2. Between Socialism and Libertarianism

On the question of what is the proper form for organizing the means of production, to use the Marxist phrase, there is a wide range of disagreement over whether a system of voluntary, competitive markets will supply the best mix of goods and services to the population at large. Even if we remember not to elevate this issue to a matter of life and death, by the same token, we should not veer too far in the opposite direction by lapsing into a form of economic fatalism, which holds that society's social ills will remain at some constant level no matter what kind of economic system we adopt. On the contrary, the level of social prosperity, and with it political peace, depends heavily on the answers that we collectively give to these economic and legal issues. Getting the issues right in the easy cases should not be greeted with stony indifference, even in comparison with the larger political issues we face.

Easy Cases and Difficult Cases

In delineating the proper role for the market and the state, it is vital for people who believe in the principles of liberal democracy, as I do and as Harold Wincott did, to get the easy cases right, even if they cannot reach firm agreement on the difficult questions, such as patent scope and airport location. In this spirit, I shall now concentrate on the easy cases and put the harder cases to one side. I hope to show how, far from reaching the appropriate classical liberal solutions to these problems, our political institutions frequently (but thankfully not universally) do everything backward, often in the worst possible manner. Institutional arrangements that should be a dull subject, not worthy of any discourse or conversation, become the object of intensive study in economic pathology to explain how societies first make one wrong step, only to follow that mistake with others, setting in motion a downward cycle that creates unnecessary social losses all along the way.

To frame this part of the argument, I think it is important to articulate the proper baseline for analysis. In my new book, *Skepticism and Freedom* (Epstein, 2003), I defend, as I have done for many years, a vision of classical liberalism that avoids two kinds of perils. One is the peril associated with an unyielding devotion to an unvarnished and incautious libertarian philosophy. The other is the greater peril that comes from embracing socialism or collectivism in all its forms. The issue is how to find the middle way between these two extremes.

I should not need to dwell at length on the weaknesses of collectivism as a system for controlling the means of production. It should suffice to note that no individual has either the knowledge or the selflessness to make vital decisions for other individuals. The high aspirations of collective ownership are always dashed by the grubby particulars of its practical realization. But this simple point has not always carried the day, so a few more words are needed on the topic. In particular, it is instructive to recall the powerful claims that were voiced on collectivism's behalf during the socialist calculation debate of the 1930s and 1940s. The basic claim was that a large computer could generate all the information about what goods and services should be produced under what conditions. Markets were not thought of as generative institutions, so the hope was that state planners could rig the rules of the game to approximate the ideal mix of goods and services that markets are (supposed) to generate. This could then be happily married to an income policy that narrowed the gap between rich and poor.

It is a tribute to the work of Friedrich Hayek that no one today quite believes this fantasy could be brought to successful completion, even though computers are a billion times more efficient now than they were when the socialist calculation debate took place. This utopian proposal is doomed to failure because all interested parties in the planning debacle, both public and private, will have equal access to these devices, no matter how powerful. As the night follows the day, every clever government intervention will invite multiple private responses, which are certain to undo whatever good might have come about if dedicated government officials (itself a generous assumption) had exclusive use of the new technologies involved. The hope that we could keep the distribution, be it of income or wealth, on one axis and the production of goods and services on a second axis, such that the twain will never meet, has disappeared into the dustbin of history. The single strongest safeguard that we have against excessive planning stems from the awareness that even its champions have that any government initiative, however noble, marks only the first step in what promises to be a long and arduous multiple-period game—a game in which it is hard to say with confidence that any one player could emerge victorious. Caution with respect to means may well slow down individuals and groups that maintain strong collective ideals about the choice of ends—most notably, the compression of income differentials through social planning.

