

The Ethics of Capitalism

Jesús Huerta de Soto
Titular Professor of Political Economy
Universidad Complutense de Madrid
Spain

Introduction

Traditional studies on natural law and justice have been eclipsed by the development of a concept of economic science that has tried to apply a methodology originally formed for the natural sciences to the social sciences. According to this line of thought, the defining content of economic theory consists of the systematic application of a narrow criterion of “rationality,” so that both individual human action and economic policy are determined by calculations of costs and benefits based on a maximization criterion that makes it possible to “optimize” the attainment of the ends pursued on the basis of given means. According to this approach, it seemed obvious that considerations relative to ethical principles as guides for human behavior lost relevance and significance. In fact, it seemed that a universal guide for human behavior had been found that could be put into practice by applying a simple criterion of maximizing the beneficial *consequences* derived from each action without the need, therefore, to adapt the behavior of human beings to predefined ethical rules. Science had apparently thus managed to eliminate considerations related to justice by rendering them obsolete.

The Failure of Consequentialism

However, the consequentialist ideal, which holds that it is possible to act by making decisions to maximize predicted consequences on the basis of given means and costs—also thought to be known—has ostensibly failed.¹ First, the evolution of economic theory itself has shown that it is impossible to obtain the necessary information regarding the benefits and costs arising from each human action. This premise of modern economics is based on the innate

creative capacity of the human being, who is continually discovering new ends and means, thus giving rise to a flow of new information or knowledge. This new insight makes it impossible to predict specific future consequences of human actions and/or political decisions adopted at any given moment.² Furthermore, the failure of real socialism, understood as the most ambitious social engineering experiment ever carried out by the human race, has dealt a shattering blow to consequentialist doctrine. By attempting to evaluate different political options in terms of costs and benefits, the former Soviet regime used coercion to impose predefined choices upon citizens in order to attain its desired ends. Yet this consequentialist strategy is incapable of meeting the expectations placed on it, thus leading to significant economic underdevelopment and great human suffering by those who employ it.

Due to a deficiency in historical perspective, we are not yet fully aware of the far-reaching consequences that the fall of socialism will have on the evolution of science and human thought, although some significant effects are now evident. First, attention should be drawn to the development of a new, more humane, and realistic economic theory based on the study of the human being as a creative actor in order to analyze the dynamic processes of social coordination in the market. This approach—the predominant force of which comes from the Austrian School—is much less ambitious than the scientific paradigm that has captured economics instruction for most of the twentieth century, misled students, and created expectations for the discipline that it cannot possibly satisfy.

Another important consequence has been the formation of an evolutionary theory of social processes, which was also developed by the Austrian economists. This theory has shown how the most important institutions for life in society (e.g., linguistic, economic, judicial, and moral) arise spontaneously over an extended period of time, on the basis of customs, as a consequence of the participation of a large number of human actors. Thus, a series of institutions appears that involves an enormous volume of information, defying comprehension by the human mind.

The third effect is the reappearance of ethics and the analysis of justice as integral to research within the social sciences. In fact, the theoretical and historical failure of scientific consequentialism has led to an increasing appreciation for dogmatic ethical principles to guide human behavior and to preserve political and economic freedom.

The Importance of the Ethical Foundation of Freedom

One of the most significant contributions of the theory of liberty in

this century has been to show that the consequentialist analysis of costs and benefits is not sufficient to justify a market economy. It is not only that a large portion of contemporary economic theory is based on the error of assuming a static framework of ends and means, but, also, even within the analytical framework of Austrian economics, the creative capacity of the human being and the study of the dynamic processes of social coordination taken by themselves are unable to ground libertarian ideology. Assuming that we abandon the static criterion of Paretian efficiency and replace it with a more dynamic criterion based on coordination, the notion of efficiency by itself will never convince those who are concerned principally with justice over those who merely advance an alternative understanding of efficiency. Moreover, neither does recognition of the effects of social inefficiencies, which arise over the long term from attempts to coerce the spontaneous processes of human interaction, guarantee agreement from those whose *time preference* is so intense that, despite the negative effects of intervention in the medium- and long-terms, place a higher value on short-term benefits.³

The development of an ethical foundation for the theory of liberty is indispensable because of (1) the failure of social engineering and, especially, of the consequentialism derived from the neoclassical-Walrasian paradigm of mainstream economics; and (2) because Austrian theoretical analysis of market processes based on the entrepreneurial capacity of the human being is not sufficient by itself to justify the market economy; thus (3) given the situation of ineradicable human ignorance and the capacity to create new information, human beings need a moral framework detailing how they ought to act; and finally, (4) because moral considerations drive the reformist behavior of human beings, who are often willing to make significant sacrifices in order to pursue what they consider to be good and just. It is much more difficult to ensure this type of behavior by cold calculations of costs and benefits that are of dubious scientific value.

