

**THE IMPLICATIONS OF CATHOLIC SOCIAL TEACHING
FOR ECONOMIC SCIENCE: AN EXCHANGE BETWEEN
THOMAS STORCK AND THOMAS E. WOODS, JR,
WITH RESPONSES**

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A CHALLENGE FROM THOMAS STORCK

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It is often claimed that there is a conflict between the ethical mandates of Catholic social teaching and the findings of economic science. However, the kind of economic analysis such critics adhere to is either the mainstream neoclassical (including the Chicago School) or the Austrian School, whose modes of economic analysis differ from that employed by the popes. Using examples from encyclicals, this article shows that the Supreme Pontiffs gave a more prominent place in their economic thinking to economic power and to institutions such as legal or cultural norms than to market forces. Instances are then given in which economic power is shown to have affected economic outcomes, and alternative schools are proposed as offering a type of economic analysis closer to that used by the popes.

Introduction

Catholic social teaching, most notably as contained in the social encyclicals and other papal documents, makes not only ethical claims and demands on economic actors and society,¹ but includes certain observations and analyses of how economies function, both of which appear to many practitioners of mainstream economics to contradict the very foundations of their discipline, and to indicate a lack of knowledge or a disregard of fundamental economic laws on the part of the Supreme Pontiffs.² It is my thesis here, however, that any tension between the teaching contained in the encyclical tradition and economic science can be easily removed if one adverts to the existence of different kinds of economic analysis, in fact, to some of the schools commonly called “heterodox,” primarily to the German historical school and to the original American Institutionalism, both of which offer a version of economics compatible both with Catholic social teaching and human reason.³

Let us begin by looking at some of the passages in papal teaching which, in my opinion, portray economic actions in such a way as to pose a difficulty for practitioners of mainstream economics. In doing so, I will focus on two points, first the question of power in economic relations and in the distribution of economic goods, and secondly and more briefly, the question of how various institutions, using that word in its widest sense, influence economic outcomes.

The Concept of Power in Papal Economic Analysis

For the first point, the question of power, let us start with the opening paragraphs of *Rerum Novarum* (1891), usually considered the first social encyclical. There Pope Leo writes that “Working Men have been given over, isolated and defenseless, to the callousness of employers and the greed of unrestrained competition” (no. 2). And later in this same encyclical, in his discussion of wage justice, he characterizes a worker who accepts less than a living wage “because an employer or contractor will give him no better,” as being “the victim of force and injustice” (no. 34).

Quadragesimo Anno (1931), Pius XI’s encyclical commemorating the fortieth anniversary of *Rerum Novarum*, contains a number of passages similar to those quoted from Leo XIII, of which I will refer to only a few.

Capital, however, was long able to appropriate to itself excessive advantages. It claimed all the products and profits and left to the laborer the barest minimum necessary to repair his strength and to ensure the continuation of his class. For, by an inexorable economic law, it was held, all accumulation of riches must fall to the share of the wealthy, while the working man must remain perpetually in indigence or reduced to the minimum needed for existence. It is indeed true that the actual state of things was not always and everywhere as bad as the liberalistic tenets of the so-called Manchester School might lead us to conclude, but it cannot be denied that a steady drift of economic and social tendencies was in this direction. (no. 54)

Later in the encyclical, he refers to the “immense power and despotic economic domination...concentrated in the hands of a few” (no. 105), and the “accumulation of power [which] is a natural result of unrestrained free competition which permits the survival of those only who are the strongest” (no. 107).

It is my contention that Catholic social teaching views the economy as an arena in which such power relations are important determinants of all economic outcomes, not just of income distribution. Otherwise it seems impossible to understand why both Leo XIII and Pius XI spoke of victims “of force and injustice” or referred to “immense power and despotic economic domination.”⁴

Nevertheless, the recognition by the popes that power is an omnipresent factor in economic outcomes and that this power can be used in an oppressive manner does not mean that the use of such power is necessarily wrong. It is simply a fact of economic life; it becomes wrong only when what is sought is unreasonable, whether this is done by capital or by labor. Consider the remarks of Leo XIII in *Rerum Novarum*, which frankly accept the ubiquity and necessity for power in determining economic outcomes.

