examination of Dr Smith’s System”

Daniel B. Klein

Adam Smith’s *The Theory of Moral Sentiments* (TMS) appeared early in 1759, and there soon followed three warm and highly favorable (albeit unsigned) notices, by David Hume in Tobias Smollett’s *Critical Review* (1759), Edmund Burke in the *Annual Register* (1759), and William Rose in the *Monthly Review* (1759). Those three notices seem to be emblematic of the warm regard and reputation that TMS enjoyed during Smith’s life.

The only bit of criticism of TMS published during Smith’s days, it seems, appeared 20 years after TMS first appeared, in the third edition of Henry Home, Lord Kames’s *Essays on the Principles of Morality and Natural Religion* (1779). Four paragraphs there attack TMS as a “system that resolves every moral sensation or sentiment into sympathy.” “Had not morality a more solid foundation in our nature, it would give very little obstruction to vicious desires or unjust actions” (Kames 2005, 70, 72).

But Kames was not alone in such sentiments. Thomas Reid and Adam Ferguson, too, had quietly penned criticism of TMS during Smith’s life. And after Smith’s death in 1790, a battery of overlapping criticisms came forth, from yet more Scotsmen—Dugald Stewart, Thomas Brown, and James Mackintosh—and a bit later from the Frenchman Théodore Jouffroy (1848), and the Englishman James Anson Farrer (1881). Their dissatisfaction with TMS centered especially on Smith’s proposition that moral approval always involves or depends on a sympathy, a proposition that I have elsewhere dubbed Smith’s organon.2 We also find TMS diminished in remarks by Henry Thomas Buckle (1861, 895), Alexander Bain

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1. George Mason University, Fairfax, VA 22030.
2. For Smith’s affirmations of the organon see TMS, 17.3—meaning page 17, paragraph 3—46.9 n.*, 110.2 (“some secret reference”), 163–165.4–5, 193.12 (final sentence), 306.21 (final sentence), 311.10, 325.14 (last three sentences), and also see Smith 1987, 49.
(1868, 642), Walter Bagehot (1876, 12–15, 24), and Leslie Stephen (1876, 71–78). Harold Laski (1920, 291) said that TMS was “written with sufficient power of style to obscure its inner poverty of thought.” As late as 1985, Samuel Brittan said that TMS “would not be studied today except by a few specialists in the period if Smith had not gone on to write [The Wealth of Nations]” (51–52).

So the swings in TMS’s fortunes have been quite extraordinary. First TMS was warmly embraced by the likes of David Hume and Edmund Burke; it seems to have solidified Smith’s persona as an ethical authority, able to morally authorize the pursuit of honest income and “the liberal plan of equality, liberty, and justice” (Smith 1976, 664). Then, soon after Smith’s death, the influentials Reid, Ferguson, and Stewart sent TMS into “oblivion,” as Glenn Morrow put it (1927, 336). There it stayed until sometime in the 1980s. Nowadays TMS is once again widely admired, and its allure seems to continue to grow.

It is my impression, however, that the battery of criticisms running through Kames, Reid, Ferguson, Stewart, Brown, Mackintosh, Jouffroy, and Farrer, have never been addressed head-on by those who might defend Smith; no one has ever mounted a defense of Smith’s organon. Their critiques, and other items including the notices by Hume and Burke, are gathered in John Reeder’s truly invaluable 1997 collection On Moral Sentiments: Contemporary Responses to Adam Smith.

Reproduced here is a selection from Thomas Brown’s Lectures on the Philosophy of the Human Mind (4 vols.), first published in Edinburgh in 1820. A brief biography of Thomas Brown (drawn from Stewart-Robertson 2004) follows the selection below. Brown’s work was well received and reprinted many times in Britain and the United States, so it, too, helped to send TMS into the oblivion from which it has only recently re-emerged.

References


3. The selection comes from volume 4, 112–145 (link). Nearly the same selection appears in Reeder (1997, 139–158), but here we also include the paragraph immediately prior to the start of Reeder’s excerpt. We thank Erik Matson and Eric Hammer for their assistance in reproducing the text.


Examination of Dr Smith’s System

Thomas Brown

After this examination of the various systems, which may be considered as more or less directly opposed to the belief of that principle of moral feeling—the original susceptibility of moral emotion on the contemplation of certain actions—for which I have contended, there is still one system which deserves to be considered by us, in relation to this belief—not as being subversive of morality, in any one of its essential distinctions, but as appearing to fix morality on a basis, that is not sufficiently firm; with the discovery of the instability of which, therefore, the virtues that are represented as supported on it, might be considered as themselves unstable; as the statue, though it be the image of a God, or the column, though it be a part of a sacred temple, may fall, not because it is not sufficiently cohesive and firm in itself, but because it is too massy, for the feeble pedestal on which it has been placed.

The system, to which I allude, is that which is delivered by Dr Smith, in his Theory of Moral Sentiments,—a work, unquestionably of the first rank, in a science, which I cannot but regard, as to man, the most interesting of sciences. Profound in thought, it exhibits, even when it is most profound, an example of the graces with which a sage imagination knows how to adorn the simple and majestic form of science, that is severe and cold, only to those who are themselves cold and severe,—as in those very graces, it exhibits, in like manner, an example of the reciprocal embellishment which imagination receives from the sober dignity of truth. In its minor details and illustrations, indeed, it may be considered as presenting a model of philosophic beauty, of which all must acknowledge the power, who are not disqualified by their very nature for the admiration and enjoyment of intellectual excellence,—so dull of understanding, as to shrink with a painful consciousness of incapacity at the very appearance of refined analysis—or so dull and cold of heart, as to feel no charm in the delightful varieties of an eloquence, that, in the illustration and embellishment of the noblest truths, seems itself to live and harmonize with those noble sentiments which it adorns.

1. From the Lectures on the Philosophy of the Human Mind (Edinburgh, 1820), vol. 4, pp. 112–145. The excerpt here presented picks up in the middle of “Lecture LXXX. Examination of the Selfish System Concluded; Examination of Dr Smith’s System.”
It is chiefly in its minor analyses, however, that I conceive the excellence of this admirable work to consist. Its leading doctrine I am far from admitting. Indeed, it seems to me as manifestly false, as the greater number of its secondary and minute delineations appear to me faithful, to the fine lights and faint and flying shades, of that moral nature which they represent.

According to Dr Smith, we do not, *immediately*, approve of certain actions, or disapprove of certain other actions, when we have become acquainted with the intention of the agent, and the consequences, beneficial or injurious, of what he has done. All these we might know thoroughly, without a feeling of the slightest approbation or disapprobation. It is necessary, before any moral sentiment arise, that the mind should go through another process,—that by which we seem, for the time, to enter into the feelings of the agent, and of those to whom his actions have related, in its consequences, or intended consequences, beneficial or injurious. If, by a process of this kind,—on considering all the circumstances in which the agent was placed, we feel a complete sympathy with the passions or calmer emotions that actuated him, and with the gratitude of him who was the object of the action,—we approve of the *action* itself as *right*, and feel the *merit* of the *agent*;—our sense of the propriety of the action depending on our sympathy with the agent; our sense of the merit of the agent on our sympathy with the object of the action. If our sympathies be of an opposite kind, we disapprove of the action itself as improper, that is to say, unsuitable to the circumstances, and ascribe, not merit but demerit, to the agent. In sympathizing with the gratitude of others, we should have regarded the agent as worthy of *reward*; in sympathizing with the resentment of others, we regard him as worthy of *punishment*.

Such is the supposed process in estimating the *actions of others*. When we regard our *own conduct*, we in some measure reverse this process; or rather, by a process still more refined, we imagine others sympathizing with us, and sympathize with their sympathy. We consider how our conduct would appear to an impartial spectator. We approve of it, if it be that of which we feel that he would approve; we disapprove of it, if it be that which, we feel by the experience of our own former emotions, when we have ourselves, in similar circumstances estimated the actions of others, would excite his disapprobation. We are able to form a judgment as to our own conduct, therefore, because we have previously judged of the moral conduct of others,—that is to say, have previously sympathized with the feelings of others;—and but for the presence, or supposed presence, of some impartial spectator, as a mirror to represent to ourselves, we should as little have known the beauty or deformity of our own moral character, as we should have known the beauty or ugliness of our external features, without some mirror to reflect them to our eye.
In this brief outline of Dr Smith’s system, I have, of course, confined myself
to the leading doctrine, of which his theory is the developement. If this doctrine
of the necessary antecedence of sympathy to our moral approbation or disappro-
bation be just, the system may be admitted, even though many of his minor
illustrations should appear to be false. If this primary doctrine be not just, the system,
however ingenious and just in its explanation of many phenomena of the mind,
must fail as a theory of our moral sentiments.

To derive our moral sentiments,—which are as universal, as the actions of
mankind that come under our review,—from the occasional sympathies, that warm
or sadden us with joys and grieves and sentiments which are not our own, seems to
me, I confess, very nearly the same sort of error, as it would be to derive the waters
of an ever-flowing stream from the sunshine or shade which may occasionally
gleam over it. That we have a principle of social feeling, which, in its rapid
participation of the vivid emotions of others, seems to identify us, in many cases,
with the happy or the sorrowful, the grateful or the indignant, it is impossible to
deny. But this sympathy, quick as it truly is to arise, in cases in which the primary
feelings are vivid and strongly marked, is not a perpetual accompaniment of every
action of every one around us. There must be some vividness of feeling in others, or the
display of vividness of feeling,—or at least such a situation as usually excites vivid feeling
of some sort, in those who are placed in it, to call the sympathy itself into action. In
the number of petty affairs which are hourly before our eyes, what sympathy is felt,
either with those who are actively or those who are passively concerned,—when
the agent himself performs his little offices with emotions as slight as those which
the objects of his actions reciprocally feel; yet, in these cases, we are as capable
of judging, and approve or disapprove,—not with the same liveliness of emotion,
indeed, but with as accurate estimation of merit or demerit,—as when we consider
the most heroic sacrifices which the virtuous can make, or the most atrocious
crimes of which the sordid and the cruel can be guilty. It is not the absolute vivid-
ness of our emotion, however, but its mere correspondence in degree with the
emotion of others, which affects our estimates of the propriety of their actions;
and it must be remembered, that it is not any greater or less vividness of our
sympathetic feeling, but the accuracy of our estimation of merit and demerit,
whether great or slight, by the sympathetic feelings supposed, which is the only
point in question. There is no theory of our moral distinctions, which supposes that
we are to approve equally of all actions that are right, and to disapprove equally of
all actions which are wrong; but it is essential to our theory—that theory which we
are considering—that there should be no feeling of right or wrong, merit or demerit,—and,
consequently, no moral estimation whatever, where there is no previous sympathy in that
particular case. The humblest action, therefore, which we denominate right, must
have awakened our sympathy, as much as those glorious actions which we are
never weary of extolling,—in the very commendation of which we think not of the individual only with thankfulness, but with a sort of proud delight of ourselves, of our country, of the common nature of man, as ennobled by the virtue, that, instead of receiving dignity from the homage of our praises, confers dignity on the very gratitude and reverence which offer them. If we were to think only those actions right, in which our sympathy is excited, the class of indifferent actions would comprehend the whole life, or nearly the whole life, of almost all the multitude of those around us, and, indeed, of almost all mankind. A few great virtues and great iniquities would still remain in our system of practical ethics, to be applauded or censured; but the morality of the common transactions of life, which, though less important in each particular case, is, upon the whole, more important, from its extensive diffusion, would disappear altogether, as morality—as that which it is right to observe, and wrong to omit,—and though it might still be counted useful, would admit of no higher denomination of praise. The supposed necessary universality then, in our moral sentiments, of that, which, however frequent, is surely far from universal, would of itself seem to me a sufficient objection to the theory of Dr Smith.

Even if the sympathy for which he contends were as universal, as it is absolutely necessary for the truth of his theory that it should be, it must still be admitted that our sympathy is, in degree at least, one of the most irregular and seemingly capricious of principles in the constitution of the mind; and on this very account, therefore, not very likely to be the commensurable test or standard of feelings, so regular upon the whole, as our general estimates of right and wrong. But though it would be very easy to show the force of this objection, I hasten from it, and from all objections of this kind, to that which seems to me to be the essential error of the system.

This essential error, the greatest of all possible systematic errors, is no less than the assumption, in every case, of those very moral feelings, which are supposed to flow from sympathy,—the assumption of them as necessarily existing before that very sympathy in which they are said to originate.

Let us allow, then, every thing which we can suppose it possible for the author of the theory to have claimed,—let us admit, that the sympathy of which he speaks, instead of being limited to a few cases of vivid feeling, is as universal as he contends,—that it is as little variable in kind, or in degree, as our notions of right and wrong,—and, in short, that it is in perfect accordance with our moral sentiments;—even though, with all these admissions, we were to admit also the very process which Dr Smith supposes to take place exactly in the manner which he supposes,—it would be very evident, that still, after so many important concessions, the moral sentiments could not be regarded as having their source in the sympathy, but as preceding it; or, if no moral sentiments of any kind preceded it,
the sympathy itself could not afford them—more than a mirror, which reflects to
us, from the opposite landscape, the sunny hill, the rock, and the trees, gleaming
through the spray of the waterfall, could of itself, without any external light,
produce all that beautiful variety of colour with which it delights our vision, as if it
were the very scene on which we have loved to gaze.

Let us consider, then, with a little nicer analysis, the process of which Dr
Smith speaks,—admitting the sympathy for which he contends, and admitting it in
the fullest extent which can be conceived necessary to his theory.

In this theory, as you have seen, he has separated our feeling of the propriety
or impropriety of the action from our feeling of the merit or demerit of the
agent,—ascribing the one to our sympathy with the emotions of the agent in the
circumstances in which he was placed—the other to our sympathy with the grati-
tude or resentment of those who have been affected by the action. I have already
endeavoured to show you, that we have only one feeling of approvableness, arising
on the contemplation of an action, which, as variously referred—to the agent, or
to the action considered abstractly—is at once the felt propriety of the action and
the felt merit of the agent. Indeed, it seems to me as absurd to suppose that we can
conceive an action to be wrong, in the moral sense of that word, without any notion
of the demerit of the voluntary agent—or conceive the demerit of the voluntary
agent, without any notion of the impropriety of his action, as it would be to suppose
that we can imagine a circle without a centre, or a centre without a circle. But let
us adopt, without objection, the supposed analysis which Dr Smith has made of
our moral sentiments; and admit, that, in the constitution of these, there are two
distinct feelings, that give occasion to corresponding moral notions of propriety and
merit,—which one of these feelings alone could not have produced;—in short, let
us admit, that we might have conceived an action to be morally wrong, without any
demerit on the part of the agent, or have conceived the greatest demerit on his part
without any moral impropriety in his action.

The first supposed sympathy which we have to consider, is that which is said
to give occasion to our moral estimates of actions as proper or improper, without
regard to the merit or demerit of the agent, that are felt by us only through the
medium of another sympathy.

This notion of moral propriety or impropriety, we are told, could not have
been produced in us by the most attentive consideration of the action, and of all
its circumstances; another process must intervene. We feel the propriety of the
action, only because we sympathize with the agent. We make his circumstances
our own, and, our passion being in unison with his, we regard it as suitable to the
circumstances, and, therefore, as morally proper.

If we have, indeed, previous notions of moral right and wrong, or some other
source in which they may be found, this belief of the propriety of certain feelings
that accord with ours, might be sufficiently intelligible; but the most complete sympathy of feelings, the most exact accordancy, is not sufficient to constitute or give rise to the moral sentiments of which we are treating,—when there is nothing more than a sympathy of feelings, without that previous moral sentiment, which, in Dr Smith’s system, we must always tacitly presuppose. In the very striking emotions of taste, for example, we may feel, on the perusal of the same poem, the performance of the same musical air, the sight of the same picture, or statue, a rapture or disgust, accordant with the rapture or disgust expressed by another reader, or listener, or spectator;—a sympathy far more complete than takes place in our consideration of the circumstances in which he may have had to regulate his conduct in any of the common affairs of life,—in which our secondary emotion, if it be at all excited, is excited but faintly. If mere accordance of emotion, then, imply the feeling of moral excellence of any sort, we should certainly feel moral regard for all whose taste coincides with ours; yet, however gratifying the sympathy in such a case may be, we do not feel, in consequence of this sympathy, any morality in the taste that is most exactly accordant with our own. There is an agreement of emotions,—a sort of physical suitableness, that is felt by us of the emotions as effects, to the works of art as causes, but nothing more; and, if we had not a principle of moral approbation, by which, independently of sympathy, and previously to it, we regard actions as right; the most exact sympathy of passions would, in like manner, have been a proof to us of an agreement of feelings, but of nothing more. It proves to us more, because the emotions, which we compare with our own, are recognized by us as moral feelings, independently of the mere agreement. We do not merely share the sentiments of the agent, but we share his moral sentiments, the recognition of which, as moral sentiments, has preceded our very sympathy.

Why is it that we regard emotions which do not harmonize with our own, not merely as unlike to ours, which is one view of them,—but as morally improper, which is a very different view of them? It must surely be, because we regard our own emotions which differ from them as morally proper; and, if we regard our own emotions as proper, before we can judge the emotions, which do not harmonize with them, to be improper on that account, what influence can the supposed sympathy and comparison have had, in giving birth to that moral sentiment which preceded the comparison? They show us only feelings that differ from ours, and that are improper because ours are proper. The sympathy, therefore, on which the feeling of propriety is said to depend, assumes the previous belief of that very propriety;—or if there be no previous belief of the moral suitableness of our own emotions, there can be no reason, from the mere dissonance of other emotions with ours, to regard these dissonant emotions as morally unsuitable to the circumstances in which they have arisen. We may, perhaps, conceive them to be physically unsuitable, in the same manner as we regard the taste as erroneous, which approves of poetry
as sublime that to us appears bombastic or mean; but we can as little feel any moral regard in the one case as in the other, unless we have previously distinguished the one set of emotions as moral emotions, the other set as emotions of taste.

With respect to the former of the two sympathies, then, which Dr Smith regards as essential to our moral sentiments, the sympathy from which he supposes us to derive our notions of actions, as right or wrong, proper or improper,—that is to say, as morally suitable or unsuitable to the circumstances in which the action takes place,—we have seen that it assumes, as independent of the sympathy, the very feelings, to which the sympathy is said to give rise.

Let us next consider the latter of the two sympathies, to which we are said to own our notion of merit or demerit in the agent, as distinct from the propriety or impropriety of his action.

These sentiments of merit or demerit arise, we are told, not from any direct consideration of the agent, and of the circumstances of his action, but from our sympathy with the gratitude or resentment of those who have derived benefit or injury; or at least whom he is supposed to have wished to derive benefit or injury, from that good or evil which he proposed. If, on considering the circumstances of the case, we feel that our emotions of this sort would in a similar situation, harmonize with theirs; we regard the agent in the same light in which they regard him, as worthy of reward in the one case, or of punishment in the other, that is to say, as having moral merit or demerit.

If our sense of merit were confined to cases in which the action had a direct relation to others, with whose gratitude we might be supposed to sympathize, this theory of merit would at least be more distinctly conceivable. But what are we to think of cases, in which the action begins and terminates, without a thought of the happiness of others, in the amelioration of the individual himself,—of sacrifices resolutely but silently made to the mere sense of duty,—the voluntary relinquishment of luxurious indulgences,—the struggle, and at last the victory over appetites and passions that are felt to be inconsistent with the sanctity of virtue,—and over habits, still more difficult to be subdued, than the very appetites or passions which may have given them their power. In such cases, our sense of the merit of the victor in this noble strife,—when we do not think of the gratitude of a single individual, because there is in truth no gratitude of which to think,—is, notwithstanding, as vivid, as if we had around us whole families and tribes of the grateful to excite our sympathy, and to continue to harmonize with it. The world, indeed, the great community of individuals, it may be said, is truly benefited by every increase of virtue, in any one of the individuals who compose it; and it may be possible, in this way, to invent some species of gratitude of the whole multitude of mankind, that may be supposed to awake our sympathy, and thus to make us feel a merit even in such cases, which otherwise we should not have felt. But, though it may
be possible for us, with due care and effort of thought, to invent this abstract or remote gratitude with which ours may be supposed to harmonize; can it be imagined by any one, but the most obstinate defender of a system, that this strange sympathy, of which no one, perhaps, has been conscious in any case, truly and constantly takes place whenever we thus approve,—that we do not feel any merit whatever in the voluntary privations which virtue makes, till we have previously excited ourselves to admire them, by reflecting on a grateful world? Such a reflex thankfulness, if it occur at all, does not occur to one of many thousands, who require, for their instant perceptions of the merit, only the knowledge of the sacrifices of present enjoyment which have been made, and of the pure emotions which led to the sacrifices. It is not only the Hercules who freed the world from robbers and monsters that we admire. We admire, at least, as much, in the beautiful ancient allegory, the same moral hero when he resisted the charms and the solicitations of Pleasure herself. The choice of Hercules, indeed, is fabulous. But the choice which he is said to have made, has been the choice of the virtuous of every age; and, in every age, the sacrifices internally and silently made to duty and conscience, have been ranked in merit with the sacrifices which had for their direct object the happiness of others, and, for their immediate reward, the gratitude of the happy. Why is it that we look with so much honour on the martyr in those early ages of persecution, which, collecting around the victim every instrument of torture, required of him only a few grains of incense to be thrown before a statue,—more noble, indeed, than the imperial murderer whom it represented, but still only a statue,—the effigy of a being of human form, who, under the purple which clothed him, with the diadem and the sceptre, and the altar,—far from being a god, was himself one of the lowest of the things which God had made! When, placed thus between idolatry and every form of bodily anguish,—with life and guilt before him, and death and innocence,—the hero of a pure faith looked fearlessly on the cross or on the stake, and calmly, and without wrath, on the statue which he refused to worship, and on all the ready ministers of cruelty, that were rejoicing in the new work which they had to perform, and the new amusement which they were to give to the impatient crowd,—do we feel that there was no merit in the magnanimity, because we cannot readily discover some gratitude which we may participate?—or, if we do feel any merit, is it only on account of some gratitude which we have at last succeeded in discovering? We do not think of any thankfulness of man. We think only of God and virtue,—and of the heroic sufferer, to whom God and virtue were all, and the suffering of such a moment nothing.

That our feeling of merit, then, is not a reflected gratitude, but arises from the direct contemplation of the meritorious action, might, if any proof were necessary, appear sufficiently evident from the equal readiness of this feeling to arise in cases in which it would be difficult to discover any gratitude with which we can be sup-
posed to sympathize, and in which the individual himself, and the circumstances of his action, are all that is before us. But though this, and every other objection to Dr Smith’s theory of our feeling of merit were to be abandoned, there would still remain the great objection,—that the sympathy which he supposes in this case, as in that formerly examined by us, proceeds on the existence of that very moral sentiment which it is stated by him to produce.

We discover the merit of the agent, in any case, it is said, by that sympathetic tendency of our nature, in consequence of which, on considering any particular action, we place ourselves in the situation of those who are benefited by the action, when, if we feel an emotion of gratitude like theirs, we of course consider the agent himself as meritorious,—worthy of the reward of which they consider him to be worthy; and in like manner, on considering any action of injustice or malevolence, we feel the demerit of the agent, by sympathizing with the resentment of those whom the action has injured.

Such is the process asserted. But what is it that is truly supposed in this process, as distinguishing the sympathetic and secondary feelings, from the primary feelings of those who were directly concerned?

We place ourselves in the situation of others—or, rather, without willing it, or knowing the charge till it is produced, we feel ourselves, by some sudden illusion, as if placed in their situation. In this imaginary sameness of circumstances, we have feelings similar to theirs. They view their benefactor as worthy of reward. W’re, therefore, considering for the moment the benefit as if conferred on us, regard him likewise as worthy of reward:—or if they consider him worthy of punishment, we too consider him worthy of punishment. Their gratitude or resentment is founded on real benefit received, or real injury. Our gratitude or resentment is founded on the illusive momentary belief of benefit or injury. But this difference of reality and illusion in the circumstances which give occasion to them, is the only difference of the feelings; unless indeed, that, as the illusion cannot be of very long continuance, and is, probably, even while it lasts, less powerful than the reality, our sympathetic feelings, however similar in kind, may be supposed to be weaker in degree.

The effect of the sympathy, then, being only to transfuse into our breasts the gratitude or resentment of those who have been immediately benefited or injured, by any generous or malevolent action;—if the original gratitude imply belief of merit in the object of the gratitude, and the original resentment imply belief of demerit in its object, we may, by our sympathy with these direct original feelings, be impressed with similar belief of merit or demerit. But, in this case, it is equally evident, that, if our reflex gratitude and resentment involve notions of merit and demerit, the original gratitude and resentment which we feel by reflection, must in like manner have involved them; and must even have involved them with more vivid feeling, since the difference of vividness was the chief or only circumstance.
of difference in the direct and the sympathetic emotions. The sympathy, then,
to which we are supposed to owe our moral sentiments of merit and demerit,
presupposes those very sentiments; since the feelings which arise in us by sym-
pathy, only from the illusion by which we place ourselves in the situation of others,
must, in those who were truly in that very situation, have arisen directly with at least
equal power. It is some previous gratitude with which we sympathize; it is some
previous resentment with which we sympathize; and merit is said to be only that
worthiness of reward which the gratitude itself implies,—and demerit that worthiness
of punishment which is implied in the primary resentment. If the feeling of
gratitude implied no notions of any relation of worthiness, which our benefactor’s
generosity bears to the reward which we wish that we were capable of bestowing on
him,—and our resentment, in like manner, implied no notion of a similar relation
of the injustice or cruelty of him who has injured us, to that punishment of his
offence which we wish and anticipate,—we might then, indeed, be obliged to seek
some other source of these felt relations. But if the actual gratitude or resentment
of those who have profited or suffered, imply no feelings of merit or demerit, we
may be certain, at least, that in whatever source we are to strive to discover these
feelings, it is not in the mere reflection of a fainter gratitude or resentment, that we
can hope to find them.

After admitting to Dr Smith, then, every thing which he could be supposed
to claim, or even to wish to claim, with respect to the universality, the steadiness,
and the vividness of our sympathetic feelings, we have seen, that in both the
sympathies which he supposes to take place,—that from which we are said to
derive our moral sentiments of the propriety or impropriety of actions, and that
from which we are said, in like manner, to derive our moral sentiments of merit
or demerit in the agent,—the process to which he ascribes the origin of these
moral sentiments cannot even be understood, without the belief of their previous
existence. The feelings with which we sympathize, are themselves moral feelings or
sentiments; or, if they are not moral feelings the reflection of them from a thousand
breasts cannot alter their nature.

Lecture LXXXI. Examination of Dr Smith’s System Concluded;
Recapitulation of the Doctrines of Moral Approbation.

My last Lecture, Gentlemen, was chiefly employed in considering a theory of
our moral sentiments which has been stated and defended with great eloquence,
by one of the profoundest philosophers, whom our country and our science can
boast—a theory which founds our moral sentiments, not on the direct contempla-
tion of the actions which we term virtuous; but on a sympathy, which it is
impossible for us not to feel, with the emotions of the agent, in the circumstances
in which he has been placed, and with the emotions, also, of those to whom his actions have been productive of benefit or injury;—our direct sympathy with the agent, giving rise to our notion of the propriety of his actions,—our indirect sympathy with those whom his actions have benefited or injured, giving rise to our notions of merit or demerit in the agent himself. Both these supposed sympathies I examined with a more minute review, than that to which they have usually been submitted; and, in both cases, we found that, even though many other strong objections to which the theory is liable were abandoned; and though the process for which the theorist contends were allowed to take place, to the fullest extent to which he contends for it; his system would still be liable to the insuperable objection, that the moral sentiments which he ascribes to our secondary feelings, of mere sympathy, are assumed as previously existing, in those original emotions with which the secondary feelings are said to be in unison. If those to whom an action has directly related, are incapable of discovering, by the longest and minutest examination of it,—however much they may have been benefited by it, or injured, and intentionally benefited or injured,—any traces of right or wrong, merit or demerit, in the performer of the action; those whose sympathy consists merely in an illusory participation of the same interest, cannot surely derive, from the fainter reflex feelings, that moral knowledge which even the more vivid primary emotions were incapable of affording,—anymore than we can be supposed to acquire from the most faithful echo, important truths that were never uttered by the voices which it reflects. The utmost influence of the liveliest sympathy, can be only to render the momentary feelings the same, as if the identity of situation with the object of the sympathy were not illusive, but real; and what it would be impossible for the mind to feel, if really existing, in the circumstances supposed, it must be impossible for it also to feel, when it believes itself to exist in them, and is affected in the same manner, as if truly that very mind, with whose emotions it sympathizes.