On the Possibility of Building a Theory of Social Ethics

A significant number of scholars still think that it is impossible to construct an objective theory of justice utilizing universal moral principles. The development of this opinion has been influenced strongly by the evolution of scientism in economics, which, obsessed by the maximization criterion, considers subjective not only the ends and means of each actor but also the moral principles that govern behavior. If, under any circumstance, an *ad hoc* decision may be made on the basis of a cost-benefit analysis, the existence of morality, understood as a scheme containing previously fixed guidelines for behavior, is

unnecessary. Against this position, one may respond that it is one issue for valuations, utilities, and costs to be viewed as subjective as shown by economic science, but the argument that no objective morality exists is an entirely different matter.⁴

Furthermore, the development of a theory of the moral principles that should guide social interaction is not only advisable but entirely possible. Several significant works in this field of research have appeared recently. Among them is Israel M. Kirzner's contribution, which offers a revised concept of distributive justice for market economies. Attention should be paid to the fact that this notion has been developed by one of the most distinguished theorists of the Austrian School, showing that economic theory is closely related to social ethics: While economic science is value-free, it can help people to adopt more well-defined ethical positions and, also, as Kirzner illustrates, to make logical-deductive reasoning easier for social ethicists. Thus, the many errors and dangers that arise in social ethics from the traditional static analysis of economic theory are, in fact, avoidable.⁵

According to this idea, the preceding reflections on efficiency and justice, far from being a trade-off, appear to be two sides of the same coin. From our point of view, then, only justice leads to efficiency; yet the reverse also holds, so that which is actually efficient cannot be placed over against that which is unjust. Therefore, both considerations—those relative to moral principles and those to economic efficiency, far from being separate or in opposition mutually strengthen and support each other.⁶

Morality and Efficiency

The argument that efficiency and justice are two different dimensions that may be combined in different proportions is a negative consequence of the mainstream neoclassical paradigm. Stated succinctly, if a person holds that it is possible to make an economic decision solely on the basis of cost-benefit analysis because all the necessary information is statically given, then it is not only unnecessary for individual actors to follow any moral code but it is difficult to avoid the conclusion that any scheme of equity imposed by force is compatible with the criteria of Paretian efficiency (the second fundamental theorem of welfare economics).

Viewing the social process, however, as a dynamic reality constituted by the interaction of thousands of human beings, each of which is endowed with an innate creative capacity, makes it impossible to calculate the costs and benefits that will arise from any given action. This means that persons must use a series of guides or moral principles to coordinate human interaction. These moral

principles tend to make coordinated interaction between different human beings possible and, as a result, generate a coordination process that could be described as “dynamically efficient.” Seen from the concept of the market as a dynamic process, *efficiency*, understood as *coordination*, arises from the behavior of human beings when they act on the basis of specific moral guidelines. But the reverse also holds true: Human actions performed in accordance with these ethical principles give rise to dynamic efficiency, understood as the coordination mechanism in social interaction.

It is unacceptable, therefore, to insist that criteria of efficiency and equity oppose each other. What is just cannot be inefficient, nor can what is actually efficient be unjust. The fact is, given the perspective of dynamic analysis, equity and efficiency are simply two sides of the same coin, which confirms the integrated and consistent order existing in the social universe. The supposed opposition between these two dimensions originates from the mistaken concept of static efficiency developed by the neoclassical paradigm of welfare economics and social justice. One of the results of this paradigm is the erroneous idea of social justice, according to which the results of the social process can be judged regardless of the individual behavior of those who participate in it.