The richer population have many ways of protecting themselves, and stand less in need of help from the State; those who are badly off have no resources of their own to fall back upon, and must chiefly rely upon the assistance of the State. And it is for this reason that wage-earners, who are, undoubtedly, among the weak and necessitous, should be specially cared for and protected by the commonwealth (no. 29).

This is also clear from Pope Leo’s remark at the beginning of *Rerum Novarum* about the demise of the guilds, and how, as a result, “Working Men have been given over, *isolated and defenseless*, to the callousness of employers and the greed of unrestrained competition” (no. 2, emphasis mine). This shows that Leo realized that workers need some kind of protection against both market forces—“the greed of unrestrained competition”—and against the power of other men—“the callousness of employers.” And he did not hesitate to locate that protection in the power of the state.

Income Disparity as Explained by Neoclassical Economic Theory

Neoclassical economics, however, presents a different account of such economic disparities. To see this, let us look at part of the presentation of income distribution given by Paul Samuelson in what is probably the most widely used economics text in the entire world, a text periodically revised and continuously used since 1948.⁵ The very title of Samuelson’s chapter, “How Markets Determine Incomes,” indicates clearly how neoclassical economic theory understands the question. Samuelson simply sees income distribution as

a special case of the theory of prices. Wages are really only the price of labor; rents are similarly the price for using land. Moreover, the prices of factors of production are primarily set by the interaction between supply and demand for different factors - just as the prices of goods are largely determined by the supply and demand for goods.⁶

In other words, the different incomes of different workers can be explained by means of a typical demand curve. Thus since “the supply of surgeons is severely limited [and] [d]emand for surgery is growing rapidly...surgeons earn \$270,000 a year on average.” But “fast-food ...jobs have no skill or educational requirements and are open to virtually everyone. The supply is highly elastic.... Wages are close to the minimum wage because of the ease of entry into this market, and the average full-time employee makes \$12,000 a year.”⁷

However, it might be contended that neoclassical economics in fact does address the question of economic power. In Samuelson’s discussion of labor unions, for example, he asks,

How can labor unions raise the wages and improve the working conditions of their members? *Unions gain market power by obtaining a legal monopoly on the provision of labor services to a particular firm or industry.* Using this monopoly, they compel firms to provide wages, benefits, and working conditions that are above the competitive level.⁸

But the point that is implicit in the social encyclicals, and that Samuelson does not recognize, is that such use of power is the norm in the economy. Pretty much everyone employs some variant of it to gain a more favorable economic outcome. As we will see, corporate CEOs arguably have mastered this art much better than have labor unions.⁹

Counterexamples to Neoclassical Theory

Samuelson acknowledges that the market does not necessarily “produce a fair and equitable distribution of income and property.”¹⁰ He does not suggest any other possible explanation for disparities in income than the quasi-mechanistic workings of supply and demand. But this is not what Popes Leo and Pius imply in the passages quoted above. Rather, both of them indicate that in an economy there are other factors at work besides market forces.¹¹ In other words, for these Pontiffs, the power of some men to dominate others can produce economic outcomes

which mainstream economists would explain as being due entirely to market forces. Indeed, the very analytical tools which a neoclassical economist employs hardly permit him to do otherwise. Although it is surely the case that labor supply and demand is very often a part of the explanation for disparities of income, it does not follow that that is the *entire* explanation and that there are never other factors at work. The simple and obvious contrast of surgeons and fast-food workers becomes a paradigm and is thus held to explain any and all examples of income distribution, no matter what other factors may be present. To introduce an alternative model, however, let me give an example of a change in income distribution brought about as a result of a change in the balance of power in an economic relationship. This is the example of the Antigonish cooperatives in Nova Scotia in the 1930s.