If, indeed, we had previously any moral notions of actions as right or wrong, we might very easily judge of the propriety or impropriety of the sentiments of others, according as our own do or do not sympathize with them; and it is this previous feeling of propriety or impropriety which Dr Smith tacitly assumes, even in contending for the exclusive influence of the sympathy, as itself the original source of every moral sentiment. The sentiments of others could not fail, indeed, in that case, to appear to us proper; if they coincided with sentiments which we had before, in our own mind, recognized as proper, or morally suitable to the circumstances—improper if they differed from these. But, if we have no previous moral notions whatever, the most exact sympathy of feelings can tell us only that our feelings are similar to the feelings of some other person,—which they may be, as much when they are vicious as when they are virtuous, or when they are neither virtuous nor vicious;—the most complete dissonance, in like manner, can tell us only that our feelings are not similar.
to those of some other person. When another calls scarlet or green what we have previously felt to be scarlet or green, we think that his vision and ours agree; but we presuppose, in him as in ourselves, that visual sensibility which distinguished the colours; and we do not consider him an object of moral regard, because his vision coincides with ours. When he is affected with a delightful emotion, similar to ours, on the contemplation of a work of art, we acknowledge mentally, and are pleased, perhaps, with this coincidence of taste. But the coincidence does not seem to us to be that which constitutes the emotions of taste. On the contrary, it presupposes, in both, an independent susceptibility of these emotions, by which we should, individually, have admired what is beautiful, and distinguished from it what is ugly, though no one had been present with us to participate our sentiments. When, in like manner, we admire, with vivid approbation, some generous action,—that is to say, according to Dr Smith’s language, when we sympathize with the feelings of any one in the circumstances in which he has been placed,—we have a coincidence of feelings, indeed, as exact, though probably not more exact, than in a case of simple vision, or admiration of some work of art, in which no moral sentiment was felt;—and this very coincidence, in like manner, presupposes a capacity of distinguishing and admiring what is right,—without which, there would have been a similarity of feelings, and nothing more, precisely as in the other cases. It is not a mere coincidence of feeling, however, which we recognize in our moral sentiments, like that which we recognize in the most exact coincidence of taste. We feel, not merely that another has acted as we should have done, and that his motives, in similar circumstances, have been similar to ours. We feel, that, in acting as he has done, he has acted properly;—because, independently of the sympathy which merely gives us feelings to measure with our own, as we might measure with our own any other species of feelings, we are impressed with the propriety of the sentiments, according to which we trust that we should ourselves have acted;—so thoroughly impressed with these previous distinctions of right and wrong, that, in the opposite case of some act of atrocious delinquency, no sympathy in vice of one villain with another, can make the common crime seem a virtue in the eyes of his accomplice,—who is actuated by similar motives and therefore by similar feelings, in a sympathy of the finest unison,—when he adds his arm to the rapine, and afterwards to the murder, which is to conceal and to consummate the guilt.

The moral sentiments which we have as yet considered, are those which relate to the conduct and feelings of others. The same inconsistencies which are found, on the theory of these, is to be found, as might be supposed, in the application of the principle to other species of supposed sympathy which we have still to consider,—in the sentiments which we form of our own moral conduct. That we should be capable, indeed, of forming a moral estimate of our own actions, from the direct contemplation of the circumstances in which we may have been placed, and
of the good or evil which we may have intentionally produced, would evidently
be subversive of the whole theory of sympathy; since, with the same knowledge
of circumstances, and of intention, if we could form any moral judgment of our
own actions, we might be equally capable of forming some moral judgment of the
actions of others. It was absolutely necessary, therefore, for Dr Smith to maintain,
that we have no power of judging of our own actions directly,—that, knowing the
choice which we have made, and all the circumstances which led to our choice, and
all the consequences of benefit or injury to individuals, and to the world, which our
choice may have produced,—it is yet absolutely impossible for us to distinguish,
without the aid of the real or supposed sentiments of others, any difference of propriety
or impropriety, right or wrong, merit or demerit, or whatever other names we
may use to express the differences of vice and virtue;—though our vice had been
the atrocious fury of plunging a dagger in the heart of her who had been our
happiness in many connubial years, and who was slumbering beside us on the same
pillow in the calmness of unsuspecting love; or our virtue, the clemency of drawing
back from the bosom of the assassin whom we had laid at our feet, the dagger
which we had wrenched from his murderous hand. Even of actions so different
as these, it would be absolutely impossible for us, we are told, to form any moral
distinction, if we were to look on them only with our own eyes, and measure them
by the feelings of our own heart. Before the one can appear to us less virtuous
than the other, we must imagine some witnesses, or hearers, of what has been
done, and sympathize with their sympathy. Such is the process which Dr Smith
believes to take place. But, surely, if our original feelings, on the consideration
of all the circumstances of an action, involve no notion of right or wrong,—the
sympathy with our feelings, or our sympathy with that sympathy, or even an infinite
series of reciprocal sympathies, if these should be thought necessary, cannot afford
the moral notions of which the original feelings, themselves more vivid, afforded
no elements. If the impartial spectator be able to discover merit or demerit, by
making our case his own, and becoming conscious as it were of our feelings; our
feelings, which he thus makes his own, must speak to us with the same voice of
moral instruction, with which, during his temporary illusion, they speak to him. If,
considering our action and all its consequences, we cannot discover any merit or
demerit, they, considering our action in all its circumstances as theirs, must be alike
insensible of any merit or demerit:—or, if they have feelings essentially different
from ours, they have not made our case their own:—and what is misnamed sympathy
has not been sympathy. Unless we presuppose, as I before said, on their part some
moral notions of what is right or wrong, meritorious or worthy of punishment, by
which they may measure our conduct and feelings,—all the knowledge which the
most complete system can afford, is merely that they have certain feelings, that we
have had certain feelings, and that these feelings are similar to each other; as our
feelings have coincided before in various other emotions, perceptions, judgments that involved or suggested no moral notion whatever.

We have now then considered, both in its relation to our sentiments of our own moral conduct, and in its relation to our sentiments of the conduct of others, the very celebrated theory of Dr Smith,—a theory, which I cannot but regard as involving, in morals, the same error that would be involved in a theory of the source of light, if an optician, after showing us many ingenious contrivances, by which an image of some beautiful form may be made to pass from one visible place to another, were to contend, that all the magnificent radiations of that more than ethereal splendour which does not merely adorn the day, but constitutes the day, had their primary origin in reflection,—when reflection itself implies, and cannot be understood but as implying the previous incidence, and, therefore, the previous existence, of the light which is reflected. A mirror presents to us a fainter copy of external things; but it is a copy which it presents. We are, in like manner, to each other, mirrors, that reflect from breast to breast joy, sorrow, indignation, and all the vivid emotions of which the individual mind is susceptible; but though, as mirrors, we mutually give and receive emotions, these emotions must have been felt before they could be communicated. To ascribe original moral feelings to this mental reflection, is truly, then, as much an error, in the theory of morality, as the doctrine of the production of light by reflection without the previous incidence of light, would be an error in the theory of catoptrics.

The argument, after the fuller views of it which I have given, may be recapitulated in very brief compass.

There are only two senses in which sympathy can be understood; one having immediate relation to the feelings, the other to the situation, of him with whom we are said to sympathize. We partake his emotions directly, as if by instant contagion; or we partake them indirectly, by first imagining ourselves in the circumstances in which he is placed; the emotion, in this latter case, being similar, merely because the situation, in which we imagine ourselves for the moment, is similar, and arising in us when the situation is imagined to be ours, precisely in the same manner, and according to the same principles, as it arose in the mind of him who truly existed in the circumstances in which our imagination has placed us. In either case, it is equally evident, that sympathy cannot be the source of any additional knowledge,—it only gives a wider diffusion, to feelings, that previously exist, or that might have previously existed. If it reflect to us the very emotions of others, as if by contagion, without any intervening influence of imagination on our part; it reflects feelings that have been directly excited in them, the primary subjects of the feelings, by their real situation; and which they would not the less have had, though no one had been present to sympathize with them, or even though the tendency to sympathy had not formed a part of the mental constitution. If, on the other hand, sympathy do
not reflect to us the very emotions of others, but make us first enter, by a sort of spiritual transmigration, into their situation, and thus, indirectly, impress us with their feelings; it still, in making their situation ours, while the illusion lasts, excites in us only the feelings, which we should have had, if the situation had been really ours; and which the same tendencies to emotion that produce them now, would then have produced, though no sympathy whatever had been concerned in the process. All which is peculiar to the sympathy is, that, instead of one mind only, affected with certain feelings, there are two minds affected with certain feelings, and a recognition of the similarity of these feelings—a similarity which, far from being confined to our moral emotions, may occur as readily, and as frequently, in every other feeling of which the mind is susceptible. What produces the moral notions, therefore, must evidently be something more than a recognition of similarity of feeling, which is thus common to feelings of every class. There must be an independent capacity of moral emotion, in consequence of which we judge those sentiments of conduct to be right, which coincide with sentiments of conduct previously recognized as right—or the sentiments of others to be improper, because they are not in unison with those which we have previously distinguished as proper. Sympathy, then, may be the diffuser of moral sentiments, as of various other feelings; but, if no moral sentiments exist previously to our sympathy, our sympathy itself cannot give rise to them.

Such, in outline, is the great objection to Dr Smith’s theory, as a theory of our moral sentiments. It professes to explain, by the intervention of sympathy, feelings, which must have existed previously to the sympathy;—or at least, without the capacity of which, as original feelings, in the real circumstances supposed, the illusive reality, which sympathy produces, would have been incapable of developing them. It is on a mere assumption, then,—or rather on an inconsistency, still more illogical than a mere assumption,—that the great doctrine of his system is founded; yet, notwithstanding this essential defect, which might seem to you inconsistent with the praise that was given when I entered on the examination of it, the work of Dr Smith is, without all question, one of the most interesting works—perhaps I should have said the most interesting work,—in moral science. It is valuable, however, as I before remarked, not for the leading doctrine of which we have seen the futility; but for the minor theories which are adduced in illustration of it,—for the refined analysis which it exhibits in many of these details,—and for an eloquence which, adapting itself to all the temporary varieties of its subject,—familiar with a sort of majestic grace, and simple even in its magnificence,—can play amid the little decencies and proprieties of common life, or rise to all the dignity of that sublime and celestial virtue which it seems to bring from heaven, indeed, but to bring down, gently and humbly, to the humble bosom of man.
That his own penetrating mind should not have discovered the inconsistencies that are involved in his theory, and that these should not have readily occurred to the many philosophic readers and admirers of his work, may, in part, have arisen,—as many other seeming wonders of the kind have arisen,—from the ambiguities of language. The meaning of the important word sympathy, is not sufficiently definite, so as to present always one clear notion to the mind. It is generally employed, indeed, to signify a mere participation of the feelings of others; but it is also frequently used as significant of approbation itself. To say that we sympathize with any one in what he has felt or done, means often that we thoroughly approve of his feelings; and, in consequence of this occasional use of the term as synonymous with approbation, the theory, which would identify all our moral approbation with sympathy, was, I cannot but think, more readily admitted, both by its author, and by those who have followed him; since what was not true of sympathy, in its strict philosophic sense, was yet true of it in its mixed popular sense. Indeed, if the word had been always strictly confined to its two accurate meanings,—as significant either of the mere direct participation of feelings previously existing, or of the indirect participation of them in consequence of the illusive belief of similarity of circumstances,—it seems to me as little possible that any one should have thought of ascribing to sympathy original feelings, as, in the analogous cases which I before mentioned, of ascribing to an echo the original utterance of the voices which it sends to our ear,—or the production of the colours which it sends to our eye, to the mirror which has only received and reflected them.

Of all the principles of our mixed nature, sympathy is one of the most irregular,—varying not in different individuals only, but even in the same individual in different hours or different minutes of the same day; and varying, not with slight differences, but with differences of promptness and liveliness, with which only feelings the most capricious could be commensurable. If ever virtue and vice, therefore, or our views of actions as right and wrong, varied with our sympathy, we might be virtuous at morning, vicious at noon, and virtuous again at night, without any change in the circumstances of our action, except in our greater or less tendency to vividness of sympathy, or to the expectation of more or less vivid sympathies in others. How absurd and impertinent seems to us, in our serious hours, the mirth that, in more careless moments, would have won from us, not our smile only, but our full sympathy of equal laughter; and how dull, when our mind is sportive, seems to us the gravity of the sad and serious,—of the venerable moralizers on years that are long past, and years that are present,—to whose chair, under the influence of any sorrow that depressed us, we loved to draw our own, while we felt a sort of comfort as we listened to them, in the slow and tranquil tone, and the gentle solemnity of their fixed but placid features. What is true of our sympathy with mere mirth, or sadness, is true of every other species of sympathy;
original temperament, habit, the slightest accident of good or bad fortune, may modify, in no slight degree, the readiness, or, at least, the liveliness of moral sympathy with which we should have entered into the feelings of others,—into their gratitude, or anger, or common love or hate; and if, therefore, our estimate of the propriety or impropriety of actions had been altogether dependent on the force of our mere sympathetic emotion, it would not have been very wonderful, if the greater number of mankind had regarded the very propriety or impropriety, as not less accidental than the sympathies from which they flowed.

**About the Author**

**Thomas Brown** (1778–1820) was a Scottish philosopher and poet. As a teenager studying at Edinburgh under Dugald Stewart, he took to metaphysics and pondered moral and mental experience as psychological or physiological phenomena. At age 20 he published a challenge to Erasmus Darwin’s materialism. Brown studied medicine, participated in the early years of the *Edinburgh Review*, published poetry, and wrote on Hume’s views of causality. Beginning in 1808 Brown assisted Stewart and then co-occupied the moral philosophy chair at Edinburgh, where he developed lectures that students found captivating. But Brown did not enjoy a solid esteem among his peers. In 1820, the year of his death at age 42, he published several works, including his four-volume *Lectures on the Philosophy of the Human Mind*, from which an extract is here presented.
Classical Liberalism in Italian Economic Thought, from the Time of Unification

Alberto Mingardi

This paper offers an account of Italians who have advanced liberal ideas and sensibilities, with an emphasis on individual freedom in the marketplace, since the time of Italy’s unification. We should be mindful that Italy has always had a vein of liberal thought. But this gold mine of liberalism was seldom accessed by political actors, and since 1860 liberalism has been but one thin trace in Italy’s mostly illiberal political thought and culture.

The leading representatives of Italian liberalism since 1860 are little known internationally, with the exception of Vilfredo Pareto (1848–1923). And yet their work influenced the late James M. Buchanan and the development of public choice economics. Scholars such as Bruno Leoni (1913–1967) joined—and influenced—liberals around the world, and they continue to have an impact on Italy today.

Besides their scholarship, all the liberal authors mentioned here share a constant willingness to enter the public debate. Viewed retrospectively they appear a pugnacious lot, even if not highly successful in influencing public policy. The standout is Luigi Einaudi (1874–1961), at once a scholar and journalist who also became a leading political figure in the period after World War II.

1. Istituto Bruno Leoni, 10123 Turin, Italy. I am grateful to Jane Shaw Stroup for valuable editorial feedback. I also wish to thank Enrico Colombatto and three anonymous referees for their helpful comments.
2. On a Fulbright scholarship, Buchanan spent a year in Italy (August 1955–September 1956). He had already read I primi principii dell’economia finanziaria by Antonio De Viti De Marco in translation and wanted to develop a fuller appreciation of Italian economics. He attended a course of Italian at the University for Foreigners in Perugia and later settled in Rome.
3. For instance, Pareto, by no means a committed journalist, between 1872 and 1923 published approximately 280 articles in the popular press (Maccabelli 2016, 83).
In this paper, my account will be far from complete, but I hope to do justice to the most relevant figures and episodes. A word of caution on terminology: In Italy, our authors would not always be labeled ‘liberali’ but rather sometimes ‘liberisti.’ In English, you might think of the difference between ‘liberals’ and ‘neoliberals,’ with the latter word being both an effort to sidestep ambiguities of ‘liberal’ as well as a smear word. ‘Liberisti,’ which was coined in the 19th century, had been embraced by some economists to signify their favor for free trade and free initiative (Martino and Iannello 2011). Their critics turned the word into a form of mockery due to their supposed mercenary concern for self-interest instead of national greatness. In the twentieth century, ‘liberalismo’ came to be thought of as a philosophy of the whole of human freedom, body and soul, whereas ‘liberismo’ focused on petty affairs of economic interest. The distinction has been instrumental in constructing a moral and aesthetic worldview that treats ‘economic’ liberty as an inferior species of freedom, thus serving those who fancy themselves as caring seriously about human liberty while actually favoring ideas and agendas that spell big government and extensive restrictions on individual liberty.

Unified Italy is often considered an economic success story, as the country shifted from agriculture to industry and caught up with industrial powerhouses (Toniolo 2012). The fact that the country long lagged in industrialization seemed to represent a prima facie case for government intervention to speed up modernization. Such rationale for interventionist ‘industrial policy’ was of course opposed by the liberal economists in Italy, and opposition to top-down development was a recurrent theme. But they found little support in agrarian Italy (Cardini 2009, 27), and the country has experienced a mostly steady and progressive growth of government.

The predecessors

Nineteenth-century Italy was no stranger to liberal sensibilities. They were built on the country’s rich Enlightenment heritage, which included such figures as Antonio Genovesi (1713–1769), Ferdinando Galiani (1728–1787), Pietro Verri (1728–1797), Cesare Beccaria (1738–1794) and Melchiorre Delfico (1744–1835). In the first half of the nineteenth century, Catholic priest Antonio Rosmini (1797–1855) expounded a version of classical liberalism which strongly emphasized the

4. Note that when I give in English a quotation from a text in the Italian language, the translation is my own.
5. Tanzi and Schucknecht (2000) report that general government revenues were 12.5 percent of the Italian GDP circa 1870, 14.7 percent in 1913, 24.2 percent in 1920, 31.1 percent in 1937, 24.8 percent in 1960, 36.9 percent in 1980, and 46.2 percent in 1996.
need for private property rights as an essential safeguard for individual liberty (see Rosmini-Serbati 2006/1848). The most significant writer in 19th century Italy, Alessandro Manzoni (1785–1873), was himself a liberal and devoted the 12th chapter of his masterpiece _I Promessi Sposi_ (Manzoni 1984/1842) to explaining the dire consequences of interfering with the free movement of prices during a shortage of grains. Einaudi, decades later, would hail that chapter as “one of the best treatises on political economy that has ever been written” (1961/1919, 272).

**Cavour and Ferrara**

Italy’s unification was by and large the result of the contrivances of Camillo Benso, Count of Cavour (1810–1861). Cavour was a political mastermind, not a professional economist; still, he “fitted squarely into the traditions of nineteenth-century liberalism in his deep commitment to the values of free trade, secularism, and constitutional parliamentary government” (Cardoza 2000, 115). A practical man, also credited with positive contributions as an entrepreneur and a landlord, Cavour was an attentive student of contemporary political economy and embraced free trade. Anthony Cardoza writes on Cavour’s achievement as the Minister of Trade and Industry of Kingdom of Sardinia in the 1850s:

[Cavour] arranged new commercial agreements with nearly a dozen countries in western and central Europe during his first two years in office. These agreements opened the way for Cavour to introduce a new general tariff schedule that lowered duties on a wide range of agricultural and manufactured products. Its ratification by a sizeable majority in parliament in the summer of 1851 effectively transformed Piedmont from protectionism to free trade. While customs revenues fell, they were more than offset by the growth in trade and a general improvement in the Piedmontese economy. A rise in international agricultural prices sparked farm exports, while the availability of imports favoured mechanization of the textile industry. Significantly, the apparent success of Cavour’s policies in the 1850s established a precedent that was extended to the new Italian nation in 1861 where free trade doctrines would hold sway until the protectionist turn of 1887. (Cardoza 2000, 116)

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7. A classic work on Rosmini’s social thought is Piovani 1997/1957.
8. By the way, Barolo, the crown prince of Italian wines, was at least in part the result of Cavour’s efforts to produce a Piedmontese wine to rival the French. Earlier, Nebbiolo grapes—the variety Barolo is produced from—were typically employed to produce a sparkling sweet wine (in sharp contrast, Barolo is dry and structured).
9. In an obituary of Robert Peel, Cavour spoke of Peel's “immortal policy” that “did not only benefit his countrymen, but also had a wholesome influence of the other peoples” (Cavour 1962/1850).
In an 1851 speech in the Piedmontese parliament, Cavour defended his own policies from contemporary protectionists. To those claiming that protectionist policies would allow infant industry to grow and prosper, Cavour retorted: “[They say that our] industry…is still a child and so long as it remains in this state of adolescence we should surround it with customs barriers. … Well, I can see industries established in our country for 20, 30, 50 years or even a century, and still I hear that they remain in their infancy” (Cavour 1868/1851, 89).

Italy was unified in the 1860s, a time in Europe when the Industrial Revolution was on dramatic display, so it is not surprising that industrialization was, right from the early years of unified Italy, the chief preoccupation of policy debate. The Piedmontese brought together territories of vastly differing levels of development. In the North, industrial activities were blooming, whereas in the South large landowners were still dominant. Which policies best suited Italy’s modernization?

If Cavour’s commitment to free trade gave the liberisti a rhetorical mooring in the words and vision of unification’s main architect, their foremost theorist was a man whose principled stubbornness got himself barred from active teaching.

Francesco Ferrara (1810–1900) was the most prominent Italian economist of the 19th century. He is best remembered for the remarkable publication series Biblioteca dell’economista, a far-reaching program of translations aimed at making the latest economic literature available to Italians. In his forceful and prolific writings the principles of individualism and economic liberalism were “glorified always and everywhere” (Weinberger 1940, 93). Commenting on Ferrara’s prose, Einaudi called him a “wizard” who “enthused thousands of mature men and ardent youths, making them fall in love with economic science” (1935, 215).

Ferrara had strong political passions. A Sicilian, born in Palermo to a family of modest origins, he entered the world of studies and politics as a statistician. In 1848, he took part in the Sicilian uprising. He was jailed briefly and later elected to the newly established Sicilian parliament. He was subsequently dispatched to Turin as part of a mission to offer the crown of Sicily to the Duke of Genoa, the brother of the Piedmontese king. When the House of Bourbon re-established its hold on Sicily, the envoys remained in Turin. In 1852, the Bourbons condemned Ferrara to “perpetual exile” (Faucci 1995, 74).

Ferrara was appointed to the chair in Political Economy at the University of Turin. He engaged widely in policy debates and in 1858 was suspended from teaching, as he often used his lectures to denounce the government and its policies, including the government’s monopoly in education. This prohibition to enter class-

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10. For instance, Umberto Ricci (1879–1946) stated that “Cavour was the master of liberalism in Italy, and all Italians who wish to deserve the noble name of liberals must always turn to his teachings” (Ricci 1920, 125). Italian liberals can hardly find a loftier point of reference in their native country.
rooms did not hamper Ferrara’s creativity and scholarship. He later taught in Pisa and eventually in Venice, after having served in a number of public offices, including briefly as a cabinet minister and a member of the Italian tax court.

The aforementioned Biblioteca dell’economista was entrusted by Ferrara to the Turin publishing house of Cugini Pomba. The Biblioteca was an “editorial triumph” as, in just two years, it had already reached the impressive number of 960 subscribers (Roggi 2007, 23). In all, 26 books were published (two series of thirteen books each), most prefaced by a long introduction by Ferrara himself. These introductions were both biobibliographical and critical, full of insights. Buchanan wrote of Ferrara’s introductions:

On the whole his criticisms are excellent by modern criteria, and he anticipated many of the neo-classical contributions. … He was forceful in his emphasis that value theory must be based on individual behavior, his whole construction departing from what he called “the economic action,” the author of such action being the individual who feels, thinks, and wants. … Ferrara was perhaps the first economist completely to shed all of the mercantilistic trappings in his rejection of economics as the science of wealth. (Buchanan 2001/1960, 62)

Not unlike the ‘Austrian’ economists, Ferrara trumpeted subjective value and was skeptical of the efforts to mathematize economics (Faucci 1995, 149). He was critical of Ricardian economics and was heavily indebted to the French: Bastiat, whom he considered a “hero and martyr in his battles for economic freedom” (Faucci 2014, 106), Antoine Destutt de Tracy, and especially Jean-Baptiste Say. Like Say, he based his view of the entrepreneurial function on a “knowledge-based approach” (Bini 2013, 93). He opposed intellectual property rights as a form of government-granted monopoly, endorsed free banking, and favoured Italian unification but opposed the development of a strong, centralized Italian state.

Ferrara was the key driver in bringing liberal economics into some prominence, but his voice did not go unchallenged. In 1874, Fedele Lampertico (1833–1906), Antonio Scialoja (1817–1877), Luigi Cossa (1831–1896) and Luigi Luzzatti (1841–1927) established the Associazione per il progresso degli studi economici

11. Later to become Utet, now part of the De Agostini group, the house is still a point of reference in Italian scientific literature.
12. For Ferrara, “a patent is the lottery win of industrious men” (Ferrara 1992/1857, 419).
13. Ferrara opposed the Italian government’s decision to introduce legal tender of money in 1866, forecasting that this would greatly increase the opportunity for monetary manipulation.
14. Ferrara maintained that centralization was not a price worth paying for unification: “I place my hopes in the unity of the Italian nation, but I cannot conceal that I am frightened by the centralization urges that manifest themselves everywhere whenever the Italian unification is mentioned, nor would I hesitate to proclaim that, in my opinion, a divided Italy is preferable to a centralized one” (Ferrara 1992/1857, 551, my emphasis).
in Italia, explicitly aimed to oppose Ferrara. Among their activities was the journal *Rassegna d’agricoltura, industria e commercio*. Ferrara long quarreled with this group, particularly Luzzatti, who identified with the German historical school but claimed to be eclectic and not quite as enthusiastic about government interventionism as the Germans. *Contra* Ferrara, this group of scholars held there were no general economic laws and that naked self-interest could not be relied upon to achieve a harmonious economic order.

In 1874 Ferrara wrote a fiery attack on the “economic Germanism in Italy,” which had brought about “a genuine canonization of the State, imagining it as a real being of flesh and bone, endowed with the complete capacity to destroy individuals and to trample on all their rights” (Ferrara 1972/1874, 565). The debate between these allegedly ‘pragmatic’ interventionists and Ferrara presented in a nutshell many of the arguments in the never-ending struggle between liberals and statists.

Besides the *Biblioteca dell’economista*, Ferrara engineered efforts to spread liberal ideas in Italy, including the publication of different journals (one was called *L’economista* echoing the British *Economist*) and establishment of the Società Adamo Smith in 1874, to bring together the intellectual devotees of free trade.

In the realm of politics, Italy moved increasingly in the direction pointed forward by Luzzatti, as the so-called Historical Left formed a cabinet in 1876. In 1878 Italy abandoned Cavour’s free trade policies by introducing a modest tariff. In 1881, it embarked on a large program of naval construction, and in 1884 an Italian ‘industrial policy’ debuted with the creation of the Terni steel mills. In 1887, Italy got a new protectionist tariff, the second highest in Europe, for the sake of protecting not only infant industries but also agriculture. The rapid undoing of Cavour’s free trade policies is emblematic of a cause of a longstanding feature of Italian classical liberalism, namely its disenchantment with politics. It is hard to take politics seriously when the talk and conduct of political actors appear so capricious.

Most of the *liberisti* were political realists, and they understood politics through the lens of the theory of the ruling classes or groups, which got its start with Pareto and Gaetano Mosca (1858–1941). For Buchanan, the theory of the ruling class “forced Italian thinkers…to devote greater attention to the form of the state” (2001/1960, 67).