The theoretical development of welfare economics based on the static criteria of Paretian efficiency arose with the naive expectation of existing apart from ethics; however, this also made it impossible to appreciate the serious problems of dynamic inefficiency that emerge when the entrepreneurial process is institutionally coerced. Viewing the market as a process not only allows efficiency to be appropriately redefined in dynamic terms but also sheds light on the criterion of justice that should prevail in social relations. This criterion is based on traditional principles of morality designating individual behavior as just or unjust in accordance with abstract moral and judicial rules regulating property rights, which allow human beings to appropriate the results of their own innate entrepreneurial creativity.

This point of view also shows how alternative criteria of justice are essentially immoral. Among them, and particularly open to criticism, is a concept of social justice that adjudicates as just or unjust the specific results of the social process at prescribed historical moments *regardless of whether the behavior of its artifices has been in line with general judicial and moral rules*. This understanding of social justice only makes sense in a phantasmagoric world where goods and services are given and constant and the principal problems relate to distribution. In the real world, however, where production and distribution take place simultaneously as a consequence of entrepreneurial impetus, this concept of social justice does not make sense.

Redistributionary concepts of social justice may be considered essentially immoral from three different perspectives. First, from an evolutionary point of view, the implications derived from this idea of social justice violate traditional principles of property rights, which have been formed by evolution and have made modern civilization possible. Second, from a theoretical point of view, it is impossible to organize society on the basis of social justice because the coercion entailed in redistributing income prevents the free practice of entrepreneurship. Limiting this free practice prohibits the creativity and coordination that makes the development of civilization possible. Third, from an ethical point of view, all human beings have a natural right to the results of their entrepreneurial creativity, which is violated with coerced redistribution. It is foreseeable that, as citizens grasp the error of this spurious concept of social justice, the call for state coercion to implement social welfare schemes will gradually disappear.⁷

Israel Kirzner's Contribution to Ethics

Kirzner's contribution consists in showing that mainstream views of distributive justice have formed the ethical foundation of important political and social movements (of the socialists and social democrats), which have their origin in the static concept of economics.⁸ The neoclassical paradigm presupposes that information is objective and given (either in certain or probabilistic terms) and, therefore, makes it possible to generate cost-benefit analyses. If this is the case, it seems logical that issues of utility maximization remain independent of moral aspects and that these two factors can be combined in different proportions. The static concept, furthermore, inexorably leads to the assumption that resources are given and known, meaning that the economic problem of distribution is separate from the problem of production. On the contrary, if resources are entrepreneurially created or discovered (i.e., not given), the question of how these resources are distributed becomes intimately related to the production process.

The static paradigm of mainstream economics has been rendered obsolete by the dynamic concept of market processes developed generally by Austrian economists and specifically by Kirzner's analysis of entrepreneurship. For Kirzner, entrepreneurship stems from the innate capacity of all human beings to appreciate or discover opportunities for gain that arise and to act accordingly. Entrepreneurship, therefore, has to do with the typically human capacity to create and discover new ends and means. Entrepreneurs are individuals eager to attain new goals, which they *discover* to have a higher value. If the ends, means, and resources, however, are not given but are created continually

by human activity, then it is clear that the main ethical question is no longer how to distribute goods on an equitable basis but, rather, how to stimulate creativity. It is here that Kirzner's contribution to social ethics can be fully appreciated: The concept of the human being as a creative actor entails the axiom that *all human beings have a natural right to the fruits of their own entrepreneurial creativity*. This is so because such fruits not only act as an incentive to stimulate the entrepreneurial and creative alertness of the human being but also because it is a universal principle that may be applied to every person under any conceivable circumstance.

This principle also has other significant advantages. First, its intuitive attraction should be accented: It is obvious that if somebody creates something, he or she has the right to appropriate it, since nobody has been prejudiced. Second, it is a universally valid ethical position closely related to a principle in Roman law having to do with the appropriation of resources that do not belong to anyone (*ocupatio rei nullius*). This principle resolves the paradoxical problem known as "Locke's proviso," according to which the limit on the original appropriation of resources is based on leaving a sufficient portion for others. For Kirzner, the principle of creativity resolves the problem of Locke's proviso by making it unnecessary. Since there were no products of human creativity before people either discovered or created goods to satisfy needs, the appropriation of the fruit of human creativity is unable to prejudice anyone. Locke's concept only makes sense in a static environment where it is presupposed that resources are fixed and should be distributed among a predetermined number of human beings.