The most forlorn picture lay in northeastern Nova Scotia and the island of Cape Breton. Along the coast lived the fishermen. Their catch of fish and lobsters was handled by local dealers who, in many cases, kept the fishermen in a state of peonage. While Maine fishermen were getting about fifteen cents a pound for lobsters, the Nova Scotian fishermen were receiving as little as two cents a pound. All other prices were scaled down in the same ratio. For everything they bought, however, from their scanty food purchases to nets and lines, they paid top prices, with the result that they were invariably bowed down with a load of debts. Appalling poverty, illiteracy, poor health, and the worst possible housing conditions existed throughout this section.

After priests from St. Francis Xavier College had begun to educate the fishermen in the philosophy of cooperatives, a

few lobster fishermen got together and made up a crate of lobsters which they shipped express to a commission agent in Boston. When the mail brought a check the group sat around, afraid to open it. So much depended upon that check; upon its size rested their hopes for better prices and better living. Probably there had never been a more momentous moment in all their lives than that moment when one of the boys finally opened the envelope and took out the check. After all shipping charges and commissions had been paid, there remained fifteen cents a pound for their shipment.^{xii}

This example does not involve wages, but it does involve income, and the point is that the locus of economic *power* does much to determine income. Market forces were not altered when the fishermen's per pound income went from 2 cents to 15 cents. What changed was the elimination of the middleman and consequently the assumption of the power which previously he had had over the fishermen by the fishermen themselves. Any analysis of this situation which fails to address the question of the structure of the economic relations, in effect, of the locus of economic power, does not do justice to what is going on. Let us look at another set of examples of power as it affects income.

These concern the extraordinary rise in corporate CEO income in the United States. The most remarkable fact about CEO compensation in the United States in recent years is that certain CEOs have received large amounts in salaries, benefits, and pensions even when the firms they headed were performing poorly or even filing for bankruptcy. How could market forces have brought this about? Was there a large and increasing demand on the part of corporations for mediocre chief executives? Actually market forces had nothing to do with the process. These CEOs were able to obtain these compensation packages because they were in a position to choose those who determined their income, the members of the compensation committees of their boards of directors. Their salaries and other compensation were not determined by supply and demand because they made use of their legal power to avoid the rigors of market forces. Let us look at a few examples.

While Apple Computer's "shareholders' return declined by 34 percent," CEO Steve Jobs received \$78 million, and while Lucent's "shareholder return declined by more than 75 percent," Pat Russo was paid \$38 million. Even more telling is the case of Disney's Michael Eisner. Eisner, "after he failed to clear his bonus hurdle two years running, his board lowered the performance bar, and then...he finally cleared it. An Olympian effort worth \$5 million."¹³

In order to accomplish this, however, it is necessary to deceive, or at least to keep in the dark, those who hold formal legal ownership of the corporation, the shareholders. How is that possible?

So why, you may wonder, aren't investors up in arms over these jaw-dropping retirement giveaways? The answer is that hardly anybody knows about them. The complex details surrounding executive pensions are typically buried deep within a company's SEC filings, far removed from the salaries, bonuses, and stock options that dominate the headlines.¹⁴

These examples illustrate my point: CEO incomes in such cases are not the result of market forces, the forces of supply and demand, but rather result from the CEO's ability to manipulate the corporate legal structure. If that legal structure were changed, if for example, CEO compensation were decided upon by a vote of all shareholders, then I think it is obvious that they could not obtain such huge amounts for themselves, especially when their companies were failing and stockholders' investments were losing value. Nor is there any reason why it is more in accordance with economic laws that CEOs should have their compensation set by one group than by another. It is simply a case of power and the ability to use or abuse the rules to favor one or another party.¹⁵

The Role of Institutions in Papal Economic Analysis

In discussing the other major analytical difference between mainstream economics and papal social teaching, the presence of institutions, we should note that it is impossible to draw a sharp line between this and the question of power in an economy. This is because institutions are in part embodiments of power and usually routinely exercise power. Moreover, it is important to understand that by an *institution* I mean more than an organization of some kind, but include the legal and tax systems, customs and culture and the state of technology.

