

Towards A Philosophy of Economics

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Disclaimer. What follows is an economic discussion and we must be mindful of Sir Karl Popper's admonition: Economics is not a science -- it is a pseudoscience. Economic statements cannot be falsified or verified by experiment. You will not be listening to the truth -- just a series of interesting conjectures.

At a campaign stop in Toledo a year ago President Obama had a conversation with a voter known as "Joe The Plumber". Joe said he was going to buy a plumbing business and would be earning more than \$150,000 a year. He asked the President: "Your new tax plan is going to tax me more, isn't it?" The President said it would and added: "My attitude is that if the economy is good for the folks from the bottom up, it's going to be good for everybody. I think when you spread the wealth it's good for everybody."

The President's remark unleashed a storm of criticism from the opposition. Sarah Palin said the remark showed the President was a socialist. Rush Limbaugh said it showed he was a Marxist. Senator McCain said the Obama program was to tax wealth while his was to create it.

At the time Joe and the President had their conversation the country had been in a recession for four quarters. The weekly close of the Dow Jones Average had fallen from the \$14,000 level in October 2007 to the \$10,000 level in October 2008, a drop of 35%. The market would continue to drop for two more quarters reaching the \$6,500 level in March of this year. In six quarters the Dow had dropped 54%. (It has since rebounded back to \$10,000.)

Let's put these figures in context. Bloomberg News calculated the total wealth of the U.S. in 2007 to be \$52 trillion. That is total net assets minus liabilities. The Federal Reserve Flow of Funds Report indicates that the total wealth of the U.S. had declined \$13 trillion by year end 2008. The Federal Debt stood at \$12 trillion with a projected \$1.8 trillion additional debt this year. Thus, the wealth loss in the current recession (13 T.) roughly equals the total Federal Debt (13.8) which has been accumulated over the past six decades that included four major wars.

The Census Bureau has some interesting facts to consider. The U.S. population is 304 million divided into 160 million households, the measuring unit used by the Bureau.

The top 1% of households own 34% of the wealth. (\$17 TR)

The top 25% of households own 87% of the wealth. (\$47 TR)

The bottom 25% of households have no wealth at all. (-0-)

The disparity in household wealth is the greatest in the western world and growing year by year.

In addition we read in the papers that the average CEO in the U.S. earns 450 times the pay of the average hourly worker. In Japan the executive's compensation is just 25 times higher than the hourly worker's.

The Census Bureau data also shows that over 50% of U.S. wealth is the result of "transgenerational altruism" -- 30% by testamentary bequest and the rest by inter vivos transfer. If you have a wealthy neighbor down the street, he may not be brilliant or hard working. It's more likely that he has a rich Daddy or Grandpa. The opportunity to acquire wealth is an economic incentive. On the other hand, transgenerational wealth is often an economic disincentive.

For a few days the campaign focused on an issue which has been debated by philosophers since the birth of government - some like Thomas Hobbes imagined a pre-political era where wealth was accumulated by force and violence and society consisted of a constant war of "all against all" and the life of man was "solitary, poor, nasty, brutal and short." Others, like Jean-Jacques Rousseau took an almost opposite view. Pre-political man was a noble savage. Civilization made him a slave to unnatural wants of wealth and property and seduced him from his original freedom. These thinkers, known as contractarians, reasoned that in the beginning communities or tribes must have agreed to form proto-governments to bring order and stability to the societies. One of the tasks these governments assumed was that of distributing the burdens and benefits of the society among its members. The burdens were taxes and military service. The benefits included rights, liberty, wealth, income, power, prestige and opportunity.

Records of early Western style governments are scant but the ones we have found indicate that governments were involved in controlling and regulating wealth from earliest times. In 594 B.C. Solon, the Archon of Athens, was asked to reform the laws in a time of economic distress. He annulled all mortgages which in those days encumbered not only the real estate but the mortgagee himself. (This was the ultimate in recourse lending.) Upon default the lender seized the property and the borrower became his slave.