Kirzner also shows, in the third place, how most of the alternative theories of justice—particularly the theory of John Rawls—are based implicitly on the neoclassical paradigm of full information, which assumes a static environment of preexisting resources. While Rawls considers a "veil of ignorance" in his analysis, he reaches the conclusion that the most just system is the one in which each human being, regardless of social status, obtains a maximum of resources even under the most unfavorable circumstances.⁹ It is clear that if society is viewed as a dynamic entrepreneurial process, then the ethical principle must be different. The most just society will be the society that most forcefully promotes the entrepreneurial creativity of the people who compose it. In order to accomplish this objective, however, each person must be certain that the results of his or her entrepreneurial creativity can be appropriated (which, by definition, does not exist in the social body before being discovered or created by each individual actor) without being forcefully expropriated.

In the fourth place, another advantage of Kirzner's analysis is that it makes apparent the immoral nature of socialism, understood as any system of institutional aggression carried out by the state against free human action or entrepreneurship. Coercion against the actor, in fact, prevents him from developing what is his most essential, natural, and typical characteristic, namely, the innate capacity to create new ends and means and to act in order to attain them. To the extent that state coercion prevents entrepreneurial human action, the human being's creative capacity will be restricted and neither the information nor the knowledge necessary to coordinate society will emerge. Precisely for this reason, socialism goes against human nature and is intellectually bankrupt, since it is impossible for the governing body to generate the information it requires to coordinate society through commands.¹⁰

Roman Catholic Social Doctrine and Israel Kirzner's Contribution

One of the most significant aspects of recent Catholic social teaching with respect to the free-market economy stems from its debt to Austrian economists, particularly to Friedrich von Hayek and Israel Kirzner, the former of whom was agnostic, the latter a practicing Jew. Michael Novak surprised the world when he publicized the lengthy personal conversation between Pope John Paul II and Friedrich von Hayek that had taken place before the latter's death.¹¹ In *The Catholic Ethic and the Spirit of Capitalism*, Novak pointed to the parallelism between the concept of creative human action developed by the pope in *The Acting Person* and Kirzner's concept of entrepreneurship.¹²

This connection was refined by John Paul II in the encyclical *Centesimus Annus*. In *Centesimus Annus*, he refers to entrepreneurial capacity or creative human action as the decisive factor in society or, in his own words, "*man himself, that is, his knowledge.*" The *knowledge* to which John Paul II refers is scientific and practical in nature, which he defines as what is necessary in order to "perceive the needs of others and to satisfy them." This knowledge, according to John Paul II, allows human beings "to express their creativity and develop their potential" and to introduce themselves into "the network of knowledge and intercommunication," which constitutes the market and society. Thus, for him, "the *role* of disciplined and creative *human work* [I would prefer to say, human action] and, as an essential part of that work, *initiative and entrepreneurial ability* becomes increasingly evident and decisive."¹³ Undoubtedly, *Centesimus Annus* shows how the pope's understanding of economic relations has been modernized, thus rendering obsolete a great deal of the Church's earlier social teaching on economics. It even surmounts significant sectors of economic science itself that have been anchored in the mechanisms of the neoclassical-

Keynesian paradigm and that exclude the eminently creative and dynamic nature of entrepreneurship. For the first time in history, due largely to the influence of Austrian economics, the social doctrine of the Catholic Church has moved beyond the mainstream paradigm of economics.

Some Critical Comments on Kirzner's Work

The first objection we would raise to Kirzner's analysis refers to the affirmation that, in circumstances where the levels of disequilibrium, uncertainty, and creativity are greatest, the proposed principle of justice, based on the appropriation of the goods and services discovered by entrepreneurs, will be most relevant. According to Kirzner, however, in relatively more stable markets this rule of justice will be less relevant.¹⁴ In my opinion, the dynamic rule of justice proposed by Kirzner has universal validity, regardless of what the particular circumstances may be at any given moment. Whenever institutional coercion is used to redistribute the social product, the human person loses creative capacity, thus inhibiting the possibility of creating new information and coordinating the social process. There is no analytic possibility, furthermore, of distinguishing situations in which the relatively more "stable" nature of the free market permits the application of alternative criteria based on distributive justice from those in which the relative social stagnation is a direct result of the systematic practice of state coercion. Kirzner, however, acknowledges that "[t]he extent to which discovery insights need to be introduced into both the economics and moral philosophy of capitalism seems to be greater and greater as capitalism itself develops and becomes more intricate and 'open-ended'."¹⁵ Unlike Kirzner, we argue that there are no exceptions to the principle of justice based on his definition of entrepreneurship, a principle universally applicable to all conceivable historical circumstances involving human beings intrinsically endowed with innate entrepreneurial and creative capacities.