When Adam Smith wrote of man's "propensity to truck, barter, and exchange one thing for another,"¹⁶ his observation doubtless had some truth, but the deductions drawn from that statement, which may be said to be embodied in the typical demand curve of mainstream economics and in its doctrine of marginal utility, are much less certain. The observed tendency to trade is taken to be a sufficient empirical foundation for an implicit philosophy of man, a philosophy of man embodied in the familiar concept of *homo economicus*. One way this is developed is via a concept very important in neoclassical economics: scarcity. Here is how Samuelson introduces the concept.

Take *scarcity* first. If infinite quantities of every good could be produced or if human desires were fully satisfied, what would be the consequences?... In such an Eden of affluence, there would be no *economic goods*, that is, goods that are scarce or limited in supply. All goods would be free, like sand in the desert or seawater at the beach.... But... [e]ven after two centuries of rapid economic growth, production in the United States is simply not high enough to meet everyone's desires. If

you add up all the wants, you quickly find that there are simply not enough goods and services to satisfy even a small fraction of everyone's consumption desires.¹⁷

Implied here is the notion that we human beings are always seeking to satisfy our unlimited wants from a necessarily limited supply of goods. But although certainly men have a natural desire for happiness,¹⁸ this does not necessarily express itself in a perpetual desire for "goods and services" designed "to satisfy...everyone's consumption desires." Numerous examples could be cited. The following from Max Weber is illustrative.

Until about the middle of the past [i.e. nineteenth] century, the life of a putter-out was, at least in many of the branches of the Continental textile industry, what we should to-day consider very comfortable. We may imagine its routine somewhat as follows: The peasants came with their cloth, often...principally or entirely made from raw material which the peasant himself had produced, to the town in which the putter-out lived, and after a careful, often official, appraisal of the quality, received the customary price for it. The putter-out's customers, for markets any appreciable distance away, were middlemen, who also came to him, generally not yet following samples, but seeking traditional qualities, and bought from his warehouse, or, long before delivery, placed orders which were probably in turn passed on to the peasants. Personal canvassing of customers took place, if at all, only at long intervals. Otherwise correspondence sufficed, though the sending of samples slowly gained ground. The number of business hours was very moderate, perhaps five to six a day, sometimes considerably less; in the rush season, where there was one, more. Earnings were moderate; enough to lead a respectable life and in good times to put away a little. On the whole, relations among competitors were relatively good, with a large degree of agreement on the fundamentals of business. A long daily visit to the tavern, with often plenty to drink, and a congenial circle of friends, made life comfortable and leisurely.¹⁹

Evidently for these merchants it is not true to say that there were "simply not enough goods and services to satisfy even a small fraction" of their "consumption desires." They seem to have been content with customary returns and a sufficiency of income.²⁰ The premise behind the ubiquitous demand curve of mainstream economics is of a calculating

desire to buy cheap and sell dear, to make the maximization of income the fundamental principle not only of the economy but of society and of life itself. My point here is that neoclassical economics has erected a superstructure on a very insufficient basis of observed human behavior. But once that basis is accepted, either by conviction that it is correct or by a simple failure to inquire into its legitimacy, the force of neoclassical economic reasoning is overwhelming. Thus, as long as its inductive foundations are accepted or ignored, the deductions which it makes will seem not only obvious, but of the very essence of a scientific approach to economic behavior. But as we have just seen, it fails when it comes into contact with the range of actual human conduct rather than the schematized behavior of *homo economicus*.²¹

The deductions typically drawn from Adam Smith's observation about human behavior illustrate the fact that cultural norms can be determinative of our economic behavior. The construction of *homo economicus* is hardly based on a rigorous induction. The actions of Weber's cloth merchants are sufficient to call it into question.