Ferrara was already well aware that “At the end of the day, all governments are a minority” (1976/1858, 40). The downside of the representative system was that it enabled governing elites to manufacture an illusion of participation in collective choices, an illusion that greatly facilitated government spending:

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15. It has been noted that, though Ferrara had such a strong personal commitment to classical liberalism, his choices insofar as what to publish in the *Biblioteca* were “exceptionally secular” (Barucci 2009, 190), in the sense that he was far from sticking exclusively to texts he approved of.
The representative system is characterized by this serious flaw, that it can effortlessly become an instrument of delusion. The people is less loath to pay, when it deludes itself into believing that its taxes—as they are assented to by its representatives, whose interests are purportedly the same as its own—are for this only reason warranted by inescapable necessities. A large number of instances presented by modern history teach us how easily the good faith of peoples can be abused and reveal the covert motive that made not a few governments to reckon that, ultimately, it was in their own interest to suffer the establishment of deliberative assemblies, as a means to get rid of the odious appearance of oppressors of their own people and to enjoy the pleasure of spending large sums… When the administration has made an outlay unavoidable, majorities tend to feel obliged to allow it. (Ferrara 1986/1856, 760–761)

Buchanan highlights Ferrara as an important figure in starting the scienza delle finanze, the Italian tradition of public finance theory. “The ‘economic’ conception of fiscal activity was, to Ferrara, an ideal. In the actual state of the world, Ferrara considered that the levy of taxes tended to be oppressive and constituted the ‘great secret through which tyranny is organized.’ … Ferrara was intensely critical of the view, which had been expressed by German writers, that merely because tax revenues are transformed into public spending and are returned to the economy, society does not undergo a net loss” (Buchanan 2001/1960, 63–64).

Scholars in the Italian tradition tried to develop a scientific definition of taxation, distinguishing two sorts: taxation necessary for financing for a limited government, and taxation that was essentially predatory. In its “purest meaning,” the imposta would be “the price—and a slim one—of the great benefits that the social state, the organized state offers to each of us” (Ferrara 1955/1849, 551–553). Given the immense utility provided by the social state (that is: by the organization of law and order in society), such a price could be understood as something that would be paid voluntarily by each taxpayer. Since “Any tax is ultimately equivalent to a prevented consumption and a prescribed one in its stead,” and so it all boils down to the question whether “the substituted consumption is more or less productive than the prevented one” (ibid., 651–652). For Ferrara, the cornerstone of the problems of taxation is the economic use of taxes, the idea that government should operate in a parsimonious way.

16. This is Buchanan’s view (2001/1960, 64), which is in substantial agreement with Einaudi (1935). Sabetti (1989) also argues for considering Ferrara a forerunner of modern public choice.

17. Somewhat ironically, Ferrara was a defender of one of the most hated taxes in Italian history, the tassa sul macinato, a grist tax. The tax was implemented through the use of contatori, instruments that counted the number of mill revolutions when grinding cereals into flour. The use of these instruments was highly contested, but was considered by Ferrara a guarantee of certainty in assessing the dues, vis-à-vis more ambiguous and therefore potentially arbitrary systems for determining how much people shall pay (see Ferrara 1871).
But if taxation can be theoretically understood as a fee, Ferrara was fully aware that historical evidence pointed in another direction:

In its philosophical concept, the organized state is the great reason that exalts the notion of taxation; in its historical understanding, however, taxation is the great secret that organizes tyranny… And if in its philosophical understanding the term “contribution” does appears to be truer and worthier, in its historical understanding I invite you to change it, but only to call it “scourge.” (Ferrara 1955/1849, 553–554)

Looking realistically at the dry facts of history, one sees taxation as the propellant of arbitrary government:

Would you like to fathom how a swarm of parasites and harlots can exist in the royal courts? Why ignorance and intrigue are exalted and knowledge and virtue are rejected and derided? How comes it that in a temperate government a bad minister can make the houses of parliament to be in thrall of his will? And representatives and newspapers can be found to conceal his faults and incompetence? Taxation contains and explains the whole riddle. Taxation is the great source of everything a corrupt government can devise to the detriment of the peoples. Taxation supports the spy, encourages the faction, dictates the content of newspapers. (Ferrara 1955/1849, 554)

Pareto and his contemporaries

The theory of the ruling class was independently formulated by Vilfredo Pareto and Gaetano Mosca. Pareto and Mosca wrote at the period when the idea that democracy enjoyed a different sort of legitimacy than other forms of government was becoming widespread.18

On the contrary, Mosca and Pareto stressed that, whenever you have politics, you end up with a small group of individuals imposing on a larger group. In all political societies, it can be observed “that the rulers, namely those who hold and exercise the public powers, are always a minority, and that under them there always exists a numerous class of individuals who, never really participating in any fashion in government, cannot but endure it. They can be called the governed” (Mosca 1884, 13).

18. This different sensibility towards democracy is at the root of the difference between classical and ‘new’ liberalism in the Anglo-Saxon world, with the first retaining its skepticism towards political power and the second embracing it as an instrument to foster social change. The point was forcefully raised by Spencer (1992/1884).
Mosca’s ambition was to establish a pattern that could serve as the cornerstone of the scientific study of politics. Likewise, Pareto aimed at making social science more robust. The theory of the ruling class enabled him to distinguish what he considered to be the fundamental facts of politics lurking behind the fog of ideology. Grand ideals and revolutionary slogans were often a cover-up for “the simple struggle of two competing elites. They believe—and want us to believe—that one elite, which is actually striving to seize power so that it can use and abuse it like the one it wishes to oust, is only driven by the purest goodwill for its fellow countrymen” (Pareto 1902, 171).

Unlike Ferrara, Pareto is still internationally renowned and considered a giant among social scientists. But it is often forgotten that he was “plunged into a one-man crusade against the state and statism” (Rothbard 1995, 456). This may be due to the fact that Pareto is strongly associated today with the technical concept of Pareto optimality. Pareto certainly aimed to be a value-free social scientist, but he himself had strong political passions, particularly in his youth.

Pareto’s liberalism is sometimes downplayed. He has been treated as a precursor of fascism, even though he died in 1923, when the Mussolini regime was still far from showing its true face. The Fascist authorities arranged for Pareto to be nominated to the Italian Senate, but Pareto never sat in the assembly: He never presented the necessary documents to validate the appointment, and he died a few months later. It is hard to think that he might have approved the single-party system Mussolini established starting in 1925. In the words of the foremost Pareto scholar, Giovanni Busino, he was a “genuine liberal, an uncertain democrat, a righteous and honest man… of all political calamities, the one he deemed the most despicable was the destruction of liberty, the one which was to be shunned at all costs” (1989, xxi).

Buchanan points out that Pareto was “an admirer of Ferrara” and maintains that much of the Paretian theoretical construction “can be found in Ferrara’s works” (2001/1960, 63 n.). Murray Rothbard observes that Pareto was “heavily influenced by Molinari” (1995, 456). Frédéric Bastiat and Herbert Spencer were two of the young Pareto’s heroes. For historian Roberto Vivarelli (1929–2014), a central element in Pareto’s thinking is the distinction, drawn by Spencer, between “military societies” and “industrial societies,” for in this latter he found the “firmest ideals in his thought: individual freedom and pacifism” (Vivarelli 2011, 37).

19. Maffeo Pantaleoni, who died in 1924, turned into a nationalist and could be considered a more committed supporter of fascism. Still, it ought not to be forgotten that after the Great War strikes and riots made the prospect of socialist revolution a very real threat in Italy (see on this Raico 1996, 6–10).
20. Pareto referred to Molinari as “Cher Maître” (see Busino 1989, 316).
Pareto was a professional engineer for the first half of his professional life, entrusted with a managerial position in the emerging steel industry in Tuscany. Only after 1893 could he devote himself totally to the social sciences, when he was called to succeed to the chair of Political Economy at the University of Lausanne, succeeding Léon Walras. His political ideas were by then largely formed, but his attitude was made somewhat bitter by the march of statism in contemporary Italy.

The fledging Italian state managed to balance its budget in 1876 (a feat never replicated thereafter), but soon the Italian political class abandoned Cavourian principles. Italian governments flirted with the idea of establishing a colonial empire, and protectionism was on the rise, along with a growing meddling with economic matters. All of this was accompanied, in Italian politics, by widespread corruption. A conspicuous episode was the 1892 scandal involving the Bank of Rome. At the forefront of criticism of government corruption were the few liberisti, led by Pareto. Initiatives such as the state monopolization of life insurance in 1911 provided another occasion to give battle. The war effort in 1915–1918 likewise propelled dirigenzismo, and the emerging pro-war camp influenced the ideological debate in the coming years.

The march of statism plausibly explains Pareto’s progressive retreat from public life, speaking only through his great works: the Cours d’économie politique (1896), Les systèmes socialistes (1902), the Manuale di economia politica con una introduzione alla scienza sociale (1906) and the Trattato di sociologia generale (1916). Pareto still sometimes contributed shorter, politically pointed pieces. But he quit the intense activity he displayed in the 1890s, when he contributed a monthly column on “Italian Chronicles” to the Giornale degli economisti, the journal of economics then co-owned by Maffeo Pantaleoni (1857–1924) and Antonio De Viti De Marco (1858–1953).

Pareto (1894, 412) defined “what we liberisti want” as the following: “that the government only takes care of securing justice for all and abstains from disrupting the free operation of political economy’s natural laws.” But liberalism only lost popularity, as government’s involvement grew, based on the existing rationales. The South remained backward, and industrial policy was needed to force industrialization.\(^21\) The liberisti did not buy into the paternalistic view that the government should pick winners and lead development. They declared proudly that their battle was as much political as economic: They wanted Italians to be considered responsible adults (Vivarelli 2011).

Pantaleoni made clear the reasons why Italy was lagging behind in industrialization, and why government was hardly a solution:

\(^{21}\) Alexander Gerschenkron (1955) argued the opposite thesis, maintaining that the government failed in properly fostering industrialization, but government intervention in speeding development up was indeed needed.
National savings were largely employed in establishing the agencies of the State, and did not suffice to make Italy advance at the same pace afforded to other European countries... Where the State uses up a share of national savings to invest it into the political machinery, namely in the establishment and operation of its own agencies...the immediate return is a political one, which benefits largely the State, and harms the public economy insofar as this return differs from an economic one. (Pantaleoni 1925, I.41)

A close friend of Pareto and an internationally recognized economist at the time, Pantaleoni is credited with being the first economist to apply marginalism to public finance and for writing a famous textbook, which made his generation of Italian economists more adept in marginal analysis (Pantaleoni 1889). As opposed to his father Diomede Pantaleoni (1810–1885), a prominent politician and a collaborator of Cavour, Pantaleoni had a less conspicuous public life, possibly because of his reputation being tainted by his involvement as a board member in a bank which went bankrupt. Pantaleoni later turned a staunch nationalist in politics, less because he had given up his allegiance to free-market ideals than because he made a deliberate choice of political sides in the struggle for greater stability. He even played a role in spreading anti-Semitic propaganda.

Pantaleoni’s works were wide-ranging and his voice was prominent in the economic debate. He was profoundly influenced by Herbert Spencer. He associated the industrial capitalism which emerged in England with a higher degree of individual freedom: “Individualism and liberty have created the conditions of affluence that are necessary and sufficient for altruism to emerge” (Pantaleoni 1925, I.281). He clearly saw that the Industrial Revolution was creating wealth and prosperity as no other development before (see Pantaleoni 1976). Like Spencer, Pantaleoni saw socialism by and large as an atavism: “The favor in which socialism is held is largely due to the hope that it can create more stable conditions,
bureaucratize life, secure pensions and get rid of the perpetual revolution that competition everywhere engenders” (1925, I.221).

Pantaleoni and his friend De Viti De Marco were both scholars of public finance. Pantaleoni “tried to construct a theory of public spending analogous to the theory of consumption to the individual with the decision-maker being the average or representative member of the legislative assembly” (Buchanan 2001/1960, 65–66). He advanced, at different moments, two different theories of taxation. At first, he focused on the notion of taxation as a fee for public goods. But later he came to consider that there are situations in which the contractual parity between the State and taxpayers does not hold. Thus, “it is clear that a tax corresponds in fact to the ransom extorted by a highwayman, at least in the share that exceeds the amount which would be spontaneously paid [by taxpayers] as the price of a good wanted at a given moment in a specific amount” (Pantaleoni 1904/1887, 155).

Taxation as fee for services versus the ‘ransom tax’ was treated by Buchanan (2001/1960) as the “basic dualism” of Italian fiscal theory. De Viti De Marco conceptualized the fiscal theory as referring to a cooperative state and a monopolistic state. Economist Richard E. Wagner explains: “One form treated political-fiscal processes as reflecting something like consensus within society, while the other form construed political-fiscal processes as operating for the particular advantage of ruling sets of people within a society” (2016, 20).

Though Pantaleoni was one of Pareto’s closest friends, “Pantaleoni and De Viti kept substantially to…pre-Paretian methodology… Neither became interested in the ‘sociological approach’ to public finance, perhaps because when Pareto’s Trattato di Sociologia Generale was published, they were close to sixty years of age” (Fossati 2012, 46). Besides the theory of the ruling class, Pareto’s contributions to this branch of economics can be considered somewhat limited. In part, he was actually at odds with rational-choice approaches: “Clearly recognizing that all actual choice must be made by individuals, whether in their capacity of taxpayer-voters or as members of some ruling class, Pareto argued that the individual choices which go into the making of collective decisions are necessarily non-logical” (Buchanan 2001/1960, 101–102). Pareto construed political behavior neither as a somewhat clumsy logic of cooperation nor as a logic of ransom and exploitation.

Pantaleoni and De Viti De Marco were not alone in constituting this school of scienza delle finanze. In this connection we should also mention Ugo Mazzola (1863–1899), Gino Borgatta (1888–1949), and Einaudi. Amilcare Puviani (1854–1907) is best remembered for his theory of fiscal illusion, which depends, as Buchanan explains, on understanding that “the actions of the government could best be explained by the hypothesis that the government always acts to hide the burden of taxes from the public and to magnify the benefits of public expendi-
tures” (Buchanan 2001/1960, 93). This happens not “as a deliberate plan” but as a work-in-progress in which successful fiscal illusions emerge as the ruling class proves effective in manufacturing such illusions.

This group of scholars is remembered and revered today for having fore-shadowed notions that were revitalized by modern public choice. Yet some of them were also active in building institutions aimed at hindering Italy’s march towards dirigisme. De Viti De Marco was a Member of Parliament from 1900 to 1921 in the ranks of the Liberal Party and established in 1904 the Lega Antiprotezionistica, with the goal of bringing together opponents of protectionism of different ideological bents, socialists included. This organization was quite short-lived, and was relaunched in 1914. In both attempts, the Lega Antiprotezionistica went awry because of the continuous quarrels in the progressive camp, in spite of the common allegiance to free trade (Tedesco 2002).

After the outbreak of the First World War the Italian intelligentsia was dominated by the supporters of the war efforts: the free-traders, pacifists as they were, were looked at as a relic of a distant past. Moreover, the extreme secularism of the liberisti made it impossible for them to forge any sort of the alliance with the emerging Popular (Catholic) movement, despite a number of issues that may look with the benefit of hindsight as likely areas of cooperation, such as polemics against the ruling class, skepticism towards the growing government’s intervention in the economy, and defense of private property.

In introducing a collection of articles published over his thirty years of active engagement in political and cultural debates, De Viti De Marco connected the misfortune of classical liberalism with the fact that, in a world of enlarged political participation, “one idea, bequeathed by the old regime, remained ascendant in all groups: the idea of class privilege” (De Viti De Marco 1929, vi). In Italy, the expansion of franchise “consisted in the growing extension of legislative privileges, from bigger to smaller groups, from older to newer groups, from landowners to industrialists, to government bureaucrats, to farmers’ cooperatives, to workers’ unions” (ibid., vii).

Even among Italian self-styled liberals, free market economics lost friends. Quite a few Italian liberals decided to go the way of a liberalismo of a more social democratic sort, convinced that a mixed economy was not incompatible with the...
basic guarantee of individual rights. Before he was killed by Fascist thugs, Piero Gobetti (1901–1926), the wunderkind of Italian liberalism, created in a handful of years an enormous array of brilliant editorial ventures. He was sympathetic to Soviet revolutionaries, though he remained a free trader.

The idealist philosopher Benedetto Croce (1866–1952), possibly the most prestigious Italian intellectual of his times and certainly the most famous of Italian liberals, maintained that “Ethical liberalism abhors authoritarian regulation of the economic process because it considers it a humbling of the inventive faculties of man” and that “the principle of laissez-faire et laissez-passer is an empirical maxim, that cannot be taken in an absolute way, and it has to be limited” (Croce 1928, 43). In his historical work, Croce recognized the role of free trade and free enterprise in making Europe a freer place in the 18th century—yet he fought against the absolutization of the principles of laissez-faire, which had been associated with a dreary anthropology focused on self-interest and greed.28 Although Croce was clearly principally aligned with the classical liberal presumptions against government intervention, his student Guido De Ruggiero (1888–1848) was much less so and wrote a history of liberalism (De Ruggiero 1981/1927) in which the hardy idea of individual liberty is obscured by idealistic “freedom” formulations.

The age of big government

In 1922–1925, under the direction of Treasury Minister Alberto De Stefani, the Mussolini regime pursued a policy of fiscal discipline, with a balanced budget via cuts to public spending including military expenditures, and of a ‘productivist’ stimulus to economic growth, including the abolition of the ‘luxury tax’ and cuts to corporate taxation. But such a course did not last long. Mussolini’s political control of the country became increasingly unchallenged after the Fascists’ assassination of Socialist leader Giacomo Matteotti went unpunished, and in the economic realm the regime resorted more and more to protectionism. The international monetary turmoil of the 1920s played its part: After the 1929 crisis, free-market policies were questioned all over the world. In Italy, not only did liberal ideas fade out of fashion, but the Fascist state was there to take advantage of the statist tide.

28. Croce (1969/1909, 380–381) maintained that “Of late, owing to the works of Jevons and of other Englishmen, of Gossen, of the Italians of the school of Ferrara, and of the Austrians, Economy has become at once more and more complicated and more simple, owing to the applications, extensions, and reductions that it has effected. But if with its progress it be able to become ever more exact and perspicuous, yet it will never for that reason become organic; its character of a quantitative discipline, of an applied mathematic, in which the atomism of the postulates and of the definitions is insuperable, does not allow of such metamorphoses.”
The repression of dissent made it impossible to voice an alternative philosophy as the liberisti had done before. The early 1930s saw Italy engaging in the institutionalization of its ‘rescue efforts.’ After a banking crisis in 1931, in January 1933 the Istituto per la Ricostruzione Industriale (IRI) was established and took control of the bank-owned companies. Although set up as a temporary measure, IRI continued to run until the 1990s. It was one of the largest state conglomerates in Europe, owning many diverse businesses such as highways, airlines, telecom companies, and food companies.

For the Fascists, these policies were also a matter of political symbols. They allowed fascism to style itself as a ‘third way’ between capitalism and socialism. Dismissing the entire legacy of the old ‘Liberal Italy,’ the government adopted the Labour Charter of 1927 and establish the National Council of Corporations in 1930. ‘Corporatism’ was born. With the purported aim of allowing for the ‘stakeholders’ of economic forces to meet and to resolve any issue in a cooperative rather than conflictual fashion, an enormous bureaucracy of committees was born.

In one of the most famous and acute readings of fascism, Ignazio Silone (1900–1978) has described the “economia corporativa” as a nexus of lies—“the lie of formal democracy is replaced by the lie of the corporatist economy”—in which “the economy blurs into politics” (Silone 2002/1934, 219). Such confusion did not vanish with the end of the fascist regime after World War II. The Italian democratic Constitution was, in its economic parts, very far from embracing ideas that would check the tendency toward government intervention.

Still, the early postwar days of the Italian Republic may well be remembered today as a moderately happy age for liberalization. The years from 1948 to 1963 were times of a remarkable economic boom, fostered by relatively light-touch regulation and light taxation. Monetary stability was a priority of the Italian Central Bank and the country joined the European common market, thereby finding a wider consumer base for its products. The liberisti achieved also a symbolic victory: In 1948 Luigi Einaudi, their doyen, after having served as President of the Central Bank and Treasury Minister right after the proclamation of the Republic, was elected President of the Italian Republic—largely a ceremonial post. In the period 1948–1963, the economy grew on average at 6.5 percent.

At the time of his election in 1948 Einaudi was 74 years old. He was the country’s most prestigious living economist. Between 1908 and 1946, he was an Italian correspondent of The Economist (Einaudi 2000). Even earlier, he was writing columns first for La Stampa in Turin and then for Corriere della Sera in Milan, until he was forced to leave his position by the Fascist regime. He seamlessly moved between academic research and journalism and back. He was highly interested in

29. Between 1903 and 1925, Einaudi wrote over 1,700 articles for Corriere della Sera (Pavanelli 2016, 185).
empirical, applied questions, but also wrote extensively on fiscal theory, following in the footsteps of De Viti De Marco. He was a tremendously productive writer, but he himself feared his writings were “useless sermons,” as he titled the collection of his journalistic pieces (Einaudi 1959).

From the 1930s, expounding the classical liberal outlook, Einaudi opposed the Keynesian measures adopted by the government as well as Keynes’s ‘new economics.’ His was a prestigious name, in Italy and abroad, but his election to the highest public rank cannot be considered an acknowledgment of the importance and validity of his ideas. While he was President of the Republic he continued to write, but published those works only after he left office.

Here’s what Einaudi, then head of state, wrote in a 1950 letter to Giorgio La Pira (1904–1977), the Christian progressive mayor of Florence who blamed unemployment on the lack of proper government measures. After having patiently explained to La Pira the many barriers to greater employment and economic growth, barriers that the very state he had headed kept in force, Einaudi notes:

> If unemployment only reached two million persons, this is due to the fact that in Italy, luckily, laws are not always enforced, that everybody disobeys as far as possible foolish and anti-social laws. Despite our innate noncompliance, however, something remains, enough to bring about unemployment and to drive many decent fellows to exacerbate it under the pretense of doing away with it. (Einaudi 1956, 390)

As with Einaudi’s other writings from the time, this letter was not published until he had left office.

Einaudi served his country loyally but with a clear-eyed understanding of the nature of its institutions. The Italian economic boom, predicated on a sort of benign neglect, happened in spite and not because of the new republic’s legal framework. The new Italian Constitution, adopted in 1948, did not relinquish the powers Fascism had availed itself of to take control of the country’s economy. The Constitutional convention was driven by a highly skeptical view of free markets. There, as noted by Pasquale Saraceno (1977, 24), “Marxist thought and Catholic social thought met on the issue of controlling the capitalist anarchy.” The result was a Constitution that values private enterprise only for its ‘social utility’ and does not consider private property a necessary bulwark of liberty.

30. For a profile of Einaudi as an economist see Forte and Marchionatti 2012.
31. An archive of Einaudi’s writings is accessible online at www.luigieinaudi.it.
32. Einaudi thought that removing all hindrances to private economic activity was the sustainable way out of the economic crisis, and was skeptical of the idea that growth could be achieved in the absence of private savings, which he pithily described as “a rabbit pie without the rabbit” (2011/1933, 87).
In post-fascist Italy, the stronghold of Fascism’s economic interventionism, IRI, was not broken up but rather became an increasingly central feature of the Italian economy. The refrain of ‘industrial policy’ to foster industrialization of the South continued to be repeated by democratic politicians. Italy knew some spectacular entrepreneurial successes—from fashion to eyeglasses to precision mechanics—most of which blossomed quite outside of the grand planning of the social engineers. The nationalizing of Italian businesses was a frequent occurrence after 1963, the year that saw the government establish a state monopoly in electricity generation and transmission. To understand the extent of state hegemony in the economy, consider the following passage from the diary of Sergio Ricossa (1927–2016):

The true Italian looks through Salmoiraghi glasses (IRI), consumes electricity from Finelettrica (IRI), listens to radio shows from RAI on Cetra records and advertisements from Sipra, smokes cigarettes from the tobacco State monopoly, makes telephone calls through IRI, eats salt from the State monopoly, bananas from the State monopoly, drinks mineral water from State-owned bottlers, entrusts his savings to IRI banks, reads newspapers supported by IRI advertisements, ENI, Monopolio, Totocalcio and further supported by the subsidies from the Cellulose Agency, travels on the State-owned railways, flies with Alitalia, gets a degree in State universities, and is buried in public graveyards. (Ricossa 1996, 62)

Privatizations only came about in the 1990s—and IRI, the allegedly temporary device to rescue the economy in the Great Depression, was officially liquidated in 2001.

In the postwar years, regardless of Einaudi’s prominence as head of state, classical liberal voices were feeble. The most important one was a Catholic priest, Luigi Sturzo (1871–1959), an outspoken opponent of the creeping nationalization of the Italian economy. Sturzo had founded the Italian Popular Party in 1919 and was virtually forced to leave the country. He visited England and the United States and developed a sincere appreciation for how these countries had historically kept substantial separation between government and the economy. Sturzo predicted that interventionism was fated to encourage the corruption of the political class, and he upheld a moral need for privatization. He denounced the growing Italian bureaucracy, claiming that it was suffocating smaller businesses whereas bigger ones found a complacent friend in government. In spite of the fact he was hailed as the great forerunner of Christian Democracy and a brave enemy

33. Sturzo was apparently somehow indirectly influenced by the liberisti even at the times of the founding of the Popular Party (see De Rosa 1958, 150).
of fascism, Sturzo was somewhat marginalized, and his articles of these years were published in a Rome newspaper, *Il Giornale d’Italia*, which lacked the circulation and prestige of the major papers.

Another figure fighting for the cause of a freer competition, and focusing particularly against state intervention as an illegitimate aid to unaccomplished capitalists, was Ernesto Rossi (1897–1967). Rossi was an economic journalist who engaged in a personal war with monopolies, both government-owned and private. Loyal to the teachings of Einaudi, he nonetheless appealed to the left and is considered an important critic of Italian capitalism—that is, of capitalism of the monopolistic bent. Neither Sturzo nor Rossi fared particularly well: Sturzo found little support in the Catholic camp, whereas Rossi was almost alone in the secular camp, in which the zeitgeist was wed to more interventionist policies.

**Bruno Leoni and Sergio Ricossa**

In 1963 Italy reached full employment, which gave labor unions more power with respect to employers. Particularly in the big industrial plants of the Northwest, labor relationships became an ideological battlefield. Political extremism was soon to plunge the country into a spiral of violent street clashes and terrorism, which culminated in the Red Brigades kidnapping and eventual murder of former prime minister Aldo Moro in 1978.

Italy had the largest Communist Party in the West, which in the 1970s sometimes won as much as 30 percent of the vote. But after the Communists lost the key election of 1948 and Italy joined NATO, they could never hope to govern the country, with the exception of local and regional administrations. This created a rather peculiar situation. On the one hand, the awareness on the left that the Communists could never really succeed in their attempt to rule the country conduced to radicalizing a good chunk of the left, since the indulgent foolishness was not meaningfully harmful to their electoral prospects. On the other hand, the Christian Democrat party, which stayed in power (albeit with different alliances) from 1948 to 1994—despite being in principle a center-right party—ended up internalizing most of the demands and assumptions of the left. The Christian Democrats oversaw an unprecedented expansion of public spending and, on top of that, resorted to nationalization as a means to govern the economy and create consensus. The refrain of ‘industrial policy’—that is, of governmentalized industrialization of ‘depressed’ economic areas—continued to work as an ideo-

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34. As Tocqueville said about the old regime in France: “because the spirit of political opposition…could not manifest itself in public life, it sought refuge in literature” (2011, 138).
logical fig leaf. Yet, in the public discourse of those years, Italian classical liberals were not confronted by a Keynesian consensus as in the Anglophonic countries in the same years; rather, they faced an intellectual climate dominated by Marxism and heavy leftism.

A leading Italian classical liberal in this period was Bruno Leoni, a law scholar. During WWII he joined the resistance against the German occupying forces and the Fascists and worked with the British espionage unit ‘A’ Force, charged with rescuing Allied prisoners behind enemy lines. Leoni was directly responsible for an operation that brought to safety some 130 British and American prisoners (Tumiati 1980).

Leoni was a flamboyant and energetic character, as well as an institution builder—truly, a Renaissance man. Besides being a full professor at the University of Pavia, he had a private practice as an attorney, he was a columnist for 24 Ora, a financial newspaper, and was politically active in the Liberal Party where, nonetheless, Leoni’s laissez-faire beliefs were marginalized. He became Dean of the Department of Political Science and, still in Pavia, he established and edited Il Politico, a scholarly journal that was to publish, in the next few years, articles by thinkers known to him through the Mont Pèlerin Society or other networks.35 They included, among others, Lionel Robbins, Wilhelm Roepke, Friedrich Hayek, Arthur Shenfield, James Buchanan, Ludwig von Mises, George Reisman, Hans Sennholz, Henry Hazlitt, Gottfried Haberler, B. R. Shenoy, Armen Alchian, P. T. Bauer, Yale Brozen, and Israel Kirzner.