The second objection refers to two somewhat disconcerting articles in which Israel Kirzner has upheld the thesis that the theory of entrepreneurship hardly justifies the existence of a spontaneous trend toward the formation and improvement of social institutions.¹⁶ Kirzner's main argument is that the supposed existence of an "externality" prevents the institutional improvements relevant to society from materializing. These improvements take the form of opportunities for explicit gain that may be exploited and appropriated by entrepreneurs. Thus, according to him, the process of entrepreneurial creativity and discovery would not take place in the field of institutions, since entrepreneurs would be unable to appropriate profits arising from their economic activity. Kirzner maintains correctly that in a market context, the existence of a

situation of “public good” cannot be considered a defect if the state prevents an adequate definition and/or defense of property rights. It is absurd, after all, to classify the absence of an ideal situation resulting from institutional insufficiencies as a “market defect.” Kirzner goes on to say, however, and this is where we disagree, that these insufficiencies may also emerge and be maintained spontaneously in relation with social institutions as a result of a supposed situation of public good. Such situations would prevent entrepreneurial activity from discovering and working toward the necessary institutional improvements.¹⁷

We cannot share the position that Kirzner has recently adopted in relation to the application of his theory of entrepreneurship to the emergence of social institutions. First, within the dynamic context of the market process, public goods do not present a problem for the market simply because they emerge as the result of an institutional “inefficiency.” The problem with public goods is never attributable to a market defect since, whenever a situation of joint supply and the impossibility of exclusion of *free riders* arises, in the absence of the coercive intervention of the state, the incentives necessary for entrepreneurial activity emerge. Appropriating the results thereof, this activity tends to discover the technical, judicial, and institutional innovations required to eliminate the supposed public-good situation. This is, for example, what occurred in relation to the commons in the American West where, until it was possible to adequately define property rights over the land that belonged to the different users (farmers and stockbreeders), there were significant conflicts in social coordination. This situation, however, created an incentive for entrepreneurs to invent barbed wire as an important technological innovation, which, from then onwards, allowed property rights to be extended over large tracts of land. This innovation resolved the public-good problem of land appropriation. From the perspective of the market, if the state does not intervene, then, dynamically speaking, the set of public goods tends to become empty as a result of the creative capacity of entrepreneurs.

It is true that among the array of social institutions (judicial, moral, economic, and linguistic) the problems arising from individual appropriation of the results of entrepreneurial creativity are more troublesome. This does not mean, however, that the results cannot be applied in social institutions and that improvements are not being routinely introduced. On the contrary, without the creative capacity of entrepreneurship, neither the process of generation nor that of development of the most important social institutions can even be conceived. Carl Menger demonstrated this truth in his analysis of the evolutionary emergence of social institutions, which he applied specifically to money, and is understood as the result of the leadership of a few relatively

more alert entrepreneurs. These people discovered before others that they could attain their ends more easily if, in exchange for their goods and services, they requested goods that were able to sell quickly, which began to be demanded as means of exchange. This phenomenon was extended throughout the market until the means of exchange became commonplace and was eventually converted into money.¹⁸ None of these innovations could be explained adequately apart from Kirzner's concepts of entrepreneurial alertness and the creative capacity of entrepreneurship.

It is evident, finally, that there is no objective criterion establishing the proposition that a rationally conceived institution—i.e., one formed by the dynamic engine of entrepreneurship—is more efficient than one formed through evolution—i.e., one generated by the dynamic process of entrepreneurship. Is, perhaps, Esperanto a more perfect and efficient language than English or Spanish? Or can it be established that the metric system is more efficient from the perspective of dynamic coordination than American standards of measurement? Furthermore, with regard to the fundamental legal principles that make social coordination and the practice of entrepreneurship possible, they have clearly emerged over an evolutionary process and can be reduced to the following concepts: respect for life, property, peacefully acquired possession, and the fulfilment of contracts.