Originally wealth consisted mainly of land, cattle and slaves. Land was most important because without it cattle had no place to graze and slaves had little work to do.

Herodotus tells us that coined money was invented by the Lydians in the Sixth Century. It became the indicia of Lydian wealth and its distribution and accumulation were controlled by King Croesus. The Greeks adopted coined money almost as soon as they learned of it and the government stepped in to control the currency from the beginning. The regulation of wealth followed. Early examples were laws of descent and distribution which regulated who could inherit wealth and titles; divorce laws regulated how marital property was to be divided; and laws determined how the spoils of war were to be parceled out among the troops. Twenty-five hundred years later we still find governments engaged in wealth distribution. Indeed, a major activity of our government is collecting checks from some citizens and writing checks to others.

Philosophers have studied government wealth distribution in an attempt to fix the parameters of a just economic order. Plato, Aristotle, Aquinas, Locke, Mill and Marx, among others, have written on the subject. Until recently a consensus seemed to form around two divergent theories; the utilitarian model of Jeremy Bentham and John Stuart Mill on the one hand

and the socialist model of Karl Marx and Fredrick Engels on the other. Both models have their critics. Utilitarian policy often described as providing “the greatest good for the greatest number” has the defect that the minority can be oppressed for the benefit of the majority. Socialist policy suffers for many reasons; among others, that it oppresses the productive members of society for the benefit of the non-productive. Moreover all systems of economic justice have the problem of weighing and valuing non-monetary benefits and burdens.

Social justice policy rested on these two concepts for 100 years. Philosophers were unable to produce any break-through ideas until 1973 when John Rawls, the leading moral philosopher of his time, published his book entitled “A Theory of Justice”. Rawls was an interesting man. He was born in Baltimore in 1921. After high school he enlisted in the army as a private and served as an infantryman in the Pacific Theater. Toward the end of the war he was offered a commission but declined it because he wanted to go to college. He attended Princeton where he distinguished himself as a scholar and an athlete. He won varsity letters in four sports and was offered a minor league baseball contract. He declined that offer because he wanted to go to graduate school. He received a Ph.D at Princeton and then taught philosophy there and later at Cornell and M.I.T. In 1950 he was invited to join the Harvard faculty. Rawls became a folk hero to philosophy teachers everywhere because his employment contract allegedly contained a “most favored nation clause”. He was to be the highest paid faculty member and if anyone was later hired at a higher salary Rawls’ compensation would be increased to maintain his No. 1 position.

A Theory of Justice was the result of two decades of study and research. It is recognized as one of the major philosophical works of the 20th Century and read and studied by every philosophy major in college today. The book is long, dense and difficult to get through. But I will try in the few minutes I have to give you some of the highlights of the author’s thinking.

The first issue Rawls addressed was the proper standard of justice to be applied to society. This issue was critical to him, and he wrote “Justice is the first virtue of social institutions as truth is of systems of thought.” This is a remarkable statement in that Rawls gives justice a societal priority ahead of issues like freedom, security, prosperity and so forth. I wonder how many persons holding public office today would agree with him.

Rawls realized that because of their dynamic nature social and economic institutions cannot be bound by universal a priori rules. Instead he proposed a system called “Reflective Equilibrium” which would verify the strong views of society - views about which we are fairly certain. This process does not produce an absolute standard, but one arising from conserving our strongest and most clearly held moral convictions.

Next Rawls formulates his “original position” which is akin to the state of nature as conceived by the contractarians. Different philosophers saw the state of nature differently. Hobbes thought life in the state of nature was intolerable and civil society made it bearable. Rousseau’s conception was just the opposite: he argued that civilization had corrupted the natural goodness of life in the pre-political era. Be that as it may Rawls considered that his original position concept would permit the formation of principles of justice that inform and legitimate our social and economic institutions and practices.