Today, Leoni is mostly remembered for one book, Freedom and the Law (1961). The book originated from a series of lectures he gave at Claremont College in California, edited and collected by his friend Arthur Kemp. Leoni wished to correct what he considered a flaw in the argument Hayek developed in his Cairo Lectures, namely, Hayek’s conflation of the rule of law and the German Rechtstaat (Hayek 2014/1955). Leoni maintained that general and uniformly applicable norms did not necessarily amount to the rule of law, understood as a consistent and stable set of rules. He distinguished between short-term legal stability (the fact that rules were written and therefore easily accessible to citizens) and long-term legal stability (rooted in procedures that made legal changes more difficult than the case under simple majority rule). This brought Leoni to re-evaluate the British common law as part of a research project consistent with Hayek’s thought in exploring law as a spontaneous order. Freedom and the Law exercised a lasting influence. It was

35. During the early years of the Mont Pèlerin Society, started in 1947, there were few Italian members. They included Einaudi, the brilliant monetary economist and statistician Costantino Bresciani-Turroni (1882–1963), the philosopher Carlo Antoni (1896–1959), and the economist Giovanni De Maria (1899–1998) of Bocconi University. Leoni joined the Society in the mid-1950s, and he later became its Secretary and briefly President.
almost immediately translated (in Argentina) into Spanish and later Portuguese. The book is now available in Chinese, Russian, Czech, French, German, Polish, and Georgian. Ironically, an Italian translation appeared only in 1995.  

Leoni however left behind many essays, albeit in a somewhat scattered form, that in recent years have been reprinted or even made available for the very first time. These works include lectures on the philosophy of law and political science; comments written for the daily 24 Ore; a book on the history of economic thought; a cornucopia of scholarly book reviews published in Il Politico and essays on different topics (antitrust and monopoly, Marxism, the concept of consumer sovereignty, and many others). A number of these essays were translated into English and published in the anthology Law, Liberty, and the Competitive Market (Leoni 2009).

Leoni died in tragic circumstances in 1967, at age 54 and at the peak of his creative powers. We can only speculate what Leoni may have accomplished, had he lived longer. But Leoni’s impact seemed negligible in the years after his death. His immediate pupils were not necessarily interested in continuing his research program, nor did they much share his free-market views. 

With Leoni, Italian classical liberalism lost a champion interested both in advancing its scholarship and in disseminating its ideas. He helped Fulvio Guerrini (1916–1979), a Turin-based entrepreneur, in establishing the Centro Einaudi in 1963, two years after Einaudi’s death. Centro Einaudi published the journal Biblioteca della libertà, initially edited by journalist Piero Ostellino and still an impor-

36. This was possible thanks to the determination of a young political philosopher, Raimondo Cabeddu, and of Aldo Canovari, who with his publishing house Liberilibri has contributed substantially to the classical-liberal library of Italian readers.
37. Leoni was murdered by a tenant who wasn’t paying his rent to one of Leoni’s clients and that Leoni confronted.
38. The most notable was Mario Stoppino (1935–2001), who at the University of Pavia played a pivotal role in the development of political science in Italy.
39. Economist Franco Romani (1935–2002) studied under Bruno Leoni at the University of Pavia but became a professor in scienza delle finanze at the University of Siena in 1968. Romani shared Leoni’s thinking in law and economics and was a truly eminent Italian social scientist, of an adamantly classical-liberal orientation. He is best known for preparing the draft of the law that established the Italian Antitrust Authority, for which he served as a commissioner. Romani’s contributions to classical-liberal thinking, which include La società leggera (1995), are often neglected.
40. A partial exception is economist Francesco Forte. Forte is well known in the public choice economists’ circles and supports Ordoliberal policies in his journalistic undertakings. He took over Luigi Einaudi’s chair in Turin. A very prolific writer and a thinker with a genuine passion for the history of economics, Forte was nonetheless best known to Italians as a prominent member of the Socialist Party, for which he served three times as a cabinet minister.
41. Two other namesake foundations were established after Einaudi, both still active. One in Turin funds mainly historical research and maintains Einaudi’s library accessible to the public; the other in Rome was established by Valerio Zanone (1936–2016), a left-liberal politician who had a passion for the discussion of ideas.
tant platform for liberal scholars. Since the late 1970s, however, the Centro Einaudi also became a leading center for social-democratic liberalism, for example by first introducing philosopher John Rawls to the Italian public.

Economist Sergio Ricossa (1927–2016) was a personal, younger friend of Bruno Leoni and a member of the Mont Pèlerin Society. A skilled mathematical economist, Ricossa was one of the pioneers of linear programming in Italy and actively contributed to its taking roots in this country. From the 1970s, Ricossa moved increasingly in a libertarian direction. As an economic theorist, he attempted a refutation (Ricossa 1981) of the system of Piero Sraffa (1898–1983). A few years later, he wrote La fine dell’economia (Ricossa 2006/1986), an erudite treatise in which he provides a critique of both the Marxist and Keynesian varieties of interventionism. In a wide-ranging overview of the history of European political and economic thought, Ricossa identifies a “seigneurial mindset” that considers market relationships as essentially debased and uncouth. Such mindset goes hand-in-hand with a hubristic attitude that considers as desirable and possible the rise of a social order free of change (and exchange). The seigneurial mindset rejects “the pursuit of utility” in favor of “the quest for the true and righteous,” and it sees profit-seeking as inherently corrupt. The seigneurial mindset informs what Ricossa calls “perfectionism,” which is a set of doctrines that “preaches a worldly kingdom of perfection, without the dominion of the economic side of life” (2006/1986, 12). What “perfectionists” from either the left or the right cannot stand is innovators multiplying goods and services available for all individuals, and people autonomously deciding whether they like them or not. But the seigneurial mindset finds consumers irrational, as they would like both to avoid change and to have a society based on consumer’s freedom to choose. “Imperfectionists,” on the other hand, are happy to have the common people give it a go. They regard “perfection to be undesirable, even more than impossible, and the economic as only one among the other sides of our life, not a part of demonology” (ibid.).

Ricossa developed his Hayekian libertarianism through the route of economic history. Himself a man from humble origins, he came to see capitalism as an unprecedented great enrichment, not unlike the view of Deirdre McCloskey (2016). In a 1974 popular work, Storia della fatica, Ricossa forcefully made the case that the industrial revolution enriched the masses. He returned to the point in later works.

Ricossa was not an institution-builder, though he collaborated frequently with Cidas, a center founded in Turin by Natale Molari (1933–2013), an engineer

42. Later editors were Fulvio Guerrini, Giovanna Zincone, Angelo Maria Petroni, Anna Caffarena, Pier Giuseppe Monateri and now Salvatore Carnubba and Maurizio Ferrera.
43. The acronym stands for Centro Italiano Documentazione Azione Studi (Italian Center for Documentation, Action and Study).
animated by a warm political passion. Over the years, Cidas organized many conferences and events including, in 1986, a Mont Pèlerin Society General meeting in Val d’Aosta. Ricossa’s great gift was not a talent for organization but his prose, which made him a brilliant popularizer for the economic way of thinking and classical liberalism.

The primary vehicle for Ricossa’s popularization of classical-liberal ideas was *Il Giornale*, a Milan-based newspaper edited by veteran journalist Indro Montanelli (1909–2001). Montanelli succeeded in bringing together what was left of an intellectual clerisy sympathetic to broadly-defined right-of-center positions, including free-market economics. In his columns in the late 1990s Ricossa announced his conversion to libertarian anarchism, thereby coming to help a young group of scholars engaged in wide-ranging translations of texts by giving them a greater visibility.  

Ricossa was not alone in preaching free-market economics from the columns of *Il Giornale*. He was soon joined by Antonio Martino, a young professor in Rome who, after graduation, spent a year at Chicago, where he was strongly influenced by Milton Friedman’s lectures. Martino was in 1982–1988 the Director of Centro Ricerche Economiche Applicate (CREA), a think tank in Rome, and in 1988–1990 President of Mont Pèlerin. Established with money from telecom pioneer Virgilio Floriani (1906–2000), CREA operated for six years, organizing seminars and publishing outreach and policy work.

In 1986 Martino and Ricossa together addressed a spontaneous and, in Italy, unheard-of uprising of taxpayers: a “March Against Taxes” (“Marcia contro il fisco”) which was attended by several thousand people. The march didn’t manage to spark off a political initiative, but Martino’s future lay in politics. He was recruited in 1994 by entrepreneur Silvio Berlusconi, when he launched his own political party, Forza Italia. Martino sketched the party’s platform, which originally included a flat tax proposal. The party surprisingly won the next national election and Martino was appointed minister in the cabinet led by Berlusconi. Alas, his remit was not the Treasury, but Foreign Affairs. When the party won again an election in 2001, he was moved to Defense. Although Berlusconi never fully abandoned a rhetoric of lower taxes and less regulation, the ideas that Martino sketched in the original party platform were never implemented. The governments led by Berlusconi were not overcrowded by free-marketers in top positions. In 2001–2003, Vito Tanzi, a

44. This group of scholars initially included Luigi Marco Bassani, Nicola Iannello, Carlo Lottieri and Guglielmo Piombini. They promoted the publication of such authors as Rothbard, Bastiat, and Gustave De Molinari. Most of these translations were published by Liberilibri. The increasing availability of classical liberal and libertarian literature in Italy was propelled by a few serious—and, at the beginning, almost underground—editorial initiatives, like Florindo Rubbettino’s and Leonardo Facco’s. Rubbettino is now a respectable academic publisher, with some 100 new titles published each year.
former Director of the Fiscal Affairs Department at the IMF and a leading fiscal expert, was State Secretary for Economy and Finance; his experience was short and not particularly fecund.  

Ricossa and Martino were the most visible Italian classical liberals of their generation. Saying that they were the only ones would be a slight exaggeration. Fellow Mont Pèlerin members included Domenico Da Empoli (1941–2016), a public choice scholar in Rome, and Angelo Maria Petroni, a philosopher. Petroni was the editor of Centro Einaudi’s Biblioteca della libertà and in the 1990s he contributed to initiatives, like the magazine Ideazione, that aimed to create a political culture around Berlusconi’s party. In Rome, philosopher Dario Antiseri and sociologist Lorenzo Infantino were active at the Libera Università Internazionale degli Studi Sociali (LUISS) and promoted a wide-ranging program of translations. Antiseri, the author of a widely circulated high school textbook and a Catholic, ostensibly helped to rediscover the relevance of figures such as Sturzo and Rosmini, both classical liberals and priests.

A messy but lively scene

Painting with a broad brush, we may say that in the 1950s and 1960s the economists that Italy exported tended to gravitate around Cambridge, where Piero Sraffa was called by Keynes in 1927. Not a classical liberal, Sraffa, who had studied with Einaudi in Turin, became one of the most prominent economists of his generation and also had a significant influence in his native country.

Later in time, the diaspora of Italian economists in the English-speaking world became far less ideologically characterized. Today the most internationally renowned Italian economists are as a rule quite distant from Sraffa’s ideological coordinates. This went hand-in-hand with the process of making academic economics in their own country less provincial and more open to new ideas from abroad. It is safe to say that in the last fifteen years of the 20th century Italian economics became increasingly academified, with contemporary neoclassical economics becoming the dominant paradigm. The most prestigious economic department in the country is at Università Luigi Bocconi in Milan, a private university established in 1902. Both Luigi Einaudi and Gaetano Mosca taught at Bocconi. Particularly after World War II, Bocconi became a seeding ground of the

45. Tanzi (2006) refers to the lessons learned in this experience. Tanzi holds a Harvard Ph.D. and is a former professor and chairman of the Department of Economics at American University, and he is a public finance economist who in many ways has continued the Italian tradition. For his broader reflections on the role of government and markets, see Tanzi 2011.
Italian elites and was one of the first universities to create strong international links with other academic institutions. Bocconi has no particular ideological orientation, though it is certainly home to many left-of-center economists. But in the public debate Bocconi is sometimes associated with a more classical liberal approach, as compared with other academic institutions.

Since 1994, the President of Bocconi University has been Mario Monti, who twice was an European Commissioner (first for the Internal Market, later for Competition) and was Italian Prime Minister (in 2011–2013) before establishing his own political party, which he left after a disappointing performance in the 2013 national election. Monti has been an active participant in the Italian policy debate for decades, particularly as a commentator for Corriere della Sera, the prestigious Milan newspaper. Sometimes associated with a version of Ordoliberalism, Monti helped to make issues like dismantling monopolies and limiting state aid important topics in the Italian agenda.46

Francesco Giavazzi, a colleague of Monti at Bocconi and a visiting professor at MIT is arguably the most visible Italian economist today beyond the boundaries of the economic profession. As a popular writer, Giavazzi has authored articles and books, some in partnership with Harvard’s Alberto Alesina, often arguing that market-oriented reforms can benefit the poor, that il liberismo è di sinistra (Alesina and Giavazzi 2007). Giavazzi has argued that vigorous spending cuts today can be the harbinger of an expansionary change in fiscal policy tomorrow (Giavazzi and Pagano 1990). Such ‘expansionary austerity’ literature has seen contributions from Alesina and from Roberto Perotti.

Perotti, also a professor at Bocconi, has actively commented for Il Sole 24 Ore, a daily newspaper owned by the association of Italian industries, Confindustria, which has often provided space for market-friendly viewpoints. In 2014–2015, Perotti served as an unpaid consultant to the Italian government led by Matteo Renzi, to draft a ‘spending review’ purportedly aimed at rationalizing public spending. Perotti resigned and little of the original project was accomplished.

Alesina has also written on the role of institutions and culture, federalism and decentralization, the effect of cultural differences between the United States and European countries, and much more. The interplay of institutions and culture is a topic of interest for Guido Tabellini,47 who is also a Professor and a former Rector

46. Blyth (2013, 167) is convinced that Bocconi produced “two generations of economists reared in… ordoliberal views” because Luigi Einaudi started teaching there in 1920. But this contention lacks evidence, not only because Einaudi did not establish a ‘school’ in a proper sense, but also because he was evicted from Bocconi as early as 1925, as he opposed fascism.

47. For a summary of Tabellini’s approach see Tabellini 2008. The various dimensions of culture and its interplay with institutions and social norms seem to be of great importance for Italian-born economists
at Bocconi. Like his colleagues, Tabellini takes an active part in the public debate, writing columns for *Il Sole 24 Ore*.

These economists, in the fashion of careful scholars, eschew labels such as ‘classical liberal’ or ‘libertarian,’ but they often preach the virtues of market-oriented public policy. A proud *liberista*, instead, is Enrico Colombatto, a professor at the University of Turin. He published an ambitious “new defence of free-market economics” (Colombatto 2012) and has also engaged in institution building. From 1991 to 2014, he was the Director and the main force behind International Centre for Economic Research (ICER), a think tank in Turin. ICER had to close, after many years of success, for lack of funds.

Think tanks have a hard life in Italy. They still seem foreign in the Italian political and social culture. For one thing, Italy has little tradition of non-profit, non-Church fundraising. For another, during most of its democratic history political foundations were monopolized by political parties.

In its global directory, the free-market umbrella organization Atlas Network lists a number of think tanks active in Italy: the Italian subsidiary of the Acton Institute; the Centro Studi Tocqueville-Acton animated by Flavio Felice, professor of Economic and Political Thought, which also aims at building bridges between Catholics and classical liberals; Think In, focused on labor policy and founded by Giuseppe Sabella, whose background is in Philosophy; Lodi Liberale, which organizes conferences and debates in Lodi; and Istituto Bruno Leoni, of which the present author is the Director General. A non-Atlas group worth noting is the Adam Smith Society, whose name recalls the Società Adamo Smith established by Francesco Ferrara; it is a club of professionals in Milan that, under the leadership of Alessandro De Nicola, a lawyer and a witty advocate of classical liberalism in Italian newspapers (he is currently a columnist for *La Repubblica*, the second Italian newspaper in circulation), organizes frequent roundtables and conferences. 48

Istituto Bruno Leoni is arguably the most substantial of these efforts, with some 60 events organized a year and many other activities, including a publication catalog of over 170 books (including translations of Hayek, Friedman, Vernon Smith, John Taylor, and many others). Still, with a staff of about ten full-time employees, IBL is far from the strength of American think tanks. Recently the

(see Alesina and Giuliano 2015; Bisin and Verdier 2001; Giavazzi, Petkov, and Schiantarelli 2014; Guiso, Sapienza, and Zingales 2006).

48. De Nicola is by no means the only non-economist who actively contributes to the public debate by providing a classical liberal viewpoint. Angelo Panbianco, one of the country’s most distinguished political scientist from the University of Bologna, is a columnist for *Corriere della Sera*; Giovanni Orsina, who teaches contemporary history at LUISS in Rome, writes for Turin-based *La Stampa*; Gilberto Corbellini, a bioethicist who teaches at La Sapienza University in Rome, writes regularly for the Sunday supplement of *Il Sole 24 Ore*; and Luca Ricolfi, a sociologist from the University of Turin, writes likewise for *Il Sole 24 Ore*.
Institute’s reputation was aided by the chairmanship of Nicola Rossi and, later, Franco Debenedetti, both having been members of Parliament with left-wing parties in the 1990s and having helped the privatization process that was started then by left-of-center governments.\footnote{Notwithstanding the many shortcomings of its Director General, IBL is however blessed by a marvelous staff and team of scholars. I shall mention, among those who most frequently intervene in the public debate, Serena Sileoni, a law scholar and the Institute’s Deputy Director General, and Carlo Lottieri, a philosopher and one of the pillars of the Italian libertarian movement.}

None of the organizations just listed are run by professional economists. If this often means that they fail in mobilizing the vast human capital of Italian economists spread out all over the world, most notably in the United States, it nonetheless reflects a trend that stretches back to the 1990s, when it was not economists but rather Antiseri and Infantino—scholars from other disciplines—who began to publish and promote works in the classical liberal tradition.

But it was a group of prominent economists that was to start perhaps the boldest attempt to push liberal-oriented reforms in Italy, just before the election of 2013. For a few years, a number of expatriate economists led by Michele Boldrin of Washington University in St. Louis and Alberto Bisin of New York University maintained the blog \textit{Noisefromamerika} to voice the dissent of Italian-born economists over the policies implemented in their motherland. This dissent was particularly harsh under the ostensibly free-market governments led by Berlusconi.\footnote{Notably, Boldrin, Bisin, and their colleagues debunked the protectionist statements of then-Minister of Finance Giulio Tremonti (see Rustichini et al. 2011).}

Boldrin and Bisin were among the signatories of a 2009 manifesto promoted by the Cato Institute against President Obama’s economic stimulus (link).\footnote{Boldrin is also the author of \textit{Against Intellectual Monopoly}, with David K. Levine, a text cherished by libertarians (Boldrin and Levine 2008).} In 2012, they themselves promoted a manifesto in Italy, “To Stop the Decline,” signed by a number of opinion-makers and entrepreneurs. The co-writers of the manifesto were Alessandro De Nicola of the Adam Smith Society and Carlo Stagnaro, at the time Research Director of Istituto Bruno Leoni,\footnote{Stagnaro, an energy expert who holds a Ph.D. in Economics from IMT Lucca, is now Chief of Staff of the Minister of Economic Development.} together with Sandro Brusco of Stony Brook University and Luigi Zingales, who is Finance professor at the University of Chicago Booth School of Business. Zingales is perhaps the best known free-market economist with an Italian family name. Besides his technical work, he is author of two acclaimed popular books, one with Raghuram Rajan, \textit{Saving Capitalism from the Capitalists} (Rajan and Zingales 2003) and \textit{A Capitalism for the People: Recapturing the Lost Genius of American Prosperity} (Zingales 2012).\footnote{Zingales seems sometimes to neglect the political realism of the Italian tradition, taking rather a more positive view of regulators (see Henderson 2012).}

\footnote{49. Notwithstanding the many shortcomings of its Director General, IBL is however blessed by a marvelous staff and team of scholars. I shall mention, among those who most frequently intervene in the public debate, Serena Sileoni, a law scholar and the Institute’s Deputy Director General, and Carlo Lottieri, a philosopher and one of the pillars of the Italian libertarian movement.}

\footnote{50. Notably, Boldrin, Bisin, and their colleagues debunked the protectionist statements of then-Minister of Finance Giulio Tremonti (see Rustichini et al. 2011).}

\footnote{51. Boldrin is also the author of \textit{Against Intellectual Monopoly}, with David K. Levine, a text cherished by libertarians (Boldrin and Levine 2008).}

\footnote{52. Stagnaro, an energy expert who holds a Ph.D. in Economics from IMT Lucca, is now Chief of Staff of the Minister of Economic Development.}

\footnote{53. Zingales seems sometimes to neglect the political realism of the Italian tradition, taking rather a more positive view of regulators (see Henderson 2012).}
The 2012 manifesto eventually produced a political party, with Oscar Giannino as spokesman. An economic journalist, Giannino became a talk radio host and, as such, rallied impressive support for aggressive tax and spending cuts and deregulation. Giannino ran for Parliament as the party leader until, one week before the election day, he was exposed by Zingales for having lied about his academic qualifications. Though it was never obvious that the party would have passed the threshold of 3 percent necessary to elect an MP, after Zingales’s exposé the party won a modest 1.2 percent. After this failure, Boldrin succeeded Giannino in the leadership of the party and made great efforts to mobilize its remains for the 2014 European election, but to no avail.

The Italian classical liberal scene is thus certainly messy, but lively, too. Classical liberal voices are increasingly available in the print press, they circulate in blogs and social media, and occasionally are heard on television. The landscape includes economists and scholars who have not lost the passion for joining public debate—and, in this respect, they are worthy descendants of that rich tradition which originated with Francesco Ferrara.

References


54. The inaccurate information was also displayed on the website of Istituto Bruno Leoni, which had—and still has—a close relationship with Giannino (that, however, did not extend to this political endeavors). Giannino is still a radio host and an influential opinion-maker. His fabrication shocked many, but he succeeded in retaining the friendship of many others, who are convinced that he was impelled to invent his degrees by a kind of psychological compulsion and who value his many talents.


Alberto Mingardi is the Director General of the Istituto Bruno Leoni in Turin, Italy, the think tank he helped to establish in 2003. He holds a Ph.D. in Political Science from the University of Pavia. He did research activity in History of Political Thought at the University of Milan. He has translated Antonio Rosmini’s *The Constitution under Social Justice*, edited critical Italian editions of works by Thomas Hodgskin and Herbert Spencer, and most recently authored a monograph on Hodgskin. In 2013, he wrote a primer on free-market economics, *L'intelligenza del denaro: Perché il mercato ha ragione anche quando ha torto*. He regularly blogs at EconLog. His email address is alberto.mingardi@brunoleoni.com.

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Faculty Voter Registration: Rectifying the Omission of Two Florida Universities

Mitchell Langbert¹, Anthony J. Quain, and Daniel B. Klein²

In the previous issue of this journal (September 2016) we published “Faculty Voter Registration in Economics, History, Journalism, Law, and Psychology” (Langbert, Quain, and Klein 2016), which focuses on the ratio of registered Democrats to registered Republicans among faculty at 40 top universities. Sean T. Stevens, in preparing a blog post (Stevens 2016) for Heterodox Academy, scrutinized our article and caught a problem, and then on 3 October 2016 kindly sent us a query about it. Sean had noticed that in footnote 5 (p. 424) we list University of Florida and University of Miami as among those universities that, though ranked high enough by U.S. News and World Report to be included in our investigation,³ were not included because they sit in states not covered by Aristotle (the database used for the study). But Sean saw that in footnote 4 (p. 423), which listed the states not included in Aristotle, Florida is not listed. Florida is in fact covered by Aristotle, so those two Florida universities should have been included in our investigation. We had mistakenly gotten it into our heads that Florida was one of the states not covered by Aristotle, prepared our list of schools to investigate, and never realized our error until Sean brought it to our attention.

To rectify our coverage error, we now present an investigation of the two universities that were mistakenly left out of our analysis. Although our subscription

¹. Brooklyn College, City University of New York, Brooklyn, NY 11210.
². George Mason University, Fairfax, VA 22030.
³. The U.S. News and World Report 2016 ranking is not available online as of this writing, so we have scanned the print version (U.S. News and World Report 2016, 74–76) and uploaded images showing the ranking here.
to Aristotle had expired, Aristotle generously restored to us temporary access to rectify the problem. We are grateful to Sean for catching our error and bringing it to our attention, and to Aristotle for generously allowing us additional access. 4

The findings for the two omitted Florida universities, the University of Miami and the University of Florida, are consistent with the findings in our initial sample of 40 institutions. With the present addendum, our revised investigation now covers 42 top universities. In the new grand set, the either-registered-Democrat-or-registered-Republican faculty from the newly added universities constitutes 6.1 percent of that of faculty of all 42 schools. As it turns out, the overall Democrat to Republican ratio (or, D:R ratio) changes so little that it is the same to the first decimal point, 11.5:1. Three of the five disciplinary ratios change slightly. In this paper we provide addenda and redo some of the central displays. We use an “A” to label the new tables and figures, following the numbering of the original article’s tables and figures. We present tables labeled A1, A2, and A3, and figures labeled A2 and A7.

Table A1 is the addendum to the original Table 1. Notice at the bottom that the overall D:R ratio remains the same as it had been, 11.5:1. 5 Table A2 replaces the original Table 2.

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<tbody>
<tr>
<td>44</td>
<td>U. of Miami</td>
<td>171</td>
<td>38</td>
<td>23</td>
<td>97</td>
<td>11</td>
<td>8.8:1</td>
<td>2</td>
</tr>
<tr>
<td>50</td>
<td>U. of Florida</td>
<td>215</td>
<td>46</td>
<td>22</td>
<td>137</td>
<td>9</td>
<td>15.2:1</td>
<td>1</td>
</tr>
<tr>
<td>Florida total</td>
<td></td>
<td>386</td>
<td>84</td>
<td>45</td>
<td>234</td>
<td>20</td>
<td>11.7:1</td>
<td>3</td>
</tr>
<tr>
<td>Total from original Table 1</td>
<td></td>
<td>7,243</td>
<td>2,120</td>
<td>1,145</td>
<td>3,623</td>
<td>314</td>
<td>11.5:1</td>
<td>41</td>
</tr>
<tr>
<td>Total, revised</td>
<td></td>
<td>7,629</td>
<td>2,204</td>
<td>1,190</td>
<td>3,857</td>
<td>334</td>
<td>11.5:1</td>
<td>44</td>
</tr>
</tbody>
</table>

Notes: (a) Not Registered includes noncitizens, individuals who cannot be reasonably identified because of similarities of names and other identifying information, individuals who have moved, and individuals who are not registered. (b) Not Affiliated includes individuals who are registered but not officially associated with a party.

4. Incidentally, the day after Sean’s bringing the coverage error to our attention, we alerted readers to it here, here, and here.