Despite Kirzner's comments to the contrary, his theory of entrepreneurship seems to be exactly what is needed to provide an adequate foundation for Austrian economic theory with respect to the emergence and development of social institutions, which also entails the possibility of "rationally" improving existing social institutions.¹⁹ This "improvement," however, could only be the result of exegesis, refinement of logical defects, and application of the principles formed through evolution to new areas and challenges that arise from entrepreneurial creativity (e.g., the application of contract law to new privatized areas of the sea, and so forth). It is possible to suggest that Kirzner is not sufficiently Kirznerian regarding the possibility of applying his own theory of entrepreneurial analysis to the emergence, development, and improvement of social institutions.

Conclusion

My critical comments have not sought to diminish the merit of Kirzner's work in the field of entrepreneurial theory and his contribution to the development of a social ethic capable of setting aside the constraint of distributive justice. Kirzner's dynamic concept of the market makes it easier to adopt an ethical position and to strengthen the argument that free markets driven by

entrepreneurship are not only more efficient but also just. There is no justification, therefore, for any entrepreneur whose actions do not violate traditional principles of property law to feel any sense of guilt in appropriating the results of his or her creative activity. Comprehending how the market process functions makes it obvious that the principle of social justice should be based on the appropriation of the results of each entrepreneur's creativity. Likewise, it is perfectly compatible with our argument for this entrepreneurial creativity to be used voluntarily to seek, discover, and alleviate situations of urgent need into which other human beings may have fallen.

Notes

1. John Paul II, Encyclical Letter *Veritatis Splendor* (August 6, 1993), 97–98. In his criticism of consequentialism, John Paul II states that “each person knows the difficulties, or rather, the impossibility of evaluating all the good or evil effects of his own actions: an exhaustive rational calculation is not possible. Therefore, what should be done in order to establish proportions that depend on an evaluation the criteria of which remain in the dark? How could an absolute obligation resulting from such debatable calculations be justified?”

2. This theorem was discovered by theorists of the Austrian School of Economics (i.e., Ludwig von Mises and Friedrich von Hayek) and has been articulated and refined in the course of the long polemic on the impossibility of socialism, which has taken place in the present century. The Austrians also made the crisis of the neoclassical-Walrasian paradigm evident, together with the static concept of economics, which presupposes that the ends and means are known and given and that the economic problem is merely a technical question of maximization. See D. Lavoie, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (Cambridge and New York: Cambridge University Press, 1985); Jesús Huerta de Soto, “The Ongoing *Methodenstreit* of the Austrian School,” *Journal des Economistes et des Etudes Humaines* VIII, 1 (March 1998): 75–113.

3. These are basically the arguments employed by Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, N.J.: Humanities Press, 1982), 201–13, in his critical analysis of the position of Ludwig von Mises.

4. “Economics does currently inform us, not that *moral principles* are subjective, but that utilities and costs are indeed subjective.” *Ibid.*, 202.

5. However, economic theory alone is not considered to be capable of *determining* moral issues and, therefore, there are no grounds for Roland Kley's criticism of Israel Kirzner. *Hayek's Social and Political Thought* (Oxford: Clarendon Press, 1994), 228, #9.

6. Therefore, the trade-off would exist, at most, between one binomial constituted by what is just and efficient and another arising from an inefficient and unjust action (in which the free practice of entrepreneurship is systematically coerced and the total appropriation of the results of human creativity is prevented). In addition, the efficiency arising from the immoral systematic coercion that the state exercises over the economy is very different from that which the neoclassical economists think they identify within the static paradigm of so-called “welfare economics.” Ultimately for these economists, measures of institutional coercion (e.g., the forced redistribution of income), give rise to the effects of distortion that distance the economic system from the points of the maximum production possibilities curve of the economy without realizing that the damage caused by these measures is much deeper. This occurs because these economists *dynamically* prevent entrepreneurs from coordinating and discovering new opportunities by continually moving the society's production possibilities curve toward the right.

7. See Friedrich von Hayek, “The Mirage of Social Justice,” in *Law, Legislation and Liberty*, vol. 2,

The Mirage of Social Justice (Chicago and London: University of Chicago Press, 1976).