But there are many ways in which such institutional structures can differ in different ages and can set the context for and shape actual economic behavior. Pope Pius XI gives one instance on the question of property. In *Quadragesimo Anno* (no. 49) Pius noted,

History proves that the right of ownership, like other elements of social life, is not absolutely rigid, and this doctrine We Ourselves have given utterance to on a previous occasion in the following terms: "How varied are the forms which the right of property has assumed! First, a primitive form in use among untutored and backward peoples, which still exists in certain localities even in our own day; then, that of the patriarchal age; later came various tyrannical types (We use the word in its classical meaning); finally, the feudal and monarchic systems down to the varieties of more recent times."

Moreover, Pius uses the fact of the varying legal and cultural concepts of property in part as his justification for saying that "the public authority, in view of the common good, may specify accurately what is licit and what is illicit for property owners in the use of their possessions" (ibid.). In other words, custom, as embodied in different legal forms at different places and times, can play a very important role in specifying property rights. There is no one form of property rights which can be called more natural than other forms.²² This is simply one example of how the institutions upon which economic actions depend cannot be defined once and for all. Just as different cultures vary in their

attitude toward fulfilling their “consumption desires,” so do their concepts of property ownership, work, competition, and of most other practices and institutions which economic activity makes use of and depends upon.²³

The Approaches of Alternative Economic Schools

If it is true that mainstream neoclassical economics, including the Chicago School,²⁴ as well as the Austrian School, fail to understand how the world actually works, and moreover, that implicit in the economic analysis employed in papal social teaching is a very different kind of economic science from neoclassical economics, then something like the original American Institutionalism, or the German historical school, or economic sociology, seems to be required if we are to examine the actual workings of economies in the manner that the popes have done.

With regard to Institutionalism, Clarence Ayres explains its overall approach in these words:

...the object of dissent is the conception of the market as the guiding mechanism of the economy or, more broadly, the conception of the economy as organized and guided by the market. It simply is not true that scarce resources are allocated among alternative uses by the market. The real determinant of whatever allocation occurs in any society is the organizational structure of that society—in short, its institutions. At most, the market only gives effect to prevailing institutions. By focusing attention on the market mechanism, economists have ignored the real allocational mechanism.²⁵

Market forces always function within the “the important roles of history and culture” which determine “economic actors’ operative goals, values, and views...”²⁶

Similar criticisms of the deductive neoclassical approach were made by the German historical school. It faulted the

classical school’s deductive method...as being too abstract [and] puts the emphasis on the inductive method. Historians point out that economic development is unique, so there can be no ‘natural laws’ in economics.... Instead of searching for generally applicable laws, the historical school therefore tried to describe the particulars of each era, society and economy.²⁷

Another and complementary critique is offered by practitioners of what is known as economic sociology. Although these social scientists do not claim to be economists, their general approach and method is similar to that used by Institutional economists in that they take account of non-market institutions, in the broadest sense of that term, as factors that help determine economic outcomes. “Our argument is that market economies are embedded within a *civil society* that is both structured by, and in turn helps to structure, the state.”²⁸

All these alternative schools recognize the reality and importance of non-market factors, and thus their modes of economic analysis are much more compatible with the economic analysis that papal social teaching seems to imply and require. In particular, these alternative schools have an explicit concern with the two points I discussed above: the place of power in determining economic outcomes and the fact that market forces necessarily work within boundaries established by the institutions of a given society or culture.

The fundamental point that all these alternative schools share is to treat economics as a *human* science, that is, one that deals with the widely varying conduct of mankind. Our behavior cannot be schematized; rather, any science purporting to deal with real men must base itself on the observed acts of man and take account of the full range of human behavior and institutions.

What [the critics of mainstream economics] have in common is the denial that economic processes...can be adequately understood and analysed as closed, i.e., self-contained and self-sustaining systems isolated from a social and physical ‘environment’ of which the economic system is a part and from which it receives important inputs and with which it is related through manifold reciprocal interdependencies.²⁹

If the economic science that results from broadening our scope of inquiry does not approximate as much as some might like to the natural sciences, we should accept that with a realistic attitude, which surely is part of a truly scientific approach.³⁰