5. Seeing that the three minor party registrants found in Florida were to the Independent Party of Florida (described here), which we will treat as a left-oriented party, in this note we revise a statement made on page 426 of our original paper. The number of left minor-party registrants in the Psychology department of the University of Miami exceeds the number of Republicans (two versus one), and in the History departments of both schools the number of Republicans and the number of minor-party registrants are both zero, so now we say: In 74 departments (or, 41 percent) of the 180 departments investigated, the number of left minor-party registrants equals or exceeds the number of Republican registrants.
### TABLE A2. Not Registered and Not Affiliated rates by discipline

<table>
<thead>
<tr>
<th>Discipline</th>
<th>N on look-up list</th>
<th>Democratic</th>
<th>Republican</th>
<th>D:R ratio</th>
<th>Minority-party</th>
<th>Not Affiliated</th>
<th>Not Registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economics</td>
<td>1,530</td>
<td>459 (30.0%)</td>
<td>103 (6.7%)</td>
<td>4.5:1</td>
<td>7 (0.4%)</td>
<td>291 (19.0%)</td>
<td>670 (43.8%)</td>
</tr>
<tr>
<td>History</td>
<td>1,917</td>
<td>1,088 (56.8%)</td>
<td>31 (1.6%)</td>
<td>35.1:1</td>
<td>11 (0.6%)</td>
<td>253 (13.2%)</td>
<td>534 (27.9%)</td>
</tr>
<tr>
<td>Journalism/Communications</td>
<td>514</td>
<td>238 (46.3%)</td>
<td>13 (2.5%)</td>
<td>18.3:1</td>
<td>5 (1.0%)</td>
<td>96 (18.7%)</td>
<td>162 (31.5%)</td>
</tr>
<tr>
<td>Law</td>
<td>1,962</td>
<td>1,159 (59.1%)</td>
<td>134 (6.8%)</td>
<td>8.6:1</td>
<td>7 (0.3%)</td>
<td>268 (13.7%)</td>
<td>394 (20.1%)</td>
</tr>
<tr>
<td>Psychology</td>
<td>1,706</td>
<td>913 (53.5%)</td>
<td>53 (3.1%)</td>
<td>17.2:1</td>
<td>14 (0.8%)</td>
<td>282 (16.5%)</td>
<td>444 (26.0%)</td>
</tr>
<tr>
<td>Total</td>
<td>7,629</td>
<td>3,857 (50.6%)</td>
<td>334 (4.4%)</td>
<td>11.5:1</td>
<td>44 (0.6%)</td>
<td>1,190 (15.6%)</td>
<td>2,204 (28.9%)</td>
</tr>
</tbody>
</table>

Table A3 is the addendum to the original Table 3. Both of the Florida schools have all five disciplinary departments, so 10 departments are now added, making 180. From the bottom rows of Table A3, notice that the D:R ratio remains unchanged for both Economics and Law, goes up slightly for History, and goes down slightly for Journalism/Communications and Psychology.

### TABLE A3. D:R ratios by institution and field (raw counts in parentheses)

<table>
<thead>
<tr>
<th></th>
<th>Economics</th>
<th>History</th>
<th>Journalism/Comms.</th>
<th>Law</th>
<th>Psychology</th>
<th>Total</th>
<th>N of depts w/ zero Rs</th>
</tr>
</thead>
<tbody>
<tr>
<td>U. of Miami</td>
<td>0:3</td>
<td>160</td>
<td>10:1</td>
<td>7.2:1</td>
<td>28:1</td>
<td>8.8:1</td>
<td>1 of 5</td>
</tr>
<tr>
<td>Original total</td>
<td>4.5:1</td>
<td>33.5:1</td>
<td>20:1</td>
<td>8.6:1</td>
<td>17:4:1</td>
<td>11.5:1</td>
<td>66 of 170</td>
</tr>
<tr>
<td>New total</td>
<td>4.5:1</td>
<td>35.1:1</td>
<td>18.3:1</td>
<td>8.6:1</td>
<td>17:2:1</td>
<td>11.5:1</td>
<td>68 of 180</td>
</tr>
</tbody>
</table>

The economics department of the University of Miami adds a wrinkle because it has zero Democrats and three Republicans. In addition to the four departments found previously—Pepperdine Economics, Pepperdine History, Pepperdine Law, and Ohio State Economics—we add University of Miami Economics: In five of the 180 departments investigated, or 2.8 percent, do Republicans outnumber Democrats.

Figure A2 is simply a handy display and replaces the original Figure 2. Figure A7 adds Florida as a region and replaces the original Figure 7.
Other results in the original paper—regarding D:R ratios in relation to gender, professor title and age, and prestige of the school—have not been redone. We presume that they would change little. Again, in the new grand set, Florida’s either-D-or-R faculty constitutes only 6.1 percent of that of faculty of all 42 schools.
References


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Mitchell Langbert is an associate professor of business at Brooklyn College. He holds an MBA from UCLA, an MBA from the St. John’s University School of Risk and Insurance (formerly the College of Insurance), and a Ph.D. in industrial relations from the Columbia University Graduate School of Business. His research has been published in journals such as *Human Resource Management Journal*, *Journal of Business Ethics*, *Academy of Management Learning and Education Journal*, *Benefits Quarterly*, *Journal of Labor Research*, and *Journal of Economic Issues*. At Brooklyn College he teaches managerial skills, human resources, and business writing. His email address is mlangbert@hvc.rr.com.

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Econ 101 Morality: The Amiable, the Mundane, and the Market

J. R. Clark¹ and Dwight R. Lee²

No economic system operates perfectly, but none has ever rivaled market-based liberalism at creating wealth and providing opportunities for human flourishing. So why are so many people so hostile to free markets?

When we were young professors, long ago, each of us puzzled over the question, particularly as teachers. We assumed the hostility resulted from ignorance, that is, from students’ simply never having been taught to see how markets make it possible for billions of people to cooperate. We designed our principles courses to rely on examples and stories to explain Adam Smith’s invisible hand, confident that appreciation for markets would follow. We had assumed that highlighting how our standard of living is improved through free enterprise is sufficient to make a strong case for markets. But over the years we continued to be rather disappointed with our results in the classroom. It eventually dawned on us that hostility toward free enterprise is based on what many see as the immorality of markets. Even if markets produce certain beneficial results, those results are contaminated by an immoral process.

Our joint search³ led to a troubling question. Could Smith’s invisible-hand metaphor, which is the basis for understanding the benefits of markets, be leading many to see markets as morally flawed? We soon became convinced that the

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2. Southern Methodist University, Dallas, TX 75275.
3. We developed some of the arguments that grew out of these discussions in Clark and Lee 2011. The present paper is offered as a substantial modification of that paper, with the emphasis on improving the teaching of economic principles.
answer is yes. This created the problem of trying to make a convincing moral case for markets when many people regard markets as inherently immoral.

We now believe that by understanding the wellsprings of moral sentiments it becomes possible to make a more compelling case for the morality of free markets than is being done today even in courses that attempt such edification. We now believe that to edify students in economics we must be moral philosophers. We begin by considering the morality that predisposes many to be hostile to markets, and we point out it is a morality that is essential to human happiness and should be warmly embraced in the principles course.

The morality of helping familiars

For most of human history we lived in small bands as hunters and gatherers with little contact with those of other bands. When such contact did occur it often involved raids and battles that killed a far larger percentage of the population than modern warfare.\(^4\) There was little trade between bands, so each was largely self-sufficient, with people in each band depending primarily on each other. Helping members of one’s band took such forms as providing them with food, shelter, clothing, protection, and extra attention when needed. When some were successful acquiring food, they shared with the less successful. When some were sick or disabled, they received care from others in the band. When some needed their shelter repaired or replaced, they received help with the construction. Such help and sharing was given personally and motivated by a sense of caring. There were surely expectations of reciprocity, but it was based on familiarity within the band, not on formal contracts that would have suggested the help was provided for personal gain.

So those who willingly (1) provided help intentionally, (2) at some personal sacrifice, (3) to identifiable others were recognized as valuable members of the band. Such recognition increased one’s status and prospects, while lacking it could result in expulsion from the band, which was often a death sentence. Favorable reactions to behavior satisfying the above three conditions became part of our emotional makeup; such behavior was expected, supposed to be owed—moral. We refer to these instincts as *amiable morality*;\(^5\) it is morality as exists among friends and familiars, who are in a position to enter into one another’s situation, and with

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4. See Keeley 1996, chs. 4–8; Pinker 2011.
5. We caution the reader not to map our distinction between “amiable” and “mundane” directly onto Smith’s distinction between “amiable” and “respectable” virtues (TMS, 23–26); there is some affinity between our “amiable” idea and his, but our distinction and his are not the same thing.
knowledge and relations good enough to really help. People are emotionally programmed to respond favorably to behavior consistent with this morality and unfavorably to behavior inconsistent with it.

We propose, then, that in teaching Econ 101 you suggest to students that they have amiable-morality instincts that predispose them against markets, and that you speak of the ancestral band as an explanation for such predisposition: We evolved in a setting that selected for instincts that, today, are unsuitable in many realms of social life, realms distinctly modern.

We realize that our proposal poses certain challenges. You may need to bone up on the ancestral band and evolution. And then there are the controversial aspects of talking evolution. Some students will, from religious convictions, be uncomfortable with an evolutionary explanation for amiable-morality instincts. You may remind the class that evolution by no means entails a denial of divine providence, and that in *The Theory of Moral Sentiments* Smith repeatedly affirms divine providence. Next, there is the discomfort with explanations involving genetic predispositions. Here you can mention that the moral dissonance arising from the genetic inheritance of the human animal living in the modern world is a problem that is not specific to certain types of human beings but rather is universal. Tell them that Smith propounded a universality of humankind, and, indeed, greatly advanced the condemnation of any kind of group supremacy. Smith taught that all of humankind began its career in a long existence as small hunter-gatherer groups (LJ, 14–16, 27–28, 201–221, 459; WN, 691, 709), in which familiarity prevailed and where survival depended on amiable morality. Amiable morality is deep within all of us.

In Smith’s way of thinking, it is natural to apply the idea of amiable morality even inward, to one’s own familiarity and friendship with oneself. In *The Theory of Moral Sentiments*, Smith spoke of the conscience as “the man within the breast” and said that self-approval is the greater part of tranquility and happiness. Here again the amiable morality operates with local knowledge and a meaningful ongoing relationship—your relationship with yourself. Smith in fact wrote of looking into the mirror and viewing one’s own face: “whether handsome or ugly, whether old or young, it is the face of a friend always, of which the features correspond exactly

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7. Some of Smith’s most notable apparent affirmations of divine providence are at TMS, 87, 106, 128, 165–166, 170, 176, 184, 235–236. In this article, we use the standard abbreviations when citing Smith’s works: TMS, WN, LJ, and EPS, with page citations to the Glasgow/OUP/Liberty Fund editions.

with whatever sentiment, emotion, or passion we may happen at that moment to feel” (EPS, 186).

Today the emotional response of amiable morality is alive in the incomparable value we continue to receive from the love and commitment that we have for our family and friends, and that they have for us, as well as in our own self-esteem. This value should be warmly embraced, even preached, in economics courses—after all, economics courses are concerned with the production of value. Smith at one point in *The Wealth of Nations* associated the wealth of nations with “the good cheer of private families” (440). We tell our students that they should not try to base their familiar relationships on formal rules and strict contractual obligations; doing so would seriously damage those relationships and the happiness they engender.

The emotional appeal of amiable morality is fully justified, but it can, and often does, blind us to, or pit us against, another morality, one that is also critical to human well-being but that has less instinctive emotional appeal. We are referring to the morality that makes it possible for multitudes of widely dispersed people who don’t know us, care about us, or intend to help us, to act as if they do.

**The morality of helping non-familiars**

A non-familiar is a person you do not know or perhaps even ever see; you and she are in no position to enter into one another’s situation, except perhaps at brief points of contact. Still, we all benefit every day from the help of billions of non-familiars. Somehow, billions of non-familiars work together. To our band ancestors it would have been astounding, and it can still astound us today, when we view the world in the amiable mode. Smith brought wonder and amazement to his reader in the very first chapter of *The Wealth of Nations* by filling two pages with a description of the various and far-flung efforts and inputs—“which often come from the remotest corners of the world!”—that flow into the production of the ordinary woolen coat owned and worn by the “day-labourer” (22–24). Smith put the amazing fact of immense cooperation of non-familiars front and center.

Today, in people’s daily lives, however, it is seldom that any thought is given to how amazing this help is, or how incredibly poor we would be without it. Walking into a supermarket containing some 40,000 different items is so routine that most people take it for granted.9 The things we seek when we go shopping are waiting for us, and we assume that will continue to be so, as though part of the

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9. The average number of different items carried by a U.S. supermarket in 2015 was 39,500, according to Food Marketing Institute, a trade association ([link](#)).
natural landscape. Getting students to be astounded by the vast system of helping is
the first step in appreciating and understanding the importance of Smith’s invisible
hand, which we might paraphrase as: Though intending only improvements to our
own amiable world, we are led by an invisible hand to promote improvements to
amiable worlds of others.

Most economics professors find the operation of the invisible hand fascina-
ting, but many are captivated with technical approaches to studying its operation,
and many ignore its moral facets. Some professors do talk of morality but only
in regard to the morality of the market outcomes that the invisible hand makes
possible. Also, those students who are most fascinated by the global cooperation of
the invisible hand, or the elegance of the analysis used to understand it, commonly
see morality as of secondary interest. Meanwhile, the students who are most inter-
ested in moral concerns are often disturbed by an immorality they see implied by
the invisible hand. Such students see actors in the invisible-hand story as violating
every tenet of amiable morality: People help others, but they do not do it intentionally,
they are instead motivated by their personal gain, and their help is of an impersonal
form, being conferred upon no one in particular. Indeed, students often think that
talk of billions of people participating in an ‘immense cooperation’ sounds fishy. It
doesn’t feel like real cooperation. How can people be cooperating when they don’t
even know each other, or even know what one another is doing? How can people
be cooperating when there is no one supervising the putative cooperation? Many
students grow suspicious. Many cannot help but suspect that markets depend on
behavior that, at best, is lacking in what most people instinctively see as morality.

In fact, the invisible hand does proceed upon a morality, but it is a morality
rather lacking in emotional appeal. Said morality involves obeying the widely ac-
cepted rules and norms of honoring your promises and contractual obligations
and respecting others’ persons and property. Practicing such virtues hardly seems
warm or amiable; they may seem so mundane as to not deserve the name virtue. But
virtues they are. They constitute mundane morality. It is similar to what Smith calls
“mere justice” or “commutative justice,” “which consists in abstaining from what
is another’s” (TMS, 269).

The adjectives mere and mundane do not belittle the importance of such vir-
tues. Smith names as the second duty of the sovereign “the duty of protecting, as
far as possible, every member of society from the injustice or oppression of every
other member of it, or the duty of establishing an exact administration of justice”
(WN, 687). This justice, like mundane morality, is necessary if we are to help and are
to be helped by myriad non-familars. In the matter of personal security, mundane
morality substitutes for amiable morality. Smith observes that mere justice in
commercial societies serves to substitute for the clan-like system of security of
small groups, and “the descendants of the same family…naturally separate and
disperse, as interest or inclination may direct” (TMS, 223). Now, in commercial society, the helping system—the ‘immense cooperation’—must rely greatly on mundane morality: Amiable morality simply cannot work, or even make sense, without genuine familiarity.

How outcomes are perceived depends on how they are achieved

Smith embraced mundane morality and its correlate, a presumption of liberty or free enterprise, because he understood them to conduce to cooperation with the Deity (TMS, 166). By writing and teaching, he attempted to infuse the mundane with a speculative amiableness. But it is a hard sell. Few see free enterprise in such a light.

Consider a few examples of outcomes motivated by amiable morality being perceived positively when similar, often superior, outcomes achieved through markets are perceived negatively.

Barn raising

When members of a community intentionally help a neighbor repair or replace his damaged barn, the result is an emotionally appealing example of amiable and genuine cooperation, as is beautifully depicted in the film *Witness.* The amiable morality motivating a traditional barn raising, however, cannot be depended on to extend effectively beyond the limits of small, close-knit communities, such as the Amish depicted in the film. Whereas, the mundane morality of markets allows millions to help those who experience such losses, through the large risk pools that insurance companies create. With insurance, the help arrives in the form of cash that recipients can use to purchase the needed work from professionals, who typically will do a better job with fewer injuries than in a community barn raising. But the relatively impersonal processes of buying and selling insurance policies, checking on the veracity of damage claims, buying services on the market, and so on have far less moral appeal than a barn raising. We can all admit the superior amiability of the barn raising, but we should also admit the strengths of the insurance approach, particularly as the barn-raising approach cannot be practiced within the amiable worlds of most modern Americans today.

10. At the time of this writing, a clip of the barn-raising scene is available on YouTube (link).
Conservation

Almost everyone claims to favor conserving resources. Most see conservation as people willingly reducing their current consumption for the sake of future generations and the environment. We would hope, however, that conservation involves not consuming resources beyond the point where their current value is equal to what their future present value is expected to be, and this is achieved most effectively by letting people speculate on future values of resources in futures markets. Of course, such speculation is not what most people think of when favoring conservation. Instead, speculators are widely scorned for driving up current prices, which is exactly what they are doing and why they are such effective conservationists. Smith explained the beneficial results of speculation and likened the animosity toward speculation to that toward witchcraft (WN, 534).

Sharing

Sharing with others is widely thought of in terms of amiable morality and applauded as such. Many people are motivated, for example, to share with victims of natural disasters by volunteering their labor or sending goods they believe victims need. Unfortunately, this sharing is limited by the fact that donors are poorly informed about what goods and services are most needed, how much is needed, and how much others are giving. Wouldn’t it be wonderful if everyone in America was motivated to share with disaster victims and did so with good information on what, and how much, they should give? Amazingly, something somewhat like that is what happens when, through the operation of free markets, the victims’ demand for needed goods causes the prices of those goods to rise around the country. This motivates Americans to share with disaster victims by reducing their own consumption of the most needed goods and thus making it possible to ship them to the disaster area. But rarely do people see the sharing that arises from market forces. Instead, people attribute post-disaster price increases to the selfish actions of ’gougers’ who ’exploit’ disaster victims (Lee 2015).

Helping the poor

When people read about reducing poverty, they assume it is a matter of government redistributing resources from rich to poor. Many accept political claims that such redistribution is motivated by the public’s amiable desire to intentionally help the poor. But Deirdre McCloskey (2016) is probably not far off when she says “that 95% of the enrichment of the poor since 1800 has come not from charity but from a more productive economy.” Even when it is accepted that
market forces benefit the poor, it is widely seen as an unintended consequence of pursuing private advantage, with no attendant moral credit. Walmart, for example, is excoriated for all manner of evils, but given little credit for bringing goods to people at low prices.  

**Saving endangered species**

The public supports the idea of preserving endangered species. Yet, there is strong moral opposition to mundane-morality ways of doing so, though very effective. For example, many exotic animals that are almost extinct in their native Africa are thriving in Texas where they live on privately owned ranches, which charge hunters for the right to shoot them. Owners are motivated to grow their animal populations and to prevent them from being shot by poachers. Despite the success of such hunting ranches, Friends of Animals and other such organizations oppose them, arguing that killing endangered animals for profit is immoral (see Logan 2012). In fact, profit-oriented activity involving endangered species is so unpalatable to amiable morality that it generates opposition even when the animals aren’t harmed. For example, a retired South African developer, John Hume, owns and protects more than 1,000 rhinoceros at a personal cost of $200,000 a month, expended on paying for armed guards and helicopter surveillance to protect his herd against poachers. He is able to finance these expenses by selling his rhinoceros’s horns, which grow back after being harvested without pain. Despite the fact that increasing the supply of these horns reduces their price and therefore can reduce the incentive for poachers to kill rhinoceroses, selling the horns has been outlawed in four South African nations. John Hume’s profitable protection of his rhinos, deemed “unethical” by critics, will end soon unless the law is not repealed quickly (see Wexler 2015).

**Kidneys**

Kidney transplants save lives, and they are applauded when the kidney is provided in accordance with amiable morality—that is, without compensation. But

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11. As a quick check, we searched for “Walmart” in Google Scholar. The results seemed to be ordered, somewhat loosely, by descending citation count. The citation counts of the first five results were: 101, 68, 50, 51, and 23. The first result was Courtemanche and Carden (2011), which attributes “substantial reductions in the prices of food” to Walmart’s efforts, but also attributes to these price reductions an increase in obesity. The second result was a book titled *How Walmart Is Destroying America* (Quinn 2005). The third result was a communications paper studying Walmart’s website as part of a cross-cultural comparison (Kampf 2007). The fourth result analyzes supermarket supply chains in Nicaragua (Michelson 2013). The fifth result was a book titled *The American Way of Eating: Undercover at Walmart, Applebee’s, Farm Fields and the Dinner Table* (McMillan 2012).
at a price of zero the quantity supplied is much less than the quantity demanded, with the result that most people with kidney disease suffer. Most governments outlaw payments to the brave souls willing to supply a kidney. Why doesn’t the public reproach such policy? It seems to be because many people exalt amiable morality, even where it does not apply, and disparage mundane morality, even when it would save lives.

Judging politics and policy

Amiable morality has an instinctive appeal that mundane morality lacks. Human nature leads people instinctively to understand social affairs in terms of amiable morality, and many dislike seeing social affairs come increasingly under the sway of mundane morality. Such attitudes conduce to support for government policies fashioned in terms of amiable morality, good intentions, and compassion. Economic arguments showing that these policies commonly undermine the social good are seldom persuasive, leaving certain politicians and interest groups able to exploit mistaken sentiments of voters.

Voters are more likely to respond to emotional appeals of amiable morality when voting with their ballots than when ‘voting’ with their dollars. When spending money in the marketplace a person gets what he ‘votes’ for, and gets it because he ‘votes’ for it. A shopper may wonder about how his purchase affects the poor, but such speculations are unlikely to motivate him to buy something he doesn’t want, or not buy something he does. The dominant motivation for buying something comes from the buyer wanting it because it benefits him.

When voting with ballots the dominant motivation of a voter has little to do with whether she gets government benefits or not, since the probability that her vote will affect the outcome of the election is minuscule and the effect of the election outcome on policy is often small. Much of a voter’s motivation comes from her satisfaction from taking part in the democratic process and expressing support for the party she believes better reflects her sensibilities about the world (Brennan and Lomasky 1993; Caplan 2007). People often vote for politicians who appeal to their sense of amiable morality even if, when elected, the politicians enact policies that make them worse off.12

It is difficult for politicians to get credit for the benefits generated by private markets. Those benefits are widely dispersed and result from invisible-hand processes that no one much understands or observes. But the credit for policies that

12. We have shown elsewhere that a voter can receive more net emotional satisfaction voting for a policy the more it costs him and the more socially wasteful it is (Clark and Lee 2016).
appears to be motivated by amiable morality is easy for politicians to claim, along with political contributions. Unfortunately, these policies often fail to deliver the noble outcomes voters thought they were voting for. Voters seldom follow up after the warm glow of voting, in part because it is hard to determine the results of the policies they voted for. Even with great effort a voter’s investigation may be bewildering and inconclusive.

We feel that it is vital for Econ 101 students to be exposed to some basic concepts from public choice, including expressive voting. Care should be taken, however, not to criticize amiable morality as such. It is important to acknowledge the tremendous benefits we derive from both moralities, amiable and mundane, and to emphasize the ability of these moralities to reinforce each other when the limits of each are recognized.

**Mutually enhancing moralities**

The invisible hand is the fundamental insight of economics. Unfortunately, the enthusiasm economic professors have for this insight sometimes motivates them to ignore the limits of the mundane morality of markets and, by doing so, aggravates the tendency for students to dismiss the morality of markets.

For example, some professors argue that giving gifts such as clothing or sporting equipment to family members is inefficient because recipients can use the cash spent on the gift to purchase something they value more. This argument attempts to substitute the mundane morality of markets for the amiable morality of familiar groups, and most students are instinctively hostile to such an attempt. They recognize that the value of gifts between those who care for each other is not only, or even primarily, determined by the price paid for the gift, but by the care of the giver to enter imaginatively into the situation of the receiver and select something suitable; it is the sympathy experienced and the love expressed in the full process of selecting, giving, and receiving. The most likely effect of preaching cash gifts is to convince students that economics lacks moral understanding and that economists are social misfits. Criticizing nonmonetary gifts for being inefficient reverses the mistake often made by critics of free markets, who want to substitute amiable morality for mundane morality. Both mistakes reflect attempts to apply a morality in situations in which it is not appropriate.

Economic professors should also exercise caution when explaining human motivations that fuel the invisible hand. It is easy to leave the impression that greed is essential to the proper functioning of markets. Obviously, self-interest is an

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important motivation in the coordination of large numbers of non-familiars. But even then, exchanges between, say, an American and a Chinese typically involve a series of intermediate exchanges, many of which are between people who regularly deal with each other, with an element of friendship and amiable morality influencing their commercial relationships. Smith said we naturally and properly feel affection for our coworkers in the workplace: “Colleagues in office, partners in trade, call one another brothers; and frequently feel towards one another as if they really were so” (TMS, 224). Sometimes blackboard analysis is simplified by assuming a cold, calculating selfishness, but economists need not see people that way. As the economist Kenneth Boulding said, “No one in his senses would want his daughter to marry an economic man, one who counted every cost and asked for every reward, was never afflicted by mad generosity or uncalculating love… Economic man is a clod” (1969, 10). Just as “economic man” would make a lousy husband, he would make a lousy coworker.

When teaching Econ 101, economists often assert that pursuing self-interest doesn’t imply selfishness. Such assertion sees amiable morality as part of self-interest. The first sentence of The Theory of Moral Sentiments reads: “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it” (TMS, 9). If people have an amiable interest in others, is that, or is that not, among their ‘self-interests’? Our recognition of the two moralities has led us to de-emphasize the term self-interest altogether, for it is often vague and misleading.

Just as amiable morality is part of one’s interests, one’s interests are part of political behavior. Organized interest groups and politicians are people with interests, who are as susceptible to greed as anyone. Such greed is especially wayward in politics. But we caution the instructor against assuming the worst about political actors. Smith taught that in governmental affairs it is particularly difficult to be virtuous, but at the same time he called for wisdom and virtue in government, and indeed he admired it. He suggested that he viewed The Wealth of Nations as a study in “the science of a legislator” (WN, 468). In The Theory of Moral Sentiments, he wrote the following about the possibility for virtue in “the leader of the successful party:”

… if he has authority enough to prevail upon his own friends to act with proper temper and moderation (which he frequently has not), [he] may sometimes render to his country a service much more essential and important than the greatest victories and the most extensive conquests. He may re-establish and improve the constitution, and from the very doubtful and ambiguous character of the leader of a party, he may assume the greatest and noblest of all characters, that of the reformer and legislator of a great state; and,
by the wisdom of his institutions, secure the internal tranquillity and happiness of his fellow-citizens for many succeeding generations. (TMS, 232)

The important question is whether the interests of political actors motivate them to serve the interests of all, that is, the common interest. Any politician will naturally focus on retaining influence and power, and that depends on winning widespread support, from the people around them and the voters. If voters are systematically misguided about what is good policy, it is hard to expect good policy to come from politicians. Expose your students to the idea that getting government to recognize the merits of mundane morality and the invisible hand depends on getting the public at large to do so. Sometimes it seems that the moral-political system is caught in a trap that spells too little regard for Smith’s invisible-hand philosophy and “the liberal plan of equality, liberty and justice” (WN, 664).

In teaching your students, it is important to explain that, in the modern world, amiable morality and mundane morality depend on one another. The ancestral band used amiable morality. But life in a world without extensive markets was harsh. Today, our ability to help those we care for through amiable morality is greatly increased because mundane morality and global markets make it possible to help, and be helped by, millions of non-familiars. On birthdays we give gifts, but we buy those gifts on the market. Every day we take care of loved ones, including ourselves, by providing goods purchased on the market. And when, by charity or volunteer work, we extend our domain of amiable assistance to help non-familiars in need, we draw again on the work of mundane morality to create the resources and to reach and communicate with those in need.

Meanwhile, mundane morality depends on amiable morality. Our personal meaning and moral fiber are rooted in, as Smith put it, the “love of those we live with,” and without such fiber it is unlikely that the people of a society could sustain mundane morality. Of itself, mundane morality is boring. Smith analogized it to the rules of grammar (TMS, 175, 327). If all one could say for a piece of writing was that it respected the rules of grammar, it would at best be a dull bit of writing. If mundane morality were our only morality, life would be thoroughly unappetizing. We would revolt against life. The mundane morality of liberal society can be sustained only if people find fulfillment within proper realms of amiable morality. Without the proper realms of amiable morality, there really wouldn’t be much point to mundane morality. Grammar serves no purpose if one has nothing to share.

14. Smith uses the phrase “love of those we live with” in TMS (166, 295, 297). However, if you search TMS (here) for “live with,” you will find 15 hits and see the pervasive importance for Smith of the sentiments of those we live with.
Conclusion

“Millennials Have a Higher Opinion of Socialism Than of Capitalism”
—Washington Post article (Rampell 2016)

The endeavor to make the case for market economics as the most effective way of achieving social harmony and human flourishing is undertaken on many fronts, but nowhere is such endeavor more important than on college campuses. The college course in economic principles offers the best opportunity to explain how markets provide the mechanisms and motivation that allow free people to promote their mutual interest through a network of global cooperation.