The argument today, therefore, has switched grounds. No longer is it said that the state can outperform the market. Rather it is said that the market itself suffers from certain "failures" that justify forms of state intervention to protect individuals who are hurt in the process. The movement toward collectivization of all public activities, if it is to take place today, will not rest on a single bold initiative that casts aside the private sector. Instead, it will take place in the form of a multiple attack along different margins, where each individual struggle does not generalize easily across the board. The long-standing objective of the modern closet socialist is to consolidate the separate beachheads after they are taken over. Thus, state dominance can be portrayed as a device that takes the irrationality, impersonality, and cruelty out of markets and not as a device that dispenses with their use altogether. In effect, the discourse takes the form of an intellectual two-step. Step one: markets are all right when they work. Step two: but markets do not work in this particular area, be it health care, labor, housing, agriculture, or whatever, each with its own "special" problems. In one sense, the quiet blessing in this approach is that it obviates the risk of a catastrophic conversion to state control through aggressive nationalization. But it gives rise to a multiple-front war in which substantial chunks of voluntary markets always find themselves at risk. The case against overall socialism is irrefutable today. But the desire to keep up with its egalitarian objectives continues to exert a considerable influence in practice. There is little reason to think that the intellectual foundations of the collective impulse are strong enough to serve as the foundation for a more viable and comprehensive philosophy. However, we still have to keep in mind the importance that market failures have in the overall analysis when it comes to the examination of the libertarian alternative.

Strengths and Weaknesses of Libertarian Thought

Even if socialism may be dispatched in a few sentences, it is far more profitable to devote some words to the commendable strengths and serious drawbacks of libertarian thought. I will start with the positives and then move on to the limitations. Without question, the sensible libertarian understands the importance of property rights, of voluntary exchange, and of keeping to a minimum state devices that could upset the precarious balance created by strong property institutions. The presumption against the use of state power means that libertarians are rightly sensitive to the problems associated with the use of force on the one hand and the various kinds of deceptions that individuals can play upon each other on the other. The good libertarian does not fall into the socialist trap of thinking that any individuals can rise above human failings only when they are placed in a position of high power, where the temptations are likely to intensify. Rather, the good libertarian starts with a reasonably astute estimation of human character. The libertarian is not somebody who believes we are all dewy-eyed individuals who will always work for the best interests of other people. Rather, he recognizes that self-interest is a force that is sometimes turned into bad ends and sometimes into good ends. Armed with that knowledge, he tries to figure out how to minimize the bad consequences of human action and maximize the good.

The basic commandment of this approach, with which I agree, is that voluntary transactions are presumptively preferred because they are positive-sum games from which both sides benefit. In contrast, the use of fraud and coercion are regarded with deep suspicion because these are pure transfer games in which one side may benefit (somewhat) and the other side will lose (a great deal more). We need some way to net out the pluses and the minuses of coercive transactions. On this score, the somber conclusion is that the minuses are likely to dominate simply because people are less likely to resort to theft when they can organize a voluntary transaction that works to their mutual advantage. When people resort to force and deception, they surely pay a price, but it is likely to be far lower than the harm they inflict on others whose lives, limbs, and fortunes are placed at risk. On these critical points, the insights of libertarian theory cannot be ignored, even if they may have to be qualified.

The second point that the libertarian rightly grasps is that one good idea—voluntary exchange—applied multiple times becomes a truly great idea. If law sets up a system in which two people make a transaction, then each can take what he receives in any given exchange and decide to consume it, invest it, or resell it to a third person. The more rapid the velocity of transactions, the more likely that all individuals will exhaust the full set of gains available from the contractual process. Mutual gain is therefore piled on top of mutual gain in transactions that involve two or more persons. In seeking to understand private contracts, it is always a mistake to think of them as one-shot transactions in a stagnant economy. Rather, it is a dynamic system in which the ceaseless exchange of goods and services generates positive consequences for other people whose opportunities are enhanced by the greater wealth and prosperity of their neighbors. The point is that a system of private property and voluntary exchange does produce a fair share of externalities, but to the extent that these are routinely positive, not negative, the externalities give truth to the old proposition of the late John F. Kennedy—a rising tide raises all ships. Quite simply, so long as all individuals can participate in the operation of a market system, no tiny group of individuals will be able to corner the wealth—and through it, the well-being—that it generates.