Next Rawls instructs that the persons in the original position should act reasonably and operate behind a “veil of ignorance”. That means they must set aside all knowledge of their personal situation -- their talents and abilities, their sex and age, their education and intelligence and their heritage and social position. Thus we have a hypothetical situation - a thought experiment - which insures that the principles of justice selected will be fair because no participant knows what his position in society will be and there will be no incentive to skew the principles to his benefit. Rawls calls this concept “Justice as Fairness” and two further principles emerge from this thinking.

The first is the Liberty Principle stated as follows:

Each person is to have an equal right to the most extensive system of basic liberties compatible with a similar system of liberty for all.

The second he calls the Difference Principle:

Social and economic inequalities are to be arranged (a) so as to benefit every member of society to the greatest benefit to the least advantaged and (b) if inequalities are attached to offices or positions they must be open to all under conditions of fair equality of opportunity.

The two principles are lexically ordered which is to say that there is a hierarchy between the two. The first is prior to the second so one can't be made to surrender his liberties in exchange for economic goals. Rawls thinks that under his hypothetical contract a Veil of Ignorance actor would use rational choice theory and choose the Maximin option. This option would make “The worst off as well off” as possible. The actor could never be sure he wasn't among the worst off and so would opt for the broadest population coverage.

So, in a nutshell, Rawls theory permanently guarantees basic liberties for all and permits inequalities in wealth but only insofar as they benefit the least advantaged. The Difference Principle is strongly egalitarian in the sense that unless there is a distribution that makes both parties better off (limiting ourselves to a two-party example for simplicity) an equal distribution of wealth is to be preferred. This principle is not surprising when you consider that classical economic theory is based on the assumption that every free exchange makes both parties equally better off.

Professor Rawls was awarded The National Endowment Of The Arts Medal in 1999. A shy man, he rarely gave an interview. Nonetheless more than 250,000 copies of A Theory of Justice have been printed and the book has been translated into dozens of languages. This is a record for a book of contemporary philosophy.

Any new philosophical theory attracts comment and criticism. Professor Rawls' ideas drew hundreds of responsive books and articles. One critic was Ayn Rand who considers herself a political philosopher but who most philosophers considered only a novelist and a poor one at that. (She was the opposite of Rousseau whose readers considered him to be a philosopher but who insisted that he was not). Nonetheless she has attracted prominent admirers such as Alan Greenspan, Clarence Thomas and Rush Limbaugh.

Miss Rand thought of altruism as a moral wrong and that fairness and charity were not virtues. Any tax money the government distributed to the needy, she said, is actually theft from the taxpayers.

Another outspoken opponent of Rawls' theory was Friedrich Hayek, the Nobel prize winner and inspirational doyen to Margaret Thatcher. Hayek thought social justice had no place in the philosophical canon and if the needy suffered it was their problem and they should look to private charity for relief. The government should steer clear of the matter. Neither Ms. Rand nor Professor Hayek think economic justice has a place in government.

Libertarians as a group largely disagree with Rawls although they do admit that justice is essential in government. But their concept of justice is based on liberty which to them is a code word for property. The government's main function is to protect their property from any threats, foreign or domestic, particularly threats from the tax collector. Libertarians tend to be found among the rich and the super-rich and a surprising number of them are physicians. Think Congressman Ron Paul of Texas.

Libertarians, on the other hand, ground their social theory on property. Libertarians consider that land (and whatever improvements are made to it on or below the surface) is the foundation of all wealth or at least has been since the abolition of slavery. Indeed our present crisis has arisen in part because bankers realized that the real property in our nation had a value of tens of trillions of dollars and that that value could be securitized to produce prodigious amounts of credit.

The philosophical underpinning of the property concept was supplied by Robert Nozick in his 1974 book "Anarchy, State and Utopia". Nozick was also a philosophy professor at Harvard and reportedly he and Rawls were good friends. He argued that a basic liberty is the right to hold and use the property you rightfully own. For the government to take some of your property and give it to others in order to spread the wealth is wrong. Nozick's theory is based on three simple principles:

1. A person who acquires a holding in accordance with the Principle of Justice is entitled to that holding.
2. A person who acquires a holding in accordance with the principle of Justice in Transfer, from someone else entitled to the holding, is entitled to that holding.
3. No one is entitled to a holding except by repeated application of (1) and (2).