We are not naive enough to believe that a course in economic principles, no matter how good it is, can bring college campuses, much less the broader society, to enthusiasm for market liberalism. We understand that amiable morality will always be more emotionally appealing than mundane morality, and that politicians and special interests, including wrongheaded and wronghearted intellectuals, will find it tempting to take advantage of that fact. But we also believe in the potentiality of ideas, in the prospect of a renewed appreciation of liberalism, of a renewed allegiance to it. In our own worlds, those we live with are gladdened when they see in us hope and good cheer. Hope and good cheer improve those worlds; they are amiable virtues. But such virtues also help us to carry on in the effort to communicate insights to non-familiars. Much as Vernon Smith has explained “The Two Faces of Adam Smith” (1998), we propose that economics be taught with an explicit discussion of two moralities.

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“Stop This Greed”: The Tax-Avoidance Political Campaign in the OECD and Australia

Chris Berg¹ and Sinclair Davidson²

LINK TO ABSTRACT

In 2014 Australia held the rotating presidency of the G20, hosting the meeting of the finance ministers and central bank governors and the meeting of the G20 leaders. Both meetings saw the G20 nations endorse the Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Action Plan had been prepared by the OECD a year earlier as a “co-ordinated and comprehensive” response to the possibilities posed by globalization for tax avoidance by multinational firms (OECD 2013a). For its part, the Australian government announced in its federal budget in May 2015 that it was going to introduce legislation to “ensure foreign and multinational companies pay their share of tax.” The Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 received royal assent in December 2015.

This paper is a critique of the political claims which have accompanied the debate about multinational tax avoidance, both at the OECD and within Australia. The movement within Australia provides an example of domestic policymakers adapting arguments pushed by international bodies to fit local political agendas. Australia provides a useful example for two reasons. First, Australia’s leaders used its presidency of the G20 to drive a domestic agenda on corporate tax avoidance. Second, it has a relatively high reliance on corporate tax revenue as a part of its total tax take (18 percent in 2013, compared to an unweighted OECD average of 8.4

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percent, and ranking in the OECD second only to Norway, which like Australia is rich in natural resources).

Multinational firms conduct commerce across national boundaries, transfer resources between affiliates across those boundaries, and exercise ownership and control over their affiliates. Another feature of multinational firms is a cosmopolitan outlook. Their choice of location is not much constrained by questions of patriotism or cultural identity. They are more or less indifferent as to the jurisdiction in which they invest, “except as determined by expected profitability, risk, or any other objective standard derived from [the] pecuniary goal” (Kopits 1976b, 627).

We describe the practices where corporate or individual taxpayers move income offshore in order to reduce their domestic tax profile as tax avoidance, rather than the more pejorative and loaded term tax evasion. This distinction is not controversial. It is true that the Australian Taxation Office has attempted to blur the distinction between avoidance and evasion (see Seldon 1979 for a discussion of tax “avoision”). Nevertheless, Australian parliamentary debate reflects the same distinction as we adopt here. As the chair of the Senate Economics References Committee, Sam Dastyari, stated in 2015, “Tax avoidance is questionably moral behaviour. It is legal. Tax evasion is illegal behaviour. I think they are the two terms.”

The prehistory of the OECD’s “Harmful Tax Competition” and BEPS projects mixes concerns about lawful tax avoidance with concerns about illegal tax evasion and money laundering. In our assessment, popular commentary on these issues, too, rarely distinguishes between tax planning practices which are legal but (judged to be) unfair or unethical, and those which are illegal under domestic tax law.

The 1981 Gordon Report

Political interest in tax havens during the 1970s led the Carter administration in the United States to commission the 1981 Gordon Report, which formulated three key attributes that would positively identify a country as a tax haven: (1) low or no tax on income from foreign sources or certain types of business, (2) common-law or statutory secrecy provisions that were not relaxed in the case of a serious violation of the laws of another country, and (3) a relatively high importance of banking to the economy. The Gordon Report recommended that the United States terminate its tax treaties with known tax havens such as the Netherlands Antilles,

3. Official Committee Hansard, Senate Economics References Committee, April 8, 2015, p. 6 (link).
increase information requirements on U.S. taxpayers concerning their international transactions, seek stronger information exchange from foreign jurisdictions, and dissuade firms from doing business in jurisdictions which maintained secrecy laws (Gordon 1981).

The United States did not immediately adopt the recommendations of the Gordon Report. That slow progress led to an increased political salience of both the existence of tax havens and aggressive tax-planning practices. By the mid-1990s international agencies such as the International Monetary Fund were warning that mobile capital meant the residency principle for levying corporate and personal income taxes would only be sustainable if there was transparent information transfer between tax authorities (Eccleston 2012). Since the 1990s, the Organization for Economic Cooperation and Development (OECD) has chiefly driven international efforts on tax avoidance; the OECD has taken the function of an “informal ‘world tax organization’” (Cockfield 2006). The OECD’s efforts on tax avoidance can be divided into two waves. The first was fashioned as the Harmful Tax Competition (HTC) project. After the perceived failure of that project, a second effort, from 2013, was fashioned as a move against Base Erosion and Profit Shifting (BEPS). We treat each in turn.

The OECD’s “Harmful Tax Competition” project

In May 1996, a communique from the G7 summit in Lyon declared that “Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases” and requested the OECD “vigorously pursue its work in this field” with the aim to establish multilateral action on reducing such competition. The OECD published its report *Harmful Tax Competition: An Emerging Issue* in 1998. This report propounded the notion that tax competition could be harmful, and it proposed to list OECD member and non-member countries with preferential tax regimes alongside its listed “tax havens.”

What constituted harmful tax competition? In its treatment, the report distinguished between the positive aspects of tax competition—globalization putting pressure on national tax systems to modernize and reduce tax barriers to capital flows—and what it saw as negative or harmful aspects—the opportunity that globalization has offered firms to “minimise and avoid taxes” and individual countries to “enact tax policies aimed primarily at diverting financial and other
geographically mobile capital” (OECD 1998, 14). In this sense the incidence of harm in harmful tax competition is placed on domestic tax systems. The report states:

... these schemes can erode national tax bases of other countries, may alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption) and may hamper the application of progressive tax rates and the achievement of redistributive goals. (OECD 1998, 14)

This distinction between positive and harmful tax competition is deeply ambiguous. The consequences outlined above—the erosion of a national tax base, changing structures of taxation, and the hampering of progressive tax rates and redistributive goals—are caused by all forms of tax competition, not only “harmful” competition. Rather than outline the characteristics of harmful competition, the OECD report instead identified the characteristics of tax havens and preferential tax regimes that it sought to tackle through multilateral action. The places against which it pushed for action were described as places where there are: zero or only nominal taxes, a lack of information exchange, a lack of transparency, ring-fencing of tax regimes to prevent residents from accessing the preferential regime or to prevent beneficiaries from accessing domestic markets (in the case of preferential tax regimes), and no substantial economic activities (in the case of tax havens). The report described these as features of “harmful tax competition” based on its own judgment that the apparently negative aspects outweigh the positive aspects. There were no empirical bases for these claims; indeed, the report noted that “The available data do not permit a detailed comparative analysis of the economic and revenue effects involving low-tax jurisdictions” (ibid., 17).

The 1998 report offered definitions of harmful competition that could be best described as casual: “redirect[ing] capital and financial flows and the corresponding revenue...by bidding aggressively for the tax base of other countries,” or when “the spillover effects of particular tax practices are so substantial that they are concluded to be poaching other countries’ tax bases” (OECD 1998, 16). At a certain level of abstraction, all competition involves “bidding”—sometimes “aggressively”—for business, and the word “poaching” is used regularly to describe events that occur in competitive markets. The existence of aggressive competition is not a black mark against competition. It is possible that tax havens and preferential tax regimes lead to suboptimal flows of capital, but this is not shown by declaring that competition between national tax regimes is “harmful.” Later in this paper we explore the economic function of international tax competition.
The OECD/G20 “Base Erosion and Profit Shifting” (BEPS) project

Having found support from a coincidence of center-left governments in major world economies in the mid-1990s, the HTC project floundered when the incoming Bush administration made it clear that the project was not in line with its priorities (Eccleston 2012; Palan et al. 2010). OECD work on tax avoidance was only revived after the 2008 Global Financial Crisis. At its second meeting in 2009, the newly constituted Group of 20 countries declared an intention to “take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over” (G20, 2009). In this way the G20 connected, at least rhetorically, the ongoing financial crisis with a crackdown down on tax competition. The OECD entered a “symbiotic relationship” (Eccleston 2012, 87) with the G20, which was trying hastily to develop an international reform agenda. The G20 structure gave the project greater authority than the OECD could provide (Kudrle 2014). In this period, the OECD and G20 greatly expanded the Global Forum on Transparency and Exchange of Information for Tax Purposes, which had been first established in 2000 to enact recommendations from the HTC project with 32 members. The Global Forum now has 130 members.

The June 2012 G20 leaders meeting directed the OECD’s tax avoidance work to be refashioned in terms of “base erosion and profit shifting,” and in February 2013 the OECD published Addressing Base Erosion and Profit Shifting (OECD 2013b). The report was followed in July 2013 by the Action Plan on Base Erosion and Profit Shifting (OECD 2013a). The BEPS project focused on the “erosion” of the tax revenue base from firms shifting profits across borders in a way that might cause double non-taxation. Here the emphasis narrowed to the “integrity of the corporate income tax,” rather than personal-and-corporate income taxes (2013b, 8). The BEPS project shifted political attention away from the HTC projects’ bellicose rhetoric about tax havens to preferential regimes, “mismatches” between domestic tax regimes that might allow firms to avoid tax liabilities, the treatment of transfer pricing and thin capitalization rules, the taxation of digital goods, and “aggressive tax planning” (ibid., 6).

The BEPS project makes two basic claims. The first is that the corporate income tax base is being eroded. The second is that the cause of that base erosion is firms shifting profits across borders. The initial BEPS paper was careful, however, not to overstate the significance of these claims. The report addressed itself to the
“growing perception” that governments are being denied legitimate revenue from corporate tax planning, noting claims in major newspapers about tax avoidance and misleading, “simplistic” arguments by non-government organizations about the nature of corporate taxation (ibid., 13). The OECD admitted that given the relatively small proportion of corporate tax as a percentage of total tax take, “the scale of revenue losses through BEPS may not be extremely large.” Furthermore, “it is difficult to reach solid conclusions about how much BEPS actually occurs” (15). However, the OECD argued that BEPS may still be significant “in monetary terms” and may be of more proportional interest due to its “effects on the perceived integrity of the tax system,” i.e., that BEPS may undermine tax morale (ibid.). The paper looked at the possible mechanisms by which BEPS might occur—principally mismatches between domestic tax regimes—rather than demonstrating that this was a materially significant tax revenue issue.

In this context, it is important to emphasize what BEPS is not. It is not about making use of bank secrecy to conceal profits, and it is not simply a case of transfer pricing. BEPS is alleged to be making use of those legal provisions to avoid double taxation to ensure the non-taxation of profit. While superficially similar to transfer pricing issues, BEPS is a distinct phenomenon and deserves to be treated as such (Kleinbard 2011a; b). The irony is that multinational corporations could be fully compliant with the letter of domestic tax law and international treaties, and still be ‘guilty’ of wrongdoing under the arguments being made to justify the BEPS program.

**BEPS in Australia**

Since the global financial crisis, the Australian federal government has run a sustained budget deficit, largely to cover recurrent expenditure (Makin and Pearce 2016). This deficit has played a large role in Australian politics, as both sides of politics have proposed and sought to implement measures to reduce this deficit. Under the Labor government (2007–2013), the Treasurer Wayne Swan had been concerned with “vested interests” who fought against proposed tax impositions on mining and carbon dioxide emissions (Swan 2012; 2014). Driven by media attention on technology companies like Google, Apple, and eBay (Butler and Wilkins 2012), the political focus narrowed during 2012 and 2013 to corporate tax avoidance.

Of particular significance was a report published by Tax Justice Network Australia in 2014 that reported that effective tax rates calculated from annual financial statements substantially deviated from Australia’s (then) statutory company tax rate of 30 percent. What was not reported, however, is the fact that every
Public company has a tax reconciliation note in its annual financial statements. There is no mystery to the “book-tax income gap,” either at a company level or from a policy perspective (see Davidson 2014b; 2015a). While the report was severely criticized (see, e.g., McCracken 2014), nonetheless it established in the public mind the notion of widespread wrongdoing on the part of business and led to a Parliamentary inquiry into corporate tax avoidance—we discuss this inquiry below.

Australian policymakers were also responsive to developments in the OECD and the G20. OECD work in 2010 on transfer pricing reform led to legislative changes in 2012 ensuring that Australian transfer pricing rules were interpreted according to OECD guidelines. Changes to Australia’s general anti-avoidance rule, foreshadowed since March 2012, were introduced into parliament the day after the release of the OECD’s BEPS report in March 2013. Two papers on the taxation of multinational enterprises by the Treasury department in May and July 2013 followed, presaging further reform (Treasury 2013a; c). The election of the conservative Abbott government at the end of 2013 coincided with Australia’s presidency of the G20, and the new government publicly aligned itself with the intention behind the OECD/G20 program (Abbott 2013; Hockey 2013). Changes to thin capitalization laws were announced in November 2013 and passed in September 2014.

The changes to Australian tax rules were accompanied by reforms to the conditions for ‘disclosure’ of corporate tax information—disclosure used in this manner means the government making public tax information about individual corporations, not those corporations disclosing information about themselves. In February 2013, the Labor government announced that “recent events in Australia and around the world call into question whether large and multinational businesses should have the same level of confidentiality about the taxes they have paid” and that “Large multinational companies that use complex arrangements and contrived corporate structures to avoid paying their fair share of tax should not be able to hide behind a veil of secrecy” (Bradbury 2013a). A Treasury paper two months later argued that Australia’s “voluntary compliance” tax system required public confidence in the fairness of that system. Perceptions of unfairness might lead to “heightened efforts to avoid tax” (Treasury 2013b, 7). Such efforts would require more intrusive compliance controls, which could also in turn undermine confidence and the tax system’s sustainability.

To counter the perception of unfairness, the Treasury proposed that the Commissioner of Taxation be required to disclose to the public limited tax return

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4. Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012.
5. Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.
information for companies whose total income is AU$100 million or more, as well as any minerals resource rent tax or petroleum resource rent tax payable. The information required was the business number and name, reported total income, taxable income, and corporate income tax payable. For publicly listed companies, this information is already available in annual financial statements, as is a tax reconciliation between financial accounting and tax accounting. Legislation was introduced into parliament to give effect to this proposal in May 2013 and passed in June. In the second half of 2015 the Coalition government modified the threshold to distinguish between publicly listed and foreign-owned companies, who were subject to disclosure if their total income was above $100 million, and private companies, who were subject to disclosure only if their total income was above $200 million. As the Australian Taxation Office (2013) noted, the purpose of disclosure reforms was to “discourage” aggressive tax planning and “encourage public debate about corporate tax policy.” Tax disclosure, however, was not a requirement or recommendation of the G20/OECD process. Indeed, the director of the OECD’s Centre for Tax Policy and Administration, Pascal Saint-Amans, argued that disclosure “may be misleading and it could do big damage unfairly” (quoted in Khadem 2014). It has been suggested that this disclosure constitutes a ‘market mechanism’ promoting greater tax compliance. Market mechanisms, however, usually work to reduce information asymmetry. In fact, for publicly listed companies, all the information being ‘disclosed’ is already publicly available. It is not clear that re-releasing public information and exposing it to a less well-informed audience than the Australian Tax Office could reduce asymmetric information and encourage greater tax compliance.

Public shaming as a revenue strategy

While in opposition the Coalition parties evinced some skepticism about the Labor government’s crackdown on corporate tax avoidance, particularly the disclosure reforms. The Coalition won government in 2013. Their period in government coincided with increasing public discussion about corporate tax avoidance. A keyword search of five major Australian newspapers finds over 800 articles referring to corporate tax avoidance between 2013 and 2015, most coming in the third year. The establishment of a Senate committee inquiry into Corporate

Tax Avoidance in October 2014 ensured a steady drip throughout the next year of newspaper reports on tax planning practices among large firms. The inquiry took testimony from more than a dozen technology, mining, and pharmaceutical firms, as well as various non-profit organizations which had campaigned on corporate tax avoidance such as the Uniting Church, the Australia Institute (a progressive think tank), and unions such as United Voice and the Community and Public Sector Union. As one commentator wrote, this inquiry gave a number of Senators the opportunity to “berate local leaders of the world’s biggest technology companies” in front of the press (Treadgold 2015).

The committee’s first report, released in August 2015, emphasized that the Australian taxation system was “strong and, in many respects, world leading,” but noted that a number of multinational companies which derived significant revenue in Australia yet paid little to no corporate tax. The title of that report, You Cannot Tax What You Cannot See, characterized the recommendations, which were concerned both with the information sharing efforts driven through the G20/OECD BEPS project, as well as further recommendations for domestic disclosure, including: (1) a mandatory tax reporting code for large Australian and multinational companies operating in Australia, (2) a public register of tax avoidance settlements, (3) an annual report of tax minimization and avoidance include estimates of revenue foregone, (4) an annual report of tax avoidance compliance activities, (5) the publication of country-by-country reports, and (6) a requirement that government tender bids state a firm’s country of domicile for tax purposes (Senate Economics References Committee 2015). Should these recommendations be adopted in whole or in part, they would be certain to guarantee the same drip-feed of press reports that had accompanied the inquiry itself. The emphasis placed on public disclosure suggests a limited range of possible public responses and the committee’s apparent view that tax avoidance is an issue best addressed through public suasion rather than reform to the tax code.

It is worth exploring this notion in a bit more detail. The problem policymakers face in conceptualizing BEPS is that companies in general and multinationals in particular are generally compliant with domestic tax law. BEPS does not suggest that companies are not paying their legally mandated tax liabilities, but rather that they should be paying more. So it appears that the Senate committee was hoping that companies would ‘agree’ to pay more tax than they are legally mandated to pay through a process of public shaming. Yet paying money to (foreign) governments in the absence of a clear tax liability or court order is likely to violate norms—if not actual laws—against paying bribes. Soliciting such payments from multinational corporations is also problematic for a country that purports to operate under the rule of law. If the Australian government wishes to raise more revenue from taxation it should pass an appropriate law through the parliament or
enforce the existing laws it has previously passed through the parliament, though there may be little scope to increase company tax revenue through more rigorous enforcement of existing laws (Davidson and Heaney 2012).

The committee was unable to come to a conclusion about how significant corporate tax minimization and avoidance was in the Australian context. The lack of conclusion was a reflection of the evidence put to the committee. Treasury officials appearing in front of the committee were asked directly about how much revenue was being lost to multinational tax avoidance. In response, the Deputy Secretary answered that they “really do not know.” We address this issue below.

The Coalition government made countering multinational tax avoidance one of the central revenue features of its 2015–16 budget. The government released draft tax legislation intended to “stop multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia.” This legislation, which was introduced to parliament in September, lowered the threshold under which the Australian Tax Office (ATO) could make a claim under the general anti-avoidance law, increased penalties for tax avoidance, and enabled the ATO to judge that profit booked in a foreign jurisdiction was taxable under Australia law. We have argued elsewhere that this places multinational firms operating in Australia under a threat of double taxation, as there is no reason foreign tax authorities would accept the ATO’s claim (Berg and Davidson 2015).

While the Coalition government sought to roll back some of the transparency provisions introduced by the previous Labor government, parliamentary negotiation in December 2015 meant that transparency provisions remained relatively unchanged. The first release of this data occurred that month. While it was accompanied with a warning from the taxation commissioner that “No tax paid does not necessarily mean tax avoidance” (Jordan 2015), the data dump was greeted with headlines such as “How our tax take has been royally Scrooged”

10. Response by Robert Heferen to question from committee chair Sam Dastyari, Official Committee Hansard, Senate Economics References Committee, April 9, 2015, p. 24 (link).
11. This was accompanied by a video advertisement (link), which stated: “Some multinational companies use Australian businesses and Australian workers to sell products and services to Australian customers every day. But when it comes to sign the contract, the Australian customer is actually signing the contract with a related company in another country. This means Australian income is not being taxed in Australia. To make matters worse, money is then being channelled through to a tax haven, escaping tax worldwide, leaving Australian companies, small businesses, families, and individuals to carry the tax burden. It is unfair and unsustainable for local businesses to pay tax on their profits when their competitors do not. From 1 January next year, this will change. The government will introduce new laws and new penalties to stop this greed, and will consult with the community on further amendments to the Australian tax law. To find out more, visit budget.gov.au.”
12. Tax Laws Amendment (Tax Integrity Multinational Anti-Avoidance Law) Bill 2015 (link).
13. The Coalition negotiated an increase in the threshold for private company disclosure, from $100 million total income to $200 million, in order to gain Greens support in the Senate.
In December 2016 the second data release occurred. The taxation commissioner made this statement:

Today’s information provides more transparency for the community on the operations of these entities, but it does not change the level of transparency they have with the ATO. We already have access to far more detailed information and regularly engage with and assure the tax behaviour of these major players in the Australian economy. (Jordan 2016, emphasis in original)

Not only is the ATO releasing information that it already knows, it is releasing information that is already in the public domain via annual financial statements. Nonetheless, it is worthwhile comparing what the ATO reported with what the media reported. The ATO:

I should also say we collect, on average, about $2 billion from our compliance activities with these large and private companies each year, which is not reflected in the data released today. (Jordan 2016)

That statement gave rise to the headline “ATO chases multinationals for $2b in unpaid tax” (Mather et al. 2016). The public is left with the impression that multinational tax avoidance amounts to some $2 billion. If correct, that would suggest that multinational tax avoidance constituted some three percent of total company tax revenue. The tax commissioner, however, was referring to all compliance matters, not just multinationals. In any event, the ATO still has no clear idea how much revenue is being lost to multinational tax avoidance. An ATO official told the Parliamentary Standing Committee on Tax and Revenue:

What we have found is that it is very important, if we are to produce a gap, that we are very confident in the underlying methodology, that it is credible and reliable. The superannuation gap, as with a couple of the other income tax gaps, got to a stage where, on external review, they were rated as low or very low reliability.  

In short, the transparency policy does not increase tax transparency to the ATO, while it provides the media with an opportunity to report misleading interpretations of information that is already in the public domain. It generates the very misleading impression that the ATO knows how much multinational tax avoidance is occurring, when the ATO in fact has no idea what the extent of
the problem could be. Overall, this policy assumes that increased exposure, of public information and of information already known to the tax authorities, will lead to less tax avoidance. We are invited to believe that the public has a better understanding of corporate taxation than does the Australian Taxation Office.

The welfare economics of tax competition

Arguments against tax competition often comprise a mixture of declama-
tions with economic argumentation. A domestic political audience with limited economic skills may find such a confused collection of ideas and arguments to be convincing. An example is provided by the former Dutch State Secretary of Finance Wouter Bos, who has argued that while tax competition is all very well in theory, it could never actually work in practice:

There is nothing wrong with different countries having different tax regimes. Tax policy is a legitimate instrument in improving competitiveness in a global market. A low and competitive tax rate will, among other things, help them to facilitate this goal. In order to pursue and sustain this low tax rate, governments must organise their scarce resources as efficient as possible. From an economic perspective, tax competition therefore leads to efficient governments and the highest possible level of wealth for everybody.

There is only one very important side condition for this last statement to be true, and that is that the global markets are perfect and there are no market failures whatsoever. This is, I am afraid, not the case in real life.

When markets are imperfect, policy goals can not be achieved by market forces alone. The same is true for competing in the field of tax policies. Any competition needs some form of regulation, so does this one. (Bos 2000)

Bos then mentions free-riding and negative externalities. He fails, however, to explain how these problems would manifest in the international taxation system in practice. Finally, he concludes:

In a perfect world differences between national policy mixes should lead to an optimal mix between the level of taxes and the level of public expenditure on the part of a state. In practice, however, there is a natural tendency to exert pressure to ever lower taxes which could—in turn—threaten the balance between taxes and public expenditures. It is at this point, where fair competition comes close to not just a “race to the bottom” but a “race to public poverty,” that fair competition turns into unfair competition and where total tax income of the countries becomes too low for governments to finance a sustainable and sufficient level of public services. (Bos 2000)
Bos frets about tax revenue being “too low” to finance a “sufficient level of public services.” A lot rides on the word “sufficient.” There is good reason to believe the current size of the public sector has a negative effect on economic growth and productivity (Bergh and Henrekson 2011; Mitchell 2005; Novak 2013). In the British tradition of constitutional government, restraints are needed to keep government from intruding into, and overwhelming, civil society. Just as market competition checks monopolistic abuse, tax competition can exert a healthy check on the ‘monopolized’ power that is government. Further, Bos suggests that tax competition is not subject to any form of regulation, but that is far from the case. The international tax architecture consists of a complex set of interlocking treaties and conventions that almost amount to an international tax cartel (Edwards and Mitchell 2008). Much like a private-sector cartel, governments have divided up the global tax base and allocated taxing rights over an exclusive domain (see Davidson 2015b). In this view the BEPS debate is simply governments squabbling over prices and market share, as would any private-sector cartel.

Julie Roin (2007a) argues that two chief questions are at the centre of the international tax regime: how much tax should be levied on income generated by transnational transactions, and which government should levy that tax. The international tax architecture establishes which government will levy taxation on income with the overarching principle that income should be taxed only once; governments seldom, if ever, enter into tax sharing agreements. Roin (1995) argues that the international norm is that the source country (i.e., the host economy) has primary taxation jurisdiction over an economic transaction, rather than the home country. The prime objective of most tax treaties is to avoid the problem of double taxation. A chief purpose of these treaties has been to promote international trade and investment.

A consequence of a policy regime designed to avoid double taxation is so-called ‘under-taxation.’ Roin (2007b) refers to this phenomenon as “double non-taxation.” It occurs when the country with primary authority does not levy a tax on economic activity. To be clear: Sovereign nations have both the right and the duty to define their own tax bases; in this instance a sovereign nation has chosen to exclude from its own tax base some economic activity over which, by international agreement, it has primary taxation authority.

There are, very often, good reasons why a country may choose to not levy a tax. The most obvious reasons would be to facilitate international trade or encourage foreign direct investment. In other instances, particular income might become tax-exempt due to treaty obligations that have been negotiated between sovereign states. Then, there may well be purely pragmatic reasons related to the mechanics of tax administration. It is important to emphasize that nontaxation by the country with primary taxing authority is a deliberate policy choice, and a
design feature of tax systems. Jawboning countries to tax where they otherwise
would choose not to tax could be viewed a form of fiscal imperialism. Edward
Kleinbard (2011a, b) argues that international tax architecture creates so-called
“stateless income.” But the very term “stateless” is misleading: Kleinbard’s com-
plaint is not that the income is stateless per se, but that it is not taxed in the United
States (Davidson 2014a). Similarly, the Australian government’s complaints about
base erosion and profit shifting can be reduced to the fact that income is not taxed
in Australia.

Sovereign nations that have taxing authority under the international tax
architecture chose their own tax regimes. Many nations have chosen, for example,
to tax intellectual property at lower rates than they do physical property. Unsur-
prisingly, multinational corporations with valuable intellectual property often
locate their property in those countries. These so-called tax havens have come
under substantial criticism from international organizations such as the OECD
and from high-taxing governments. Yet it is well-known that tax havens promote
investment and economic activity. Mihir Desai, Fritz Foley, and James Hines
(2006) have found that “tax haven activity enhances activity in nearby non-
havens.” Higher after-tax returns enable multinational corporations to maintain
higher levels of foreign investment. A strong case can be made that the impact a
tax haven has on economic activity in neighbor countries is positive, not negative.
The question of whether governments suffer adverse revenue effects from tax
competition is addressed below.

International taxation arrangements are regulated and constrained by
international treaties, domestic law, and business conventions. The international
tax architecture operates much like a cartel. It is unsurprising if governments dislike
obstacles to their taking more wealth from the private economy, and that the
Australian government, which has run persistent and growing budget deficits,
would want to renegotiate the rules to gain more tax revenue rather than reduce
expenditure.

How significant is profit shifting?

The material published by the OECD and the Australian government makes
much of popular perceptions of widespread profit shifting. That material has
focused on the mechanisms by which profit shifting might occur, and on the
vulnerability of tax systems to aggressive tax planning, but mostly unanswered
is how widespread or significant profit shifting is. Here we survey the academic
literature on profit shifting and the use of tax havens. Advances in both method and the acquisition of more fine-grained data have allowed a greater understanding of the extent of profit shifting (Dharmapala 2014).