Unlike the model of socialism, the libertarian position has positive features that must be incorporated in any more comprehensive view of the world. The libertarian model comports so well with our ordinary experiential base that it is easy—almost too easy—to think that it offers the full solution to our social problem. After all, there is much to be said for a system that allows complex social organizations—commercial, social, and charitable—to arise out of a sequence of voluntary transactions that recombine initial endowments of property and labor in packages that work to the long-term advantage of all their participants. The point of vulnerability of this system, however, is that it cannot generate from its own motion the background social conditions that allow it to flourish. A system of property rights requires the enforcement of the boundaries that keep persons apart. Self-help is one possible solution to this problem, but it is a mantle that can be claimed by aggressors as well as by their victims. Self-declarations will not allow us to sort out these two groups from each other. Nor will it be easy to find a market solution to this problem, because every side to a dispute (many of which involve more than two individuals) will demand some control over the choice of the final referee. It is because of this void that we have the need for (and fear of) a single institution that makes authoritative decisions about the rights and duties of the various individuals and firms within a complex society. We thus find ourselves in the unhappy situation of demanding some sort of state monopoly to enforce the rights that make a decentralized economic system possible. Indeed, the ambiguities go deeper than all this, for voluntary transactions and private property take place on top of a social infrastructure that no market can supply.

On this point, I am always impressed by market-oriented writers, such as Hernando DeSoto (1989, 2000), who start with the social necessity of having single state-run systems for market economies to flourish. DeSoto's simplest example was that of ordinary street addresses, without which it is not possible to organize a system for delivering the mail or supplying electricity, gas, police, and fire services. This simple commitment to a legal and physical infrastructure requires a system of public taxation and finance. These institutions cannot operate strictly and solely on voluntary cooperation, because virtually all (self-interested) individuals will have a tendency to let others pick up the lion's share of the cost from the collective institutions from which they hope to benefit (see, for example, Olson [1965]). Public-spirited individuals are too few and far between to pick up the slack. Unfortunately, everyone cannot stand back from collective responsibilities in the vain hope that necessary public services will somehow be supplied by others. Hence, the great challenge in liberal democracies is to figure out how to use systems of coercion to benefit the very individuals and institutions subjected to them. Stated otherwise, the public provision of any goods and services necessarily presupposes a system of public taxation and finance. For these funds to be spent intelligently, we need to develop a sound collective judgment as to which infrastructure projects are worth undertaking and which are not. If the libertarian holds fast to the assumption that all forms of state coercion are equal, then he strips himself of the tools that might allow him to segregate those state projects that are worth doing from those that are not. Likewise, the rejection of all systems of taxation makes it impossible to distinguish between better and worse systems of taxation and exposes a serious political theory to the most dangerous of refutations—ridicule.

There is a bright side, however. Once we recognize that private markets need these public systems, we can at least develop a criterion by which we should judge the public use of force: does the use of coercion benefit those who are subject to the taxes and regulation that government imposes? Stated in a single sentence, the key weakness of the hard libertarian position is that it does not make room for situations where property is, and ought to be, taken—be it by occupation, regulation, or taxation—in exchange for just compensation—be it in cash or in the form of in-kind benefits, such as the increased security of private property and voluntary transactions. This immense area of forced exchanges does not concede an "open sesame" to state power. Rather, it is hemmed in with serious limitations on what state actions may be undertaken, and toward what end, and what forms of compensation should be supplied. I have written of these subjects at great length elsewhere (Epstein, 1985; Epstein, 1993). Suffice it to say, it is possible to devise rules that permit the provision of needed public goods without allowing the state to succumb to political favoritism that leads to massive transfers of wealth from one political faction to another. The candid response to the challenge of forced exchanges to the provision of public (i.e., nondivisible and nonexclusive) goods is what the standard libertarian theory most critically lacks. It is for this reason that I often prefer the label "classical liberal," on the ground that the basic theory recognizes the need for some government role in supplying public good that libertarians may acknowledge but that their stripped-down theories cannot fully explain.

Competitive Markets and Compensation for Competitive Harms

Rather than pursue this thorny topic here, I am approaching this lecture in a more simpleminded mood. Because I want to address the easy cases that do not depend on the complex conceptions of public goods and just compensation, which play so large a role in markets such as transportation and communication, the differences between the libertarian and the classical liberal are, for this exercise at least, relatively unimportant. More concretely, my objective is to return to those many markets where we do not have to worry about these massive coordination problems precisely because two individuals can enter into exchanges that promote their mutual gain even if they are unable to secure the cooperation or participation of anyone else. Where then does the simple logic of voluntary contracting lead us in this connection?