Although it is not the task of the Church to elaborate an economic science, for in such “technical matters...she has neither the equipment nor the mission,” nevertheless, since “economic activity and moral discipline...are [not] so distinct and alien that the former in no way depends on the latter,”³¹ Catholic social teaching must necessarily make

use of some type of economic analysis. And this analysis, I have argued, hardly comports with neoclassical or Austrian deductive economics, for the popes are not content to accept market forces as the only or primary factors in an economy, but frankly recognize the prime role of power as exercised by dominant individuals and institutions. Thus, a kind of economic science is necessary which understands the working of market forces within the constraints of all the human factors which generally operate in earthly affairs, including particularly cultural and legal norms. Such an economic science is available in a number of the “heterodox” schools and subsidiary disciplines which have not received the same recognition as has neoclassical economics.³² Although I am not arguing that any of these alternative economic schools is by itself necessarily sufficient to ground a complete economic analysis, taken together they suggest an approach which Catholic social philosophers and economists should find fruitful, and which gives a wide field for further development.³³

For only by working along these lines can justice be done to the papal analyses, and at the same time, the legitimate status of economics as a science, but as a *human* science, be upheld.³⁴

Appendix: Is the Chicago School an Exception?

It may be objected, however, that the foregoing criticism of mainstream economics does not apply to adherents of the so-called Chicago School, who are known for their espousal of a purely *positive* economics which claims a purely empirical basis for each of its statements.³⁵ Positive economics claims to be seeking “systematized knowledge concerning what is.”³⁶ The way in which it seeks and verifies this knowledge is through its ability to provide predictions. To understand how this works, consider an example that Milton Friedman gives.

I venture the judgment, however, that currently in the Western world, and especially in the United States, differences about economic policy among disinterested citizens derive predominantly from different predictions about the economic consequences of taking action—differences that in principle can be eliminated by the progress of positive economics—rather than from fundamental differences in basic values.... An obvious and not unimportant example is minimum-wage legislation. Underneath the welter of arguments offered for and against such legislation there is an underlying consensus on the objective of achieving a “living wage” for all.... The difference

of opinion is largely grounded on an implicit or explicit difference in predictions about the efficacy of this particular means in furthering the agreed-on end. Proponents believe (predict) that legal minimum wages diminish poverty by raising the wages of those receiving less than the minimum wage as well as of some receiving more than the minimum wage without any counterbalancing increase in the number of people entirely unemployed or employed less advantageously than they otherwise would be. Opponents believe (predict) that legal minimum wages increase poverty by increasing the number of people who are unemployed or employed less advantageously and that this more than offsets any favorable effect on the wages of those who remain employed.³⁷

This approach, however, is open to criticism for several reasons.³⁸ I will focus on those aspects of the concept which seem to me to betray its ultimately deductive foundations and thus open it to the same kind of criticisms I made above regarding mainstream economic theory. For example, it seems odd that a theory claiming to be wholly empirical could claim to discover whether a certain economic relationship held good always and everywhere. That is, could we assume that even if we had proven that minimum wage laws had such and such an effect on employment this time, that this would *always* be their effect? Friedman, however, seems to assume that in the case of minimum wage laws, as in the case of other economic questions, we can come up with an answer that is correct in all or nearly all situations. This ignores, however, the question of what unique factors might or might not operate in any given situation, a question that one thinks should especially concern a pure empiricist. But it appears that despite his claim to a purely empirical methodology, in fact, in Friedman's view,

Individuals are viewed as self-interested maximizers who function with a timeless sort of reason, unbounded by any cultural or institutional artifacts other than the available choices provided by the market itself. Thus it is not relevant that Americans might be culturally prone to seek fulfillment through consumption rather than in creative work environments.³⁹

A similar criticism can be made of his discussion of whether or not firms rationally seek to maximize their returns.