Observing the growth in multinational firms after the Second World War (Kopits 1976b), the first generation of scholarship to study multinational profit shifting was conducted in the late 1970s and early 1980s. These studies asked whether relative tax rates were likely to influence the behavior of multinational corporations. It was understood that differential taxes and tariffs were an important determinant of transfer pricing (Copithorne 1971; Horst 1971), but data was scarce and little quantitative evidence was available. Exploiting research commissioned by the Colombian government between 1966 and 1970 to identify “overpricing” in the foreign subsidiaries of pharmaceutical firms, Sanjaya Lall (1973) and Constantine Vaitos (1974) found overpricing ranging from 33 percent to 300 percent, possibly driven by Colombian restrictions on profit maximization. Other studies attempted to indirectly estimate transfer pricing through least squares estimation (Kopits 1976a; Müller and Morgenstern 1974), but lacked actual pricing data.

A second generation of scholarship in the 1990s tried to answer that question by subtracting a counterfactual ‘true’ income of an affiliate from the observed pre-tax income. The ‘true’ income was determined by an assessment of the affiliate’s capital and labor inputs. The result of this calculation was the profits that had been shifted to the affiliate. James Hines and Eric Rice (1994) and Harry Grubert and John Mutti (1991) exploited country-level aggregated data of U.S. affiliate firms from the U.S. Department of Commerce. Hines and Rice (1994) find that a ten percent decrease in a country’s tax rate would be associated with an increase in hypothetical reported profits from $100,000 to $122,500—implying a very large amount of profit shifting (see Dharmapala 2014, 28, Table 1). However, an alternative approach taken in the accounting literature compares the accounting rates of return across United States and foreign operations to derive an estimate of shifted income. Using this method, Julie Collins, Deen Kemsley, and Mark Lang (1998) found no evidence of income shifting out of the United States between 1984 and 1992.

Such analyses were based on country-level or consolidated worldwide data. Aggregating firms together removes important differences between industries, individual firms within an industry, and the structure of tangible and intangible assets. In recent years, however, researchers have been able to employ highly disaggregated data which break down financial information to the affiliate level, using, for example, the Orbis and Amadeus databases. Employing firm-level data, the literature has seen a steady reduction in the estimates of the magnitude of profit shifting. Similarly, controlling for industry-specific shocks and other factors
has reduced estimates further. Table 1, reproduced from Dhammika Dharmapala (2014, 28), demonstrates that studies in the early 1990s reported large estimates of profit shifting but that more recent studies have reported much lower estimates. Dharmapala suggests that a semi-elasticity of 0.8 of pretax income is a consensus estimate, but also points out that a number of more recent studies have reduced that estimate further.

<table>
<thead>
<tr>
<th>Study</th>
<th>Data</th>
<th>Period</th>
<th>Semi-Elasticity</th>
<th>Interpretation: a 10% point decrease in a country’s tax rate (e.g., from 35% to 25%) is associated with an increase in reported income from $100,000 to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hines and Rice (1994)</td>
<td>BEA (country-level)</td>
<td>1982 (cross-section)</td>
<td>2.25</td>
<td>$122,500</td>
</tr>
<tr>
<td>Huizinga and Laeven (2008)</td>
<td>Amadeus</td>
<td>1999 (cross-section)</td>
<td>1.3</td>
<td>$113,000</td>
</tr>
<tr>
<td>Dischinger (2010)</td>
<td>Amadeus</td>
<td>1995–2005 (panel)</td>
<td>0.7</td>
<td>$107,000</td>
</tr>
<tr>
<td>Heckemeyer and Overesch (2013)</td>
<td>Various</td>
<td>Various</td>
<td>0.8 (&quot;consensus&quot; estimate)</td>
<td>$108,000</td>
</tr>
<tr>
<td>Lohse and Riedel (2013)</td>
<td>Amadeus</td>
<td>1999–2009 (panel)</td>
<td>0.4</td>
<td>$104,000</td>
</tr>
</tbody>
</table>

Source: Reproduced from Dharmapala (2014, 28, Table 1).

According to the more recent estimates, the extent of profit shifting is quite low. The recent work suggests that multinational firms operating in high-tax jurisdictions shift between 2 percent and 4 percent of their profits to lower tax jurisdictions. Hines (2014) argues that the magnitude is lower again, despite the ample opportunities firms have to exploit tax havens and low tax jurisdictions. Dharmapala (2014) asks whether 2 to 4 percent of income shifted from multinational firms ought to be considered large or small. In our view, a highly relevant policy consideration is the effect that efforts to reduce income shifting would have on the investment climate within the domestic economy. In the OECD BEPS project, the term “base erosion” assumes what needs to be proven: that profit shifting is having a material effect on the domestic tax base.
The evidence for base erosion

The OECD BEPS program is premised on an argument that a country’s tax base is, or risks, being eroded by tax avoidance and profit shifting. Such language has been adopted by the Australian government (Australian Taxation Office 2016; Bradbury 2013b). Base erosion is an empirical question. Here we investigate the notion that base erosion has occurred. Peter Birch Sørensen (2007) has provided an analysis where the ratio of company income tax revenue to GDP is decomposed into its component parts:

\[ \frac{R}{Y} = \frac{R}{C} \cdot \frac{C}{P} \cdot \frac{P}{Y} \]

where \( R \) = company income tax revenue, \( Y \) is GDP, \( C \) is total company profit, and \( P \) is total profit earned in the economy. \( R/C \) is a proxy for the average effective company income tax rate, \( C/P \) is the company share of profits, and \( P/Y \) is the profit share of the economy. The decomposition allows us to determine whether any changes in the ratio of company tax revenue to GDP are due to changes in the effective company tax rate or the company tax base (defined as the interaction of the share of company profits and the profit share of the economy).

Following Sørensen (2007), we employ corporate operating surplus as a proxy for corporate profit and total operating surplus as a proxy for total profit. Data for operating surplus and GDP are taken from the Australian Bureau of Statistics and company tax data are taken from the OECD.16 Sørensen provides the decomposition for several OECD economies over the period 1981 to 2003. In Figure 1, we replicate the decomposition for the period 1965–2013 for Australia. To provide greater clarity we show each of the component series separately in Figure 2.

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16. Australian Bureau of Statistics, Catalogue 5206.0—Australian National Accounts: National Income, Expenditure and Product (link); OECD Tax Database (link). There is a question as to whether aggregate time series data can be employed to answer the question we pose. It is always true that aggregate data contain less information than analysts would like. We subscribe, however, to Lord Kelvin’s maxim that in the absence of numbers our knowledge is meager and unsatisfactory. Now, even with numbers our knowledge may remain meager and unsatisfactory, but this is a problem faced by all participants in the BEPS debate, including the Australian Taxation Office.
Figure 1. Company income tax decomposition for Australia

Source: ABS, OECD iLibrary, and author calculations

Figure 2. Company income tax decomposition for Australia, component series

Source: ABS, OECD iLibrary, and author calculations
As these figures show, the ratio of company tax revenue to GDP has increased since the early and mid-1980s, as has the ratio of company tax revenue to company profits. These changes are largely due to Australia adopting a dividend imputation tax system (see Twite 2001; Cannavan et al. 2004). The profit share of the economy (\(P/Y\)) has steadily increased since the mid-1970s while the share of company profits fell until the early 1980s and remained more or less steady after that. The spike in the average effective company tax rate in 2000 is associated with income tax reforms that were introduced to coincide with the imposition of the Goods and Services Tax (the Australian value-added tax on consumption) that was introduced in that year. The decline after 2008 is associated with the global financial crisis and its aftermath. These data do not support the view that the company income tax base in Australia is being eroded. To the contrary, it appears that the Australian company tax base has broadened over time, especially since the early 1980s. This result is consistent with Sørensen’s original analysis using a different time period and data source. He too interprets his result as suggesting that the Australian company tax base has broadened, not eroded, over time.

One alternative explanation for our results could be that multinationals have been profit shifting from Australia over several decades, and the problem simply has not gotten any worse since the 1970s and 1980s. We are not convinced by this argument. It invites us to believe that large-scale tax avoidance is occurring while the profit share of the economy is rising. Profit shifting would be consistent with a declining profit share, as ‘costs’ become inflated. At the same time the company share of profits has been stable since the early 1980s. The decline in the company share of profits over the period of the 1970s is quite consistent with the economic turmoil of those years, and declines also occur during recessions in the early 1980s and early 1990s, and also in the years after the financial crisis of 2007–09. Furthermore the argument that profit shifting was well established by the 1980s and has not changed since then is inconsistent with the argument as to which companies engage in this sort of behavior. BHP Billiton is the largest Australian taxpayer, and in recent years it has been accused of profit shifting through a tax strategy known as a ‘Singapore Sling’—but its Singapore hub was established in 2001 (Saunders 2015). Other companies that are regularly singled out for criticism include Amazon, Apple, Adobe, Abbott Laboratories, Facebook,Forest Laboratories, Google, IBM, Johnson & Johnson, LinkedIn, Microsoft, Starbucks, and Yahoo (Chessell 2014). Many of these companies did not exist in the early 1980s. The conditions for the so-called ‘Double Irish with a Dutch Sandwich’ also were not in place at that time, and many of the companies that have employed that strategy did not exist.

Two other objections might be raised against our approach. It could be claimed that the relevant comparison is not absolute change in the company tax
over time but change relative to what it would have been with stronger anti-BEPS policies been in place in that period. This is a plausible argument, but analysis in support of this claim has not been forthcoming. The Australian Taxation Office admits that “Company income tax receipts continue to move in line with macro-economic indicators, reflecting broad compliance by corporates with their income tax obligations” (2015, 34). Our analysis above corroborates that argument. A related claim might be that the long-term stability of company tax revenue reflects a concerted effort to keep Australia’s tax laws up to date with business practices. According to Joe Hockey, treasurer in the Abbott government, Australia has some of the “the strongest anti-avoidance laws in the world” (Hockey 2014). Again, the fine-grained analysis that would support such a claim has not been forthcoming, and in that absence, it strikes us as a leap of faith to suggest that individual anti-avoidance reforms have been well-calibrated enough to ensure that company tax revenue is consistent over time.

**Conclusion**

The corporate tax avoidance debate has many of the hallmarks of a moral panic. A moral panic consists of hyperbolic media and popular claims about threats to the social order, reinforced by political and legislative action that reproduces and amplifies those claims (Krinsky 2013). Moral panics are typically dramatic and sudden, characterized by rhetorical similarity across media and politics, and are “out of all proportion to the actual threat offered” (Hall et al. 1978, 16). This describes the corporate tax debate quite well. It is certainly true that multinational firms seek to minimize their tax liabilities, in Australia as much as anywhere in the world. However, there is little to no evidence consistent with hyperbolic claims about the level of tax paid by multinational firms—often based on misleading or incomplete information—that have been a common feature of Australian news media since the start of the OECD BEPS project. In the context of a federal budget in deficit, with the state of Commonwealth finances being a major political issue, corporate tax avoidance was associated with the constrained fiscal outlook and need for spending reductions. This debate has had a heavily moral dimension. It conveniently locates the source of Australia’s budget problems on corporate avarice. An advertisement produced by the Australian government in 2015 accompanying its corporate tax reforms stated that “The government will introduce new laws, and new penalties, to stop this greed.” Such language from a right-of-center

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17. See note 11 above.
Coalition government echoes that used by left-wing campaigners against corporate tax avoidance. ¹⁸

We have presented an outline of central claims in government discourse about corporate tax avoidance, and evidence that rejects those claims, or at least casts grave doubts on them. Governments of all stripes have a responsibility to maintain a high standard in their discourse about the exercise of their fiscal powers. Corporate taxation is a complex area, and the interaction between domestic tax systems and international taxation architecture is even more so. It is not surprising that there is much public confusion about corporate taxation. It is unfortunate that governments have chosen to exploit, rather than counter, that confusion.

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¹⁸. See, e.g., the statement by Richard Denniss of the Australia Institute, Official Committee Hansard, Senate Economics References Committee, April 9, 2015, p. 11 (link).


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About the Authors

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Propagandistic Research and the U.S. Department of Energy: Energy Efficiency in Ordinary Life and Renewables in Electricity Production

Daniel Sutter

LINK TO ABSTRACT

I treat two cases of what I believe can be characterized as research propaganda attributable to the U.S. Department of Energy (DOE). The first concerns the extent to which Americans are mindful of energy efficiency in their cars, appliances, homes, and machinery, and the second concerns the mandating of the use of renewable fuels in electricity production. I contend that the DOE-based research is unsound and that the unsoundness amounts to propaganda. The DOE should bear material responsibility for its research, its dissemination of research, and its influence over the research of others.

Energy efficiency in the ordinary lives of Americans

Are Americans mindful of energy efficiency in using their automobiles, lawn mowers, and appliances? The received wisdom of many energy policy experts is ‘no,’ a proposition which has been dubbed the ‘energy paradox’ or ‘energy efficiency paradox’ (or ‘gap’). American households and businesses allegedly pass up

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billions of dollars of cost savings by ignoring some of the cost of using products. On this matter the DOE has helped create and perpetrate major distortions of the truth.

The so-called energy efficiency paradox has had an enormous impact on public policy. The Energy Policy and Conservation Act of 1975 authorizes the establishment and periodic updating of energy conservation standards for residential and commercial products. Energy efficiency standards restrict freedom of choice by households and businesses as follows. Standards for minimum efficiency in energy use are set through the standard rulemaking process, supposed to be “technically feasible and economically justified,” and reviewed by the DOE every six years (link). Once a standard is set, appliance manufacturers must submit evidence from testing that each model they wish to sell in the U.S. meets the standard.2 The DOE establishes protocols for the tests that manufacturers are supposed to conduct to demonstrate compliance with the standards; these protocols also govern the information used to report annual energy cost for Energy Guide labels. The DOE is supposed to follow these same protocols when it conducts any product tests. Models for which manufacturers cannot submit test data showing compliance cannot be sold in the U.S. The DOE generally accepts the authenticity of data submitted by manufacturers from tests following the protocols and does not generally conduct its own tests or require third-party testing. The DOE conducts its own tests if it receives complaints about a particular model of appliance. If DOE testing reveals that a model does not meet the standards, the product must be pulled from the market and the manufacturer is subject to prosecution.

The DOE has aggressively strengthened these standards in recent years; 44 new or updated standards have been issued since 2009. Documents from the DOE tout enormous savings: “Today, a typical household saves about $319 per year off their energy bills as a result of standards, and as people replace their appliances with newer models, they can expect to save over $460 annually by 2030. ... The cumulative utility bill savings to consumers are estimated to be more than $1 trillion by 2020 and grow to nearly $2 trillion through 2030.” The DOE estimates that just one new standard, for commercial air conditioners and heat pumps, will save businesses $167 billion in total (DOE 2016a). And energy efficiency offers the promise of further gains, as emphasized by a DOE-sponsored report by McKinsey & Company: “Energy efficiency offers a vast, low-cost energy resource for the U.S. economy—but only if the nation can craft a comprehensive and innovative approach to unlock it. ... Such a program is estimated to reduce end-use energy consumption in 2020 by 9.1 quadrillion BTUs, roughly 23 percent of projected

2. Information about the Appliance and Equipment Standards Program is available via energy.gov (link).
demand, potentially abating up to 1.1 gigatons of greenhouse gases annually” (Granade et al. 2009, iii). A meta-analysis of engineering studies found that the potential energy savings could be as much as 60 percent (Rosenfeld et al. 1993).

The efficiency standards take less energy-efficient models off of the market. If households and businesses reasonably evaluate the tradeoff between energy use, price, and other product features, then restricting consumer choice, by taking options off the market, imposes costs on consumers. The energy efficiency paradox is required to provide an argument that restricting choice makes consumers better off. As the DOE puts it, “These solutions [standards] result in energy bill savings for consumers as the least-efficient product models become ineligible for sale in the United States” (2016a). What in the past would have been considered costs have been transformed into a new type of benefit of regulation, what have been called “private benefits” (Beaulier and Sutter 2012).

An energy efficiency ‘paradox’ result arises in two types of stories, or in a combination thereof. One story is that the price of energy might not reflect externalities, such as pollution, national defense spending to safeguard the energy supply, or subsidies or tax breaks in energy production. I do not treat the externality story. The other story is that, from a lack of prudence, people systematically under-exploit opportunities for energy efficiency. I do not treat the externality story here, for two reasons. First, the inefficiency possibly resulting from externalities is conceptually distinct from that alleged to result from poor decisions. Consequently the validity of the externalities attributed to energy use is distinct from the propagandistic argument regarding decisionmaking. Second, the external benefits of recent energy efficiency regulations have been small relative to the private benefits. For instance, Ted Gayer and Kip Viscusi (2013, 252) note that externalities total around 10 percent of the estimated benefits for the 2017–2025 model year fuel economy requirements for cars and light trucks. Sofie Miller (2015) calculates that private benefits constituted 88 percent of the quantified annual benefits of 25 DOE energy efficiency rules issued between 2007 and 2014.

The proposition that Americans systematically under-exploit opportunities has not, in my judgment, been established. Gayer and Viscusi argue that “There are a number of alternative reasons that can explain a purported energy efficiency gap, many of which are consistent with individual rationality.” They also say that “the evidence in the economics literature on the existence and magnitude of such an energy efficiency gap is mixed and does not provide a compelling justification for

3. Allcott and Greenstone (2012) offer another story: Builders or landlords make decisions about building energy conservation into structures and fail to offer energy efficient options to homebuyers or renters, perhaps because they believe customers will not be willing to pay extra for conservation. Consumers then cannot register a preference for energy efficiency.
overriding consumer decisions” (2013, 249). They conclude, “Taken as a whole, the engineering, empirical, and behavioral literature on the energy-efficiency gap does not provide strong, credible evidence of persistent consumer irrationality” (ibid., 250). Hunt Allcott and Michael Greenstone write that the literature demonstrating inefficiencies with regard to energy efficiency investments “frequently does not meet modern standards for credibility,” and “the empirical magnitudes of the investment inefficiencies appear to be smaller, and indeed substantially smaller, than the massive potential savings calculated in engineering studies” (2012, 5).

Energy efficiency investments involve households or businesses incurring upfront costs in exchange for lower energy costs over time. Allcott and Greenstone (2012) offer an overview of this decision problem (see also Jaffe and Stavins 1994). The key variables will be the estimated lifetime energy cost savings, which can be broken down into the reduction in energy use and the energy prices expected over the period of the investment, the discount rate, and the cost of investment. The cost of the investment includes the differential in the upfront expense and other ‘costs’ of the investment including transaction costs and reduced performance and enjoyment. Studies will often demonstrate an energy efficiency paradox by calculating the discount rate at which a decisionmaker would be indifferent about making the investment in energy efficiency, with a decision to not invest revealing application of a discount rate in excess of this threshold. If the threshold discount rate is too high, say because it exceeds the rate of interest which the decisionmaker faces in the market, the decision is ‘irrational.’ Allcott and Greenstone note that the opportunity cost term is generally unobservable and note that “in order to argue that an agent is not maximizing an objective function, the analyst must credibly observe that function in full” (2012, 5).

Engineering analysis is typically employed by DOE in assessing the potential energy savings. As illustrated by the Technical Support Document for one recent proposed regulation on residential dishwashers (DOE 2014), assumptions must be made about: the technology available to make a product using less energy; manufacturer cost of producing a product with this technology; how performance characteristics reduce energy (and water) use; retail markups based on the added costs; use by households (the number of cycles per year for a dishwasher); choice of a discount rate; expected useful life; and any added maintenance costs. Furthermore, even if not made explicit, assumptions must also be made about the costs to users of apprehending, comprehending, and implementing a new, more energy-efficient product. The Technical Support Document for this one proposed regulation runs to 489 pages, reflecting the detail of the analysis.

Nonetheless, energy efficiency investments often fail to deliver the promised savings. Heterogeneity provides an important reason why. Miller (2012) shows, using the DOE’s own assumptions, that households with fewer persons—which
include on average households headed by the elderly and low income earners—
run fewer dishwasher cycles per year and would never recoup the higher upfront
costs of the more efficient models. Differences across businesses can be even
greater. Ronald Sutherland (1991) found that energy savings predicted by engineers
in commercial building retrofits frequently differed by 20 percent or more from
realized savings, reflecting the importance of particular circumstances. Managers’
reluctance to make any given investment could easily result from a better
recognition of their particular circumstances.

Other studies suggest that projected energy savings are systematically over-
stated. A study by Proctor Engineering Group claimed a prospective 50 percent
rate of return on attic-insulation investments, but Gilbert Metcalf and Kevin
Hassett (1999) estimated a 9.7 percent rate of return. Metcalf and Hassett note
that engineering studies “misrepresent savings because they are based on highly
controlled studies that do not directly apply to actualized savings in a representative
house” (ibid., 516), and furthermore that the engineering studies are sometimes
provided by the makers of the products, raising questions of credibility. Other
studies also document disappointing results (e.g., Fowlie, Greenstone and Wolfram
2015b).

Transactions costs are an unavoidable challenge to credibly communicating
information. Assuming the costless transmission of true (and only true) product
quality claims commits the Nirvana fallacy that Harold Demsetz (1969) warned
against. Consequently, difficulty conveying knowledge of energy savings is not
necessarily a market failure, as those who posit an energy efficiency gap presume. It
is a hardy fact that households and businesses are unwilling to trust unverified and
frequently overstated energy efficiency claims, a fact that must be incorporated into
cost-benefit analysis.

The credibility challenge can be seen in the federal government’s effort at
certifying energy efficiency, the Energy Star program. Energy Star is a voluntary
certification program run jointly by the DOE and the Environmental Protection
Agency. The program is intended to provide consumers a “trusted source of unbi-
ased information” regarding the most energy efficient products on the market
(EPA IG 2010, 2). In principle, as Viscusi and Gayer (2016) argue, information
provision is a targeted and noncoercive way for the public sector to address
decisionmaking biases. Energy Star certification and Energy Guide labels provide
consumers with information about estimated energy use and should provide an
antidote to myopia. The information in the certification and labels, however, must
be perceived to be credible. Numerous government reports have documented
Energy Star’s considerable design flaws (GAO 2007; 2010; 2011; DOE IG 2009;
EPA IG 2010). One GAO report (2010) documented the weakness of the Energy
Star certification process by submitting 20 bogus products for certification. Fifteen
of the products received Energy Star certification, with three still pending review at the conclusion of the test; only two were rejected. Until recent reforms, Energy Star never relied on independent, third-party testing, which is the core of successful private quality-certification programs (see Holcombe 1997). Rather, the DOE presumes that the manufacturers’ documentation is valid and relies on competitors to challenge the authenticity of bogus claims (GAO 2010). The EPA’s Inspector General concluded that “We believe the ENERGY STAR program has sought to maximize the number of transactions of qualified products at the expense of identifying products and practices that maximize energy efficiency” (EPA IG 2010, 12). Manufacturers may have more or less success than the DOE and EPA in convincing consumers, but establishing credibility is never costless. We don’t consider fuel scarcity a market failure. Why should we consider trust scarcity to be one?

Engineering studies frequently ignore the full costs of investments. Engineering analyses often claim to compare more and less energy efficient versions of products delivering equivalent services, but ignore that only consumers and not engineers can offer a final assessment of this. Susan Dudley (2000) reports survey evidence of a consumer preference for top-loading clothes washers, which were at risk of being forced off the market in favor of more energy efficient front-loading models. Jeffrey Tucker (2015) discusses many consumers’ frustration with low-flush toilets. The DOE’s analysis of proposed standards for residential dishwashers used an estimate of the number of cycles per year for machines available before the proposed standards (DOE 2014, ch. 7). The analysis implicitly assumes that households accept the level of cleaning provided by the new models and do not adjust use based on observed differences in performance. Any reduction in consumer satisfaction due to modified product attributes should be included as a cost.

Other cost omissions seem even less defensible. Estimates of savings through electric utilities’ conservation programs often include only the costs incurred by the company, not customers, and thus overstate the return on conservation and the tragedy of a failure to invest (Joskow and Marron 1992; Allcott and Greenstone 2012). The Federal Weatherization Assistance Program has assisted 7 million low-income households since 1976, but assessments typically exclude several costs of household participation, including the onerous application process, the need to meet with the inspectors and contractors, and the

4. The same presumption of credibility applies to the documentation submitted by manufacturers to demonstrate that models meet energy efficiency standards. Energy efficiency standards will be less coercive than they might appear if bogus documentation goes unchallenged and less efficient models are allowed to remain on the market.
inconvenience of having work done in their homes (Fowlie et al. 2015a). Meredith Fowlie, Michael Greenstone, and Catherine Wolfram (2015b) estimate that with all relevant costs included and energy savings accurately measured, the rate of return on investment for weatherization is −9.5 percent a year.

Customers might fail to accurately forecast energy prices, contributing to a purported paradox, but again we are dealing with hardy facts that must be incorporated fairly. Many energy efficiency investments have an expected life upwards of 15 years, and price expectations over such an extended period must be rough guesses even to our best wizards. Energy experts sometimes fail to forecast even major price movements, such as the declines in natural gas prices after 2009 and oil prices since 2014. A decade ago numerous experts and books declared the end of cheap oil (see, e.g., Heinberg 2005; Roberts 2004). Consumers face knowledge costs in obtaining and comprehending energy price forecasts, in assessing the credibility of alternative forecasts, and in taking on new decisions. Yet as David Henderson (1985) observed, consumers appear to have better anticipated the oil price declines of the 1980s than did industry experts. Even should consumer forecasts of future prices happen to exhibit, as some allege, a downward bias, it is inappropriate to treat a failure to solve a challenging forecasting exercise as evidence of foolish decisionmaking.

One man’s efficiency is another man’s ordeal. What do researchers really know about the particularistic world of the individual man or woman or business they presume to nudge or coerce?

A more reasonable test of whether people mind opportunities for energy efficiency is to see whether behavior is affected by energy prices and changes in energy prices. The evidence is clear: Energy prices and the lifetime cost of energy consumption matter. Jerry Hausman (1979), who provided the first evidence typically cited in support of the energy efficiency paradox, found that consumer choice could be rationalized by a discount rate of between 12 and 18 percent, a rate that is higher than the risk-free rate of return but not out of line with interest rates that households and even smaller businesses might face for borrowing. Mark Dreyfus and Kip Viscusi (1995) found similar results. Recent papers have examined changes in car prices along with changes in gas prices. The prices of more and less fuel-efficient cars afford a relatively clean test of whether the expected cost of energy use affects current decisions. James Sallee, Sarah West, and Wei Fan (2015) find that used car prices change to fully reflect a change in gas prices. Meghan Busse et al. (2013) find a significant change in the market shares of the most and least fuel-efficient new car models in response to an increase in gasoline prices. They also find that sales of used cars adjust in a manner consistent with the interest rates that car buyers face in the market. Hunt Allcott and Nathan Wozny (2014) find that used car prices change to reflect about 70 percent of a change in gas prices. Proponents
of strict market efficiency might point to the first two studies for support, while Allcott and Wozny (2014) has been cited as evidence of myopia. I read all three studies as showing that energy efficiency matters to consumers.

The proposition that Americans do not adequately mind energy efficiency opportunities affects policy, particularly DOE regulations. Private benefits provide the cost-benefit justification for recent DOE energy efficiency standards. As Miller describes it, the DOE “believe consumers are not adequately equipped to trade off upfront price increases against long-term energy savings. Overcoming this presumed cognitive failure is the primary focus of DOE’s energy conservation standard” (2015, 6–7). But as Gayer and Viscusi (2013) note, the regulatory impact analyses of these proposed regulations provide no more than general reference to the (allegedly well-established) proposition that decisionmakers systematically ignore energy use savings. The 2014 standards for commercial clothes washers exhibit the extension of this thinking to its natural, albeit dubious, limit. The DOE projected that the new standard would generate $38 million in annualized benefits, $30 million of which were private benefits, against $30,000 in annualized costs (Miller 2015, 28, rule #1904-AC77), which would imply an opportunity for a 1,000-fold bang for the buck! Such a benefit-cost ratio might be dismissed as preposterous propaganda—and rightly so. It also reflects institutionalization of the DOE’s research propaganda. The autonomy and moral worth of individuals is the foundation of the liberal society of voluntary exchange and limited government. Persons who so disdain their fellow citizens’ capacity as to suspect that for-profit businesses (which are free to hire energy efficiency experts as consultants) will fail to make an investment yielding $1,000 in benefits for every $1 in cost should not serve in the government of a liberal society. And economists should be wise enough to incorporate into their research the old adage that an offer that looks too good to be true probably isn’t.