In the beginning, that is as far back as our knowledge goes, ownership of land was established by use and occupancy. This didn't mean much because all men were free to use any land. It was treated as we treat the oceans. But there came a time when men drove stakes in the ground, put up fences, and tried to exclude others from it. This was the beginning of the first distribution of wealth. As civilization took hold deeds and records came into use. It is accepted that a thief never gets title to his stolen property, nor can a subsequent transferee acquire title to it from him. Should there be any increase in the value of the stolen property that increase reverts to the rightful owner. This is where Nozick's theory breaks down, at least as a matter of morality. For in this sense all property in the New World seems to have a title defect, at least from a moral or philosophical point of view.

Consider this case. I can recall as a young lawyer when Ford Motor Company decided to purchase land near the airport to build a factory. It ordered an extensive title search before the closing. The title report was fascinating; I only wish I had kept a copy.

Title to land in this part of North America, it said, ultimately relies on grants made by King Henry VII in the 15th Century. Henry claimed ownership of the land (including that comprising Brookpark, Ohio) through the explorations of John Cabot. Now Cabot was not an English citizen and that was not even his real name. He actually was Zuan Coboto, a citizen of Venice. Cabot told the King that he planned to sail to the Western seas in search of land. The King refused him any financial backing but granted an exemption from English customs duty on any goods Cabot brought back. In return the Crown was to receive 20% of the profits of the voyage.

Cabot sailed from Bristol in 1497, with one ship, the Matthew, and a crew of 18. Months later he turned up on the French coast of Brittany. He said he had sailed to what he called "new found lands" and took his ship down the coast while waving an English flag. He then returned home but missed England on the way back. Most historians credit Cabot with having discovered the island of Newfoundland which is not part of the North American continent. Other scholars doubt he discovered anything. The next year Cabot sailed off on a second voyage, this time with four ships. But they were never heard from again, presumably all lost at sea. He soon disappeared from history as well. All this shows King Henry had no real claim of ownership of the North American continent and under Nozick's principle of Justice in Transfer his subsequent transferees don't have good title to their premises either. Now don't leave here thinking the ownership of your home may be in jeopardy. The Legislature has passed a statute to save you. The Doctrine of Adverse Possession insulates a proclaimed landowner from suit if he has been using the land for 21 years. Conceptually he may not own the land or have any moral right to it but no one can take it away from him.

Thus we see that Nozick's Justice in Transfer principle does not answer Rawls' fairness doctrine because under its literal application most original property transfers were not just. European explorers acquired land from the Indian owners by guns and whiskey, not by fair purchase.

In 1999 Donald Trump (of all people) wrote an article in Forbes magazine suggesting a one-time 5% federal wealth tax which would be used to retire the entire Federal Debt. The comments were that the wealthy taxpayers would never stand for it. But we have witnessed a 30% drop in wealth with little outcry. More outrage seems to be directed against the Administration's efforts to dig the economy out of the hole it's in and to regulate the financial markets going forward.

Should the U.S. enact a wealth tax to alleviate the debt problem we have today and the growing one we will have in the future? Wealth taxes were used long before the income tax was devised. But they have been phased out in this country except for property taxes used to support local governments and schools.

Professor Rawls has left us with two concepts which philosophers should consider in resolving this question.

1. Economic justice is an essential feature of the governing process.
2. Economic welfare is a matter of justice not merely a matter of charity. It is a social obligation, not just an option.

We do know this:

1. The distribution of wealth in the U.S. is unfair and borders on the unconscionable.
2. It can't be squared with modern concepts of justice such As Rawls' Difference Principle.
3. The inequalities of our system aren't arranged for the benefit of the least advantaged.
4. It distorts our political process by making the preservation of inequality the primary economic goal.