8. The ideas of Israel Kirzner on social ethics began to be forged in section 4 (chapters 11-13) of his book *Perception, Opportunity and Profit* (Chicago and London: University of Chicago Press, 1979) concerning "Entrepreneurship, Justice and Freedom," were even more clearly profiled in his article "Some Ethical Implications for Capitalism of the Socialist Calculation Debate," in *Capitalism*, ed. Ellen Frankel Paul, Fred D. Miller, Jr., Jeffrey Paul, and John Ahrens (Oxford: Basil Blackwell, 1989), and which culminated in his book *Discovery, Capitalism and Distributive Justice* (Oxford and New York: Basil Blackwell, 1989).

9. See John Rawls, *A Theory of Justice* (Cambridge, Mass.: Harvard University Press, 1972).

10. This impetus and entrepreneurial creativity also appears in the field of aid to the needy and the prior search for and systematic detection of situations of need. Thus, state coercion or intervention through the mechanisms of the welfare state neutralizes and, to a great extent, makes impossible the entrepreneurial search for urgent human need and the possibility of aid to others, thus stifling the natural aspirations of solidarity and collaboration that are so important to most persons. This idea has been well-understood by John Paul II, who has recently stated that "by intervening directly and depriving Society of its responsibility, the Social Assistance State leads to a loss of human energies and an inordinate increase of public agencies, which are dominated more by bureaucratic ways of thinking than by concern for serving their clients, and which are accompanied by an enormous increase in spending. In fact, it would appear that those needs are best understood and satisfied by people who are closest to them and who act as neighbours to those in need." John Paul II, Encyclical Letter *Centesimus Annus* (May 1, 1991), no. 48.

11. "During the last months of his life, Hayek had the opportunity for a long conversation with Pope John Paul II. There are signs of Hayek's influence in certain portions of the pope's encyclical *Centesimus Annus*. In paragraphs 31 and 32, in particular, *Centesimus Annus* employs unmistakably Hayekian insights." Michael Novak, "Two Moral Ideas for Business," *Economic Affairs* (September-October 1993): 7.

12. Michael Novak, *The Catholic Ethic and the Spirit of Capitalism* (New York: The Free Press, 1993), 117; Karol Wojtyla, *The Acting Person* (Boston: D. Reidel, 1979).

13. See *Centesimus Annus*, nos. 32-33.

14. See Kirzner, *Discovery, Capitalism and Distributive Justice*, 126-27, 176-77.

15. *Ibid.*, 176.

16. See Israel Kirzner, "Knowledge Problems and Their Solutions: Some Relevant Distinctions," in *The Meaning of Market Process: Essays in the Development of Modern Austrian Economics* (London and New York: Routledge, 1992), 163-79; *The Limits of the Market: The Real and the Imagined*, Proceedings of the Regional Meeting of the Mont Pelerin Society, Rio de Janeiro, September 5-8, 1993, forthcoming.

17. "There appears to be no obvious way in which any private entrepreneur could be attracted to notice the superiority of the metric system—let alone any chance of it being within his power to affect its adoption. The externality of the relevant benefit to society arising from a change in the metric system appears to block the translation of this unexploited opportunity, jointly available to members of society, into concrete, privately attractive opportunities capable of alerting entrepreneurial discovery." Kirzner, "Knowledge Problems and Their Solutions," 174.

18. "The happy idea of proceeding in this way could strike the shrewdest individuals, and the less resourceful could imitate the former's method." Mises, *Human Action*, 3rd ed., rev. (Chicago: Regnery, 1966), 406. Perhaps there is no more concise or precise way of referring to the dominant role played by entrepreneurial alertness and creativity in the emergence of institutions than these words written by Mises in his comment praising Menger's contribution.

19. This consideration does not legitimate the neoclassical analysis of law and judicial institutions—which it has been used for—by assuming a context of constancy, equilibrium, and the strict rationality of the economic agents based on the principle of profit maximization. The contradiction contained in the economic analysis of law is obvious since, in the static framework described, laws and institutions would not be necessary: simple commands that included the full information assumed to be available would be sufficient to coordinate society. Over against this paradigm, we urge that judicial rules and institutions should not be judged in the narrow terms of static efficiency that

originate from Pareto, comparing costs with supposedly known profits but, rather, should be judged by a criterion of dynamic efficiency, depending on whether they promote and encourage the entrepreneurial coordination of the market. Therefore, rather than “optimal” case-law rules and decisions from the Paretian point of view, what should be sought are *just* case-law rules and decisions that, from the point of view of the dynamic efficiency of the entrepreneurial market processes, drive the coordination therein.