**Mandating use of renewable energy in electricity production**

Another area in which the DOE discredits itself by issuing propaganda is in the matter of mandating renewable energy in electricity production. For decades national and state governments have promoted and invested in alternative or renewable energy sources (Vietor 1984; Morriss et al. 2011). And perhaps not surprisingly, the DOE extols the enormous benefits allegedly provided by such investments and subsidies. Consider a recent restatement of the benefits of renewable energy:
Decades of investments by the federal government and industry in five key clean energy technologies are making an impact today. The cost of land-based wind power, utility and distributed photovoltaic (PV) solar power, light emitting diodes (LEDs), and electric vehicles has fallen by 41% to as high as 94% since 2008. The cost reductions have enabled widespread adoption of these technologies with deployment increasing across the board. … These technologies are now readily available and our country has already begun to reap the benefits through their increased adoption. (DOE 2016b, 1)

One related policy is mandating that electric utilities use more electricity generated from renewable fuels, or Renewable Portfolio Standards (RPS). Although states and not the DOE have adopted RPS, the DOE is responsible for the propagandistic claim that such mandates will not increase and could even lower the cost of electricity.

RPS sets thresholds for the minimum amount of electricity that utilities must supply from renewable energy sources, and have been set by states. Consumers pay for electricity generated from renewable sources regardless of whether these sources are cost competitive. The burden on consumers derives from the government control of public utilities. A public utility is granted by government an exclusive franchise for a geographic area, with its rates and terms of service subject to approval by a state regulatory board. Utilities operate under a common carrier rule, meaning that they must sell to all customers willing to purchase at the regulatorily approved terms. Public utilities regulation burdens consumers by allowing purchase only from the designated monopolist, and the terms of service can only be influenced by lobbying the regulators.

RPS imposes requirements on utilities to generate or purchase a minimum amount of power from renewable sources like solar or wind power (what qualifies as “renewable” differs across states). Since utilities operate on some variant of cost of service regulation, the costs of renewable-fuel-source electricity will be passed on to customers. Thus an RPS provides a hidden subsidy to politically favored fuel suppliers and electricity suppliers, on top of other forms of assistance like federal loan guarantees and tax credits.

The first state to adopt an RPS was Iowa in 1983, with Massachusetts and Nevada being next in 1997. Currently 29 states plus the District of Columbia have a mandatory RPS, while eight states have voluntary standards. A national RPS has been proposed but has not been adopted to date.

5. West Virginia repealed its mandatory RPS, while Ohio has a two-year freeze on its mandatory standard, but it remains on the books. For details on state RPS standards see Durkay (2016) or the Database of State Incentives for Renewables & Efficiency (link).
A typical standard will specify that 10 percent of electricity must be generated from renewable sources beginning in a given year. States’ rules differ in exactly which fuels count as renewable, and some have provisions to exempt compliance if the price of renewable energy is too high (see Michaels 2008). The threshold and year in which the standard must be first met vary, and some states have separate initial thresholds and higher ultimate thresholds. Hawaii’s RPS requires at least 30 percent renewable fuel production beginning in 2020, rising to 100 percent by 2045. States also differ in the threshold for renewables use applied to different types of utilities, with investor-owned utilities sometimes held to a higher standard than municipal or cooperative providers.

Consider a utility purchasing electricity from suppliers using renewable and nonrenewable fuels. Think about the stripped-down, admittedly simplistic textbook model: The supply from both fuels is competitive, the utility makes purchases to minimize cost, and they will equate the marginal cost of electricity from each source. That is, profit maximization leads to resource cost minimization. Mandating the use any other mix of fuels consequently must increase cost. Now, it is fine to depart from that simple model: But do the departures really turn the basic logic of cost minimization on its head, such that mandating higher-cost inputs would not increase costs to the firm? To achieve that, the departures would have to be pretty remarkable—and should satisfy our demands for plausibility. And shouldn’t those imposing coercion bear the burden of proof when it comes to showing the net benefits they promise to achieve?

More than a dozen studies have estimated that an RPS would only modestly increase or might even decrease the price of electricity (Wiser and Bolinger 2007). The studies generating this result use the National Energy Modeling System (NEMS), compiled and updated periodically by the DOE’s Energy Information Administration (EIA). As Robert Michaels (2008) explains, the NEMS has hundreds of equations arranged in modules created by different groups, makes literally thousands of assumptions, and has 3,500 pages of documentation. Users are given the opportunity to make selections among certain model assumptions as well. Ultimately the complexity of the modeling system ensures that no more than a handful of specialists fully understand its workings.

How then did studies using NEMS find that fuel purchase mandates overturn a fundamental principle of cost minimization and possibly lower electricity prices? Studies by Ryan Wiser and Mark Bolinger (2007) and Carolyn Fischer (2010) identified natural gas prices as the channel; Fischer also emphasizes the

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6. Electric utilities have been subject to public utilities regulation by state governments and thus perhaps should not be viewed as maximizing profit prior to the implementation of an RPS. This point has not been offered as part of the story of how an RPS mandate will lower cost.
relative elasticities of supply for electricity produced from natural gas and renewable sources. To reconcile the projections with the assumption that the firm is interested in reducing its costs, researchers offer the following pecuniary-externality story: The reduced use of natural gas to generate electricity due to the RPS reduces the price of natural gas and the price of electricity produced using natural gas. This price reduction creates a transfer of producer surplus from natural gas suppliers to electric utilities. The wealth transfer gets passed on to electricity customers through average cost pricing and is treated by the studies as a welfare gain, even though it is not—the gain for consumers corresponds to a loss for natural gas suppliers, a loss somehow overlooked by the analysts. The studies do show that the resource cost of electricity produced is increased by an RPS. The proposition therefore I think is more misleading, than wrong. Prices normally reflect the cost of production to society. Because an RPS also effects a wealth transfer from the suppliers of natural gas, this masks the higher resource cost of electricity. Normally in markets, lower prices reflect lower resource costs, and a decline in the real price is a signal of progress over time. The higher resource cost of electricity production with an RPS means that the economy will be poorer, not more prosperous, despite a possible decline in electricity prices.

Another reason why the incorrect inference contained in the proposition is not wholly innocent is the use of modeling results as if they were evidence from the world. Predictions must always be compared with reality, especially since RPS will mandate the supply of larger quantities of electricity from renewable fuels than ever supplied before, and so the NEMS model must be relying on assumptions about the cost of this supply, which could prove wildly inaccurate. Ignoring actual prices is misleading, to put it mildly, because electricity prices are higher in states with binding RPS provisions. I gathered data on the matter, shown in Table 1. The table reports the average all-sector retail electricity price for states in each category during the fall of 2014. The table also reports the change in the retail price over the previous year. I divide states into three groups: no RPS, a voluntary RPS, and a mandatory RPS. I omit Alaska and Hawaii since their electricity markets are not integrated with the contiguous states. States’ RPS requirements vary substantially, and a mandate that 10 percent of electricity be generated from renewable fuels presumably impacts a market less than does a 40 percent standard. So Table 1 also reports the average price for the states with an ultimate RPS threshold in excess

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7. Ignoring, as mentioned earlier, external cost arguments for renewable fuels.
8. I distinguish voluntary RPS states from states without an RPS because a voluntary RPS may signal to utilities the likelihood of a future mandatory rule, affecting fuel choice today. Hawaii has a mandatory RPS, while Alaska has no RPS, and inclusion of both states has little effect on the difference in average price between no RPS and mandatory RPS states. All of the states with mandatory RPS in Table 1 had a mandate in place since at least 2008, allowing time for purchases to affect decisions and costs.
of 20 percent. Electricity prices were 29 percent higher and price increases one
percentage point higher in states with a mandatory RPS than in the no standard
states. Average prices were 40 percent higher and the price change almost two
percentage points higher in states with the strictest RPS thresholds. The averages
in Table 1 show that the predictions from NEMS-based assessments to be at odds
with observed prices. States with stricter RPS requirements have consistently had
higher electricity prices since at least 2010; the year-to-year changes in prices show
more variation. This simple cross-sectional comparison of prices cannot hope to
prove causality, since states with mandatory RPS could have had higher electricity
prices prior to enactment of the mandates. But higher electricity prices in RPS
states is a fact that must be addressed by a serious argument that renewable
electricity mandates will not raise costs.

<table>
<thead>
<tr>
<th>TABLE 1. State retail electric prices and renewable portfolio standards</th>
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<tr>
<td>Price of electricity, 10/2014, cents per kwh</td>
</tr>
<tr>
<td>No standard</td>
</tr>
<tr>
<td>Voluntary</td>
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<tr>
<td>Mandatory</td>
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<td>Mandatory, threshold &gt;20%</td>
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(Source: Author’s calculations (Excel file [here](#)), using prices from the Energy Information Agency and status of state Renewable Portfolio Standards as of January 2015 from the Database of State Incentives for Renewables and Efficiency. Notes: Alaska (no RPS) and Hawaii (RPS with threshold >20%) are excluded from the above averages.)

A different piece of evidence in support of the costless RPS mandate proposition was provided by a study from the National Renewable Energy Laboratory and Lawrence Berkeley National Laboratory (Heeter et al. 2014). This study formed the cost component of a more recent overall analysis of RPS (Wiser et al. 2016). Jenny Heeter and collaborators (2014) purport to examine evidence on costs of renewable fuels mandates from across the country. As the authors note, “Most of these policies have five or more years of implementation experience, enabling an assessment of their costs and benefits” (Heeter et al. 2014, iv). This study would appear to be evaluating the actual impact of RPS on electricity prices, as I suggested. Heeter et al. report an average incremental cost of RPS of about 1 percent on electricity prices, suggesting that the NEMS-based projections of a modest price impact are being borne out. Again, however, actual electricity prices are not examined; instead, Heeter et al. offer cost estimates based on the regulatory treatment of renewable fuels. This is misleading, for two reasons. First, politically determined prices are not market prices based on mutual agreement and do not

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always reflect opportunity costs. Whether regulators allow utilities to pass the cost of renewable fuel purchases on to consumers does not affect whether electricity from renewable sources actually costs the utility more. Second, utilities are regulated on many margins, and regulators could easily let costs be passed on along some other margin. The regulatory treatment of renewable fuels is exactly the type of political action that can be taken for show without real effect. The authors acknowledge that the methods and assumptions made by regulators vary widely across states, that the reported cost figures exclude certain types of costs (e.g., estimates of the cost of wind power often exclude the cost of connecting wind to the grid), and that the figures they report “do not represent net costs to society, nor do they necessarily represent the costs ultimately borne by rate payers” (ibid., iv–v). But if the authors realize that the reported numbers have no connection to economic costs, why was the study titled, “A Survey of State-Level Cost and Benefit Estimates of Renewable Portfolio Standards”? Attempting to confuse the plain meaning of cost represents a not-so-innocent error.

State lawmakers and not the DOE have passed RPS. Still, the role of the DOE is clear, and it likely affected the diffusion of RPS mandates. We can first note the direct efforts of the DOE in the research. Five of the 12 studies reviewed by Ryan Wiser and Mark Bolinger (2007) were conducted by the DOE’s EIA. The model-based predictions all use the DOE’s NEMS. And Heeter et al. (2014) and Wiser et al. (2016) were produced by the NREL and Lawrence Berkeley National Laboratory, two DOE labs.

A second factor involves the timing of the research. The first studies reviewed by Wiser and Bolinger (2007) were conducted by the EIA and appeared beginning in 1998. All but two of the current mandatory RPS were enacted between 1997 and 2008. Renewable fuels do offer some benefits relative to fossil fuels, but the primary cost would be the use of more resources to supply electricity. Clearly if the cost can be claimed to be trivial, this makes an RPS almost appear to be a free lunch. Opponents of RPS in different states did produce studies claiming that electricity prices would be driven much higher by the mandates (Tuerck, Bachman, and Head 2011; 2012; Bryce 2012). At a minimum, the NEMS-based studies made the question of whether mandates had any significant cost a point of debate among experts, muting an otherwise strong argument against an RPS. The stamp of government approval lent distortion to the debate.

Concluding remarks

The propositions that Americans currently ignore the cost of energy use and that renewable fuel mandates might be costless are not only based on bad
economics, but in duplicity. In view of government duplicity, I offer two points. The first starts with the NEMS, the complex energy market model used by studies claiming that RPS might lower electricity costs. Economists who understand that the market economy is a spontaneous order understand that loose pattern predictions, at best, can be made about the economy, and that even those are sometimes wrong. Economic policy should not be based on precise predictions of the magnitude of effects. Many actors in the economy, however, have an interest in pretending to be able to forecast economic variables. Many decisionmakers will use forecasting models, even if forecasts are dubious. A plurality of forecasting models probably generate benefits to society through the wisdom of crowds. Should government privilege any one model by making it official? Should government construct its own model to guide policymaking? This is what the DOE has done with NEMS. If the government builds official models, then the hundreds of assumptions involved all take on political significance. If the DOE constructs the model of the energy sector to be used for policy decisions, and if this model becomes the standard for academic research, the DOE is also constructing the measuring stick for use in evaluating its policies. There is great potential for mischief in selecting assumptions to achieve the desired assessments.

Second, the NREL illustrates a potential problem with government labs invested in one research area. Undoubtedly there may be gains from co-locating leading researchers on a topic at the same lab, making the resulting science more productive. From normal bureaucratic incentives to maintain one’s organization and seek budget increases, however, the danger arises for a special purpose lab to become cheerleaders for such research, a label that I think could fairly be given to Wiser et al. (2016). A representative citizen might well choose to have government fund and perhaps even conduct research on specific technologies for using renewable energy. An investment in research to assess the potential of wind or solar might be prudent. The representative citizen, however, would want government to conduct the research impartially, and be willing to end research when a design shows little promise. Special purpose labs seem to run a risk of becoming special interests, at odds with the general interest in expanding the stock of knowledge. We should be concerned that under many guises the government uses taxpayer money to grow the government faction.

Appendix

An Excel file with the author’s calculation used for Table 1 is available here.
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**About the Author**

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Slip and Drift in Labor Statistics Since 2007

Clifford F. Thies

LINK TO ABSTRACT

We must preserve not only the bodies of the unemployed from destitution but also their self-respect, their self-reliance and courage and determination.

—Franklin D. Roosevelt (1935)

The U.S. Department of Labor perhaps more than any other agency of government is susceptible to propagandizing through statistics. The agency has its roots in the provision of statistics, a few of which remain focal points for attention from economists and the press. A key responsibility for the Department is to help the public interpret the data that it produces, and such interpretations are often provided by the Secretary of Labor.

Here I focus on the statistics concerning unemployment produced by the Department of Labor, finding some indications that they might not be fully reflecting changes in labor market conditions. Labor force participation has slipped since the recession, even after controlling for demographic changes in the population; and, the official unemployment rate has drifted a bit from other measures of the performance of the labor market—measures that are not produced by the Department. I suggest that, if the Department’s statistics alone are becoming less adequate for understanding and assessing labor market performance, that the Department’s interpretations and statements should correspondingly be considered less adequate for such purposes. Perhaps economists should make greater

1. Shenandoah University, Winchester, VA 22601. The author thanks Ryan Daza for his contributions to an early draft.
use of additional sources of data on the labor market. In the final section of this paper I reflect on the importance of long-term unemployment as a social problem.

**A brief history of the Department of Labor**

The U.S. Department of Labor could be said to have had its origins in the labor movement of the mid-19th Century (Lombardi 1942; Grossman 1973). By the end of the century, there were several dozen state bureaus of labor statistics, most prominent among them Massachusetts (Keyssar 1986), as well as a U.S. Bureau of Labor Statistics (BLS). The mission of these bureaus was to collect and publish information on labor and employment. The BLS initially pursued this mission through annual reports and periodic studies. By the early 20th century, the BLS began publishing price indexes on a monthly basis, first wholesale (today, producer) and then retail. By the mid-20th century, the bureau began to collect data and publish monthly statistics on labor market conditions, plus an expanding array of other statistics of various periodicities.

In 1913, when the modern day, cabinet-level Department of Labor was formed, it consisted of four disparate agencies (BLS, Immigration, Naturalization, and the Women’s Bureau). Secretaries of Labor formerly tended to come from the ranks of the private-sector unions of the country, or were lawyers for these unions or academics specializing in labor relations. During the past several decades, they have been career public servants, having previously served in either appointive or elective offices.

Over the years, the department gained responsibility over the regulation of wages and hours of employment and occupational safety, for the federal government’s role in the nation’s system of unemployment insurance, and for the administration of various manpower and training programs, while losing immigration and naturalization to the Department of Justice.\(^2\) Even with its expanded responsibilities, the release of the Employment Situation Summary on the first Friday of the month is a signature event for the department. The Employment Situation Summary covers the findings of two very large surveys: the Household Survey (or, Current Population Survey) and the Establishment Survey (Current Employment Survey; referred to by journalists as Jobs Report). It is from the former that statistics on unemployment and labor force participation are developed.

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2. Immigration and naturalization were subsequently moved to the Department of Homeland Security.
Communication of facts and statistics on the current recovery

Two of the statistics published monthly by the Department, job growth and the official unemployment rate, have long tended to receive the lion’s share of public attention. But as a great deal of research has found—as do I, later in this paper—that in the years following the recession of 2007–2009, those two statistics have failed to reflect an important change in the labor market, namely a weak recovery in labor force participation. The unemployment rate has recovered comparably better, and that, I contend, has created an unfortunate alignment of incentives regarding communications from the Department: Continuing, routine placement of emphasis on the two traditional headline statistics projects the image of a recovery stronger than is really justified, which of course is the image any incumbent administration would like to foster.

Not surprisingly, Secretary of Labor Thomas E. Perez has consistently and repeatedly invoked the traditional headline statistics, while facts about labor force participation tend to appear in his discourse much less often. As an illustration, I reviewed the last twelve of the blog posts that Perez made on the Department website each month upon the release of the new figures. Perez references each of the two headline statistics in all twelve posts. I find that Perez conveyed a fact or statistic about labor force participation in only three of the twelve posts. By comparison, Perez conveyed information about new jobless claims in eleven of the posts, about earnings or wages in six posts, and about job openings in five posts. And he frequently conveyed economic statistics or facts unrelated to labor markets, invoking auto sales in six posts and consumer confidence in six posts.

To be sure, the Secretary of Labor is a political appointee, and can be presumed to serve the interests of the administration. Furthermore, the Democratic Party, being the center-left party of this country, is disposed to attribute poor economic performance to the marketplace and good economic performance to government activism. To some extent, then, the emphasis of certain statistics and de-emphasis of others, and the attribution of cause variously to the marketplace or

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3. “Official unemployment rate” is a term the BLS itself uses; see, e.g., the U-3 row in Table A-15 of the Employment Situation news release (link).
4. A spreadsheet documenting my investigation is available for download (link). I emphasize Perez’s monthly blog posts because they lend themselves to systematic review, but I do see the pattern elsewhere. For example, in his March 16, 2016, testimony before Congress (link), Perez summarized the post-recession “turnaround” with his third paragraph. The statistics and facts he included are the unemployment rate, job growth, auto sales, unemployment insurance claims, and job openings.
to the government, is fair game in politics. Continued economic growth over a long period of time at a moderate rate can be looked at two ways. Some can say, pointing to the growth part, that the glass is half full. Others, pointing to the performance of the economy relative to prior trends, that it is half empty.

**Official unemployment rate versus labor participation rate**

From a peak of 10 percent during October 2009, the unemployment rate fell to 5 percent during October 2015 and has since stayed at about this level. The reported fall in unemployment has been criticized for being driven by a fall in labor force participation, as opposed to being driven by vigorous job growth.

Figure 1. Civilian labor force participation rates by age and overall (percent)

Writing in the Department’s *Monthly Labor Review*, Steven F. Hipple (2016) presents a comprehensive picture. Since 2000 (a starting point prior to the focus of this paper), labor force participation has been falling among almost all age groups:
• **Teenagers (16–19).** Participation declined both among those who are in school and among those who are out of school, as well as because school enrollment has increased.
• **Young adults (20–24).** Participation declined among those who are in school, a group which made up an increasing share of young adults. Among young adults out of school, participation has been steady.
• **Prime-age adults (25–54).** Participation declined among both males and females.
• **Older adults (55+).** Participation rose from 2000 to 2007 and has been steady since then.

Across age cohorts, those whose labor force participation fell the most were less educated persons. Participation also declined because there was a shift of persons from the prime-age to the older cohort.

These trends in labor force participation can be seen in Figure 1. Because of these changes and shifts between age cohorts, the overall participation rate (thick black line in the middle) has fallen by 3 points from 2007 to 2016.

To isolate changes in participation within age groups from the shift of people from one to another age group, Figure 2 presents re-calculations of the overall participation rate as the weighted average of the participation rates of these four age groups, with the weights frozen at their 2007 levels. Instead of \[ P_t = \sum_{i=1,4} w_{it} P_{it} \] where \( P_t \) is the overall participation rate at time \( t \), \( w_{it} \) is the weight and \( P_{it} \) is the participation rate of the \( i \)th age group at time \( t \), participation is calculated as \[ P_t = \sum_{i=1,4} w_{2007} P_{it} \]. This calculation suggests that about half of the decline in participation over the period 2007–2016 was due to demographics, and about half to other reasons.\(^5\)

This fixed-demographics measure of participation fell over the period, but not by as much as the reported participation rate. The decline of participation due to reasons other than demographic changes I will call ‘the slip.’ Were the slip to be added to the reported unemployment rate, the fall in unemployment from its peak would be only to 7 percent, as is shown in Figure 2.

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5. Conducting the exercise over 1999–2007 reveals no such slip in participation. Basically, rising participation by older persons offset falling participation by younger persons.
Other analysts have offered similar findings. Willem Van Zandweghe (2016) focuses on the “rapid decline” in labor force participation from 2007 to 2011. Demographic changes, changes in the culture, and so forth, he says, are likely to result in gradual changes in participation. The dramatic changes he finds during 2007–2011 are “cyclical” in the sense that they occurred during the downturn in the economy and its immediate aftermath (and yet he demonstrates that labor force participation is usually only modestly procyclical). In addition, the several extensions of unemployment benefits during the period masked the eventual fall in participation, as many people who lost their jobs during the downturn remained in the labor force, looking for work as is required to receive unemployment benefits, until their benefits expired, at which time they exited the labor force. Shigeru Fujita (2014), examining the reasons people cited for not being in the labor force, attributes about 1.5 points of the fall in participation to reasons other than retirement or disability. He also finds that retirement and disability rose.

Alternative measures of unemployment

Since 1991, the BLS has been publishing expanded measures of unemployment. Among these is the “U6” measure that counts as unemployed persons who...
are without work who are discouraged and marginally attached to the labor force, and those who are working part-time but would like to work full-time, in addition to those who are (completely) without work and actively looking for work. When promulgated, the U6 measure was about twice the size of the “official” concept. The high correlation exhibited between the two measures supports the use of the standard concept at least as an index of the underutilization of labor. While the official measure has returned to its level at the onset of the 2007–2009 recession (5 percent), the U6 measure remains above that level (10 versus 9 percent).

Jim Clifton (2015), chairman and CEO of the Gallup Organization, has been a blunt critic of reliance on the official unemployment rate: “There’s no other way to say this. The official unemployment rate, which cruelly overlooks the suffering of the long-term and often permanently unemployed as well as the depressingly underemployed, amounts to a Big Lie.” Every month, Gallup interviews about 30,000 people in its ongoing omnibus survey, which includes questions sufficient to construct a measure of unemployment similar to the official unemployment rate, as well as an expanded measure, which is described as an underemployment rate, roughly similar to the U6 unemployment rate.

Figure 3 shows that the unemployment statistics produced by the BLS have been drifting away from these comparable statistics produced since 2010 by Gallup. During the first two years, BLS unemployment rate was lower than the Gallup figure by an average of only 0.1 percentage points. But, during the two years ending August 2016 the BLS unemployment rate has been on average lower by 0.7 percentage points. As for the expanded measures of unemployment, they have drifted apart to a greater extent. During the first two years, the Gallup figure was on average 2.4 percentage points higher. This initial difference probably reflects differences in the definitions of the BLS U6 unemployment rate and the Gallup underemployment rate. During the past two years, the Gallup figure has been on average 4.1 percentage points higher, a drift of 1.7 percentage points.\(^6\)

The BLS and Gallup survey approaches do differ. In the Current Population Survey, respondents are not directly asked if they are “unemployed.” Rather, unemployment is inferred from whether—if they were not working during the reference week—they were actively looking for a job. Gallup, in determining unemployment, does rely on respondents’ colloquial understanding of “unemployed” (Jacobe 2012). The initial similarity of the BLS and Gallup measures of unemployment, and the rough similarity of their trends since Gallup began to track the unemployment rate, can be taken as validation of both approaches. The

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\(^6\) Regressions of the spread of the Gallup and BLS figures against time are highly significant for both the official unemployment rate (\(t = 4.21\)) and the expanded measure (\(7.64\)).
The Council of Economic Advisers recently released an admirable report that attempts to assess the usefulness of different BLS-produced statistics. The CEA concludes that one of the two major surveys used by BLS, the Establishment Survey, produces information on monthly changes in employment that is far more useful than the information produced by the other, the Household Survey (2017, 2–5). I hope that economists will mount similar investigations of the usefulness of other sources of data on the labor market, such as the Gallup survey.

**Beyond discouraged**

The earliest statistics we have of unemployment concern persons with “gainful occupations” who were not at work (Moen 1988; see also James and Thomas 2003; Vedder and Gallaway 1992). By the 1930s, unemployment became redefined as persons not working who are looking for work, with concern for persons not working who are not looking because they are discouraged (Card
The earlier, “gainful occupation” approach basically presumed that prime-aged men sought work, along with some women perhaps because they were without male support, and that not working was caused by sickness or injury, strike activity, bad weather, industrial recession or some other such cause. The new, search-based definition of unemployment better fits an increasingly diverse work force, especially in terms of age and gender, so that a person’s choice to look for work is determinative. There remains, in the search-based definition of unemployment, a presumption that those who should work will seek to work, except those who are discouraged.

For various reasons, labor-force attachment appears to be on the wane in the United States. Workers may be less inclined to work or to work full-time because income security programs raise the reservation wage, and taxes and the means-testing of income security programs make work unprofitable for some low-wage workers (Mulligan 2012; Thies 2012).

Erik Hurst (2016, 27:30) discusses trends in employment, cohabitation, leisure activities, and happiness of less educated males, out of school, aged 21 to 30. He finds substantial decreases in employment and marriage, increases in living with parents or other close relatives, and increased playing of video games. Russ Roberts, conversing with Hurst, finds it difficult to believe that young men are choosing a lifestyle of living in their parents’ basements playing video games instead of seeking employment and marriage (ibid., 43:30). But, according to Hurst, these young men describe themselves as happy.

Although we economists describe the sentiment of failure in finding acceptable work merely as being discouraged, some fellow social scientists are more descriptive, using terms such as “learned helplessness” (e.g., Beck 1990, 253–267). Early work distinguished the effects of short-term unemployment from those of long-term unemployment, the latter of which is more corrosive (Harrison 1976; Hill 1977). Learned helplessness can explain continued non-participation even following a vigorous recovery (Zippay 1995). Among the consequences of learned helplessness, especially among those who identify themselves as disadvantaged, are the loss of self (or, self-identity) and distrust of others. Some individuals may externalize their continued failure, indulging themselves in self-righteousness, while others may internalize their continued failure, indulging themselves in self-blame (McClure 1985, 1537).

7. To be sure, from time to time, complications arise as to whether to count persons participating in work projects and other manpower programs as employed, unemployed or out of the labor force (e.g., Darby 1978).

8. Perhaps the earliest investigation in this genre was Eisenberg and Lazarsfeld (1938).
While increased unemployment represents the loss of a wasting asset and thus a true social loss, reduced labor force participation may represent something more terrible. The focus on the official unemployment rate to the exclusion of other measures of the performance of the labor market tends toward a focus exclusively on output lost from the underutilization of labor. It tends to obscure the idea that, for many, work earns one respect and organizes and gives meaning to life. There is a sense in which hidden unemployment, from discouragement, is a worse problem, and that the real justification in using the official measure of unemployment is its correlation with broader concepts. But, it appears, such correlation has not been entirely steady. Let’s keep watching, with a mind to reconsider our habits in interpreting labor statistics.

Appendix

Data used to construct the three figures is available for download (.xlsx format).

References

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