Confidence in the maximization-of-returns hypothesis is justified by evidence of a very different character.... [U]nless the behavior of businessmen in some way or other approximated behavior consistent with the maximization of returns, it seems unlikely that they would remain in business for long. Let the apparent immediate determinant of business behavior be anything at all—habitual reaction, random chance, or whatnot. Whenever this determinant happens to lead to behavior consistent with rational and informed maximization of returns, the business will prosper and acquire resources with which to expand; whenever it does not, the business will tend to lose resources and can be kept in existence only by the addition of resources from outside.⁴⁰

Friedman argues that this theory is confirmed by “experience from countless applications of the hypothesis to specific problems and the repeated failure of its implications to be contradicted.”⁴¹ But what experience has he consulted? Apparently not that recounted by Max Weber, for example.⁴² Another example of his selective attitude toward the evidence is found in his comments on firms that fail. Apparently he considers these in some way a confirmation of his theory that firms maximize returns. “The process of ‘natural selection’ thus helps to validate the hypothesis—or, rather, given natural selection, acceptance of the hypothesis can be based largely on the judgment that it summarizes appropriately the conditions for survival.”⁴³ But, in fact, many businesses do fail. Did those not seek to maximize their returns, and is their evidence not highly relevant? If they did, then “natural selection” proves nothing. But if the reason for their failure was that they did not seek maximization of returns, then not only is Friedman’s original hypothesis disproved, but he would seem to be ignoring some of the important evidence which might confirm or disconfirm his theory.

Friedman’s implicit commitment to the neoclassical deductive method is shown most clearly in his discussion of what he calls the “assumptions” of a hypothesis or theory. He ridicules the notion that the assumptions of a theory can be completely realistic by suggesting that in that case one would have to take account of all the individual characteristics of those engaged in a particular economic process, e.g., their hair color, education, etc. Of course he recognizes that this “is in part a straw man.”⁴⁴ But he is entirely serious when he rejects any criticism based on the notion that in fact businessmen do not do the things that his theories say they do.⁴⁵

...criticism of this type is largely beside the point unless supplemented by evidence that a hypothesis differing...from the theory being criticized yields better predictions for as wide a range of phenomena. Yet most such criticism...is based almost entirely on supposedly directly perceived discrepancies between the “assumptions” and the “real world.”⁴⁶

By arguing that any details which might tend to contradict his hypotheses are irrelevant, he is able to specify in advance that some facts are not important, and in addition, largely eliminate the consideration of alternative explanations. Thus, if Friedman insists that, despite appearances, firms do engage in behavior which maximizes returns, and rejects as irrelevant anything which suggests otherwise, it is not surprising that he reaches results which seem to confirm his theory, especially if he ignores the distinction between maximizing returns and simply having a positive income flow.

Friedman then, and by extension the Chicago School, may be said to disguise their crucial assumptions beneath their discussion of methodology. By their treatment of what they call a theory’s “assumptions,” they decide in advance to ignore certain types of evidence and to limit their empirical research to behavior which already appears to confirm their theory.

The complexity of the real world is to be viewed through the lenses of supply and demand, equilibrium, and maximization subject to constraints. As such, universally applicable hypotheses are devised which transcend institutional and historical variations. The lenses focus potential economic research upon and, in effect, constrain attention to the behavior of atomistic agents. Such agents are assumed to act rationally and exclusively on the basis of market given information.⁴⁷

The sorts of behavior we saw above, whether the leisurely methods of Weber’s cloth merchants or the manipulation of corporate rules to maximize CEO compensation or any of the other types of behavior which do not conform to market explanations, are ruled out in advance by Friedman as irrelevant. He will adhere to his market-based hypotheses, and by excluding any contrary evidence, quite naturally he will achieve results which appear to confirm them. Thus, despite an appeal to a purely empirical method, Friedman draws all his theories from the central model of neoclassical economics, based on insufficient induction and blind to many of the realities of human affairs.

Notes

1. These begin with *Rerum Novarum*, and include its well-known demand for “remuneration...enough to support the wage-earner in reasonable and frugal comfort” (no. 34), and continue through *Centesimus Annus*, which not only reiterates that imperative (no. 8), but includes many others, for example, “that the market be appropriately controlled by the forces of society and by the State, so as to guarantee that the basic needs of the whole of society are satisfied” (no. 35).