Clearly, this world is not devoid of problems. In any exchange between two persons, it is important to ask whether it is truly voluntary or whether it is subject to duress, fraud, or some other form of undue influence. This will certainly be an issue in transactions that involve medical treatment for old or infirm persons whose cognitive capacities are sharply limited. Indeed, much of the debate in medical ethics relates to the question of what should be done in situations where people are, at best, marginally competent to make critical decisions about their own future. But the concerns that permeate certain specialized transactions are, thankfully, not a serious concern in most organized markets. Undue influence is not a real issue in mercantile transactions that take place on open exchanges. These trades usually work just as the textbook says they should: they produce benefits to the two traders, which in turn sets up opportunities for a third person to profit as well. So, the basic situation leaves us in the best of all possible worlds, where a local improvement between two parties is accompanied by a generalized form of social improvement. But it is here that our difficulties begin, for any successful trade may often leave in its wake one or more disappointed competitors who are worse off in this particular instance because of their inability to make the sale. Their competitive loss is a real economic harm, and it is always possible for individuals to ignore the systematic gains from trade and insist that they should receive some sort of compensation for their competitive loss.

It is on this big, easy question that the rubber hits the road, for anyone who is committed to the classical liberal position will fight to the death against the compensation for losses arising in a competitive economy, notwithstanding the fierce resistance routinely encountered in practice. The common argument is that economic losses from competition are every bit as real to their victims as those that result from the use of force. If we allow compensation for physical injuries and injunctions against their future occurrence, then we should do the same for competitive losses, which should likewise be enjoined or compensated.

As I noted earlier, the classical writers on this subject rejected these claims with a Latin phrase, *damnum absque ininuria*, which translated means "harm without injury," or, as lawyers would say today, "harm but not actionable harm." Clearly, the use of this Latin expression smacks of the argument by fiat to which I referred earlier. It is important to note that we can develop a more systematic, theoretical argument against this claim for protection from or compensation for competitive losses, which runs as follows. There is a world of *social* difference between the harms inflicted by the use of force and those inflicted through competition. In the first case, we know that injury to the person and damage to property reduces the total store of resources available for human betterment. One person, to make himself better off, inflicts the losses on a second person. That individual's reduced stock of wealth necessarily reduces the opportunities for trade that are available to third persons. The externalities from coercion turn from generally positive to sharply *negative*. However much a single actor might benefit from his own use of force, no one thinks it is possible to prosper in a society that generalizes from that experience and that allows all individuals to adopt the same practices at will.

In contrast, competition may cause harm to one rival producer, but it also leaves his stock of labor and capital intact for a second transaction. By helping trading partners, it opens up new avenues to those individuals who receive goods at low prices and of high quality and to the many third persons who stand to benefit in further transactions. To take a broad definition of actionable harm transforms liability from an occasional occurrence, such as a car accident, into an inevitable and ubiquitous occurrence: If A's success in competition is an actionable harm to B, then so too is B's success to A. A's claim only looks plausible when considered in isolation; it looks grotesque when its full implications are considered.

Here is not the place to repeat the demonstrations that competitive markets maximize welfare by exhausting the gains from trade. It is quite enough to say that compensation for or protection from competitive losses destroys the gains from trade at every juncture. It may well be that the disappointed trader loses more from competition than from petty theft. But from a larger point of view, competition as a process produces systematic social gains, while coercion and force as a process produce systematic social losses. The willingness to protect individuals against physical loss to person or property, or against defamation and other forms of molestation that involve either misrepresentation or threats of force, has the great virtue of allowing individual lawsuits to go forward when private and social welfare are perfectly aligned. But any offer of compensation or other protection to the disappointed trader has exactly the opposite effect: it places a giant wedge between individual and social welfare. The point here does not depend on the particulars of the product or service offered. It is not undermined by the most painful stories novelists can write about the havoc that demonic competition imposes on those who have found themselves displaced by market forces. It is a general proposition that is capable of general affirmation. It is one of those easy cases that it is absolutely vital to get correct: *there must be no compensation or protection against economic losses sustained through the operation of competitive markets*. It is a principle that is widely acknowledged and violated in practice.