Quotations from *Rerum Novarum* and *Quadragesimo Anno* are from the Paulist translation as published in *Seven Great Encyclicals* and elsewhere; *Centesimus Annus* quotations are from the Daughters of St. Paul edition.

2. An extreme example of this line of thinking may be found in the paper by Thomas Woods, Jr., “Catholic Social Teaching and Economic Law: An Unresolved Tension,” delivered at the Austrian Scholars Conference at the Mises Institute, Auburn, Alabama, March 2002. Woods stated inter alia, “The primary difficulty with much of what has fallen under the heading of Catholic social teaching since Pope Leo XIII’s *Rerum Novarum* (1891) is that it assumes without argument that the force of human will suffices to resolve economic questions, and that reason and the conclusions of economic law can be safely neglected, even scorned” (p. 4). The entire paper is available at www.mises.org/asc/2002/asc8-woods.pdf

Although I will be discussing chiefly conventional or mainstream neoclassical economic theory in this article, Woods, in the paper cited above, writes from the standpoint of Austrian economics, which is usually considered as one of the “heterodox” economics schools. However, Austrian economics, like the neoclassical school, exhibits a basically deductive approach to economic analysis, and thus can be considered generally as falling under the criticisms made here. As Anton D. Lowenberg wrote, “I use the term ‘neoclassical’ here very broadly; it includes all theories that are based on the economizing behavior of individual value-maximizing agents.” “Neoclassical Economics as a Theory of Politics and Institutions,” *Cato Journal*, vol. 9, no. 3, winter 1990, p. 620.

3. For a recent survey of the chief “heterodox” schools of economics, see David L. Prychitko, ed., *Why Economists Disagree: An Introduction to the Alternative Schools of Thought* (Albany : State University of New York Press, c. 1998).

Mary E. Hobgood, in her book, *Catholic Social Teaching and Economic Theory: Paradigms in Conflict* (Philadelphia : Temple

University, 1991) makes essentially this same point of a conflict between Catholic social teaching and mainstream economics, but does not stress the necessity for a non-deductive economic science of the kind offered by some of the “heterodox” schools of economic thought. In addition, this book suffers from a feminist social perspective and modernist theology.

4. Nor can it be rightly claimed that even if earlier popes did employ this type of economic analysis, all this changed with John Paul II’s *Centesimus Annus*. Aside from the fact that the ethical mandates in this latter encyclical are virtually the same as in the prior papal documents, John Paul also asserts the duty of the state to enforce economic justice and specifically criticizes “a radical capitalist ideology...which blindly entrusts [the solution of poverty and economic exploitation] to the free development of market forces” (no. 42). If the state has a key role to play here, and if market forces are not to be the controlling factor, then John Paul clearly understood the fact that economic force and power are realities that must be reckoned with.

5. Paul Samuelson and William Nordhaus, *Microeconomics*, (Boston: McGraw-Hill Irwin, 17th ed., 2001). The macro and micro sections of this text are also available as one volume.

6. *Ibid.*, p. 229.

7. *Ibid.*, p. 236.

8. *Ibid.*, p. 255. Emphasis in original.

9. John Kenneth Galbraith points out that nearly every economic actor has been eager to escape from so-called market discipline and achieve some measure of economic security or advantage. “But the large corporation has been only the leader in the retreat from risk. Nearly everyone else has participated to the best of his ability and ingenuity...” *The Affluent Society* (New York : Mentor, c. 1958) p. 88. See also pp. 84-85.

10. *Microeconomics*, p. 239.

11. Although outside of a few passages in *Centesimus Annus* the papal social encyclicals rarely address the question of the existence of market forces, I wish to make clear that I acknowledge without hesitation their reality and importance. But I simply point out that they always function alongside of, and in the context of, other factors, which can be equally, or even more powerful, than they are. In addition to simply raw power, these other factors include cultural expectations, the legal and tax systems and the state of technology.

12. Bertram B. Fowler, *The Co-operative Challenge* (Boston: Little, Brown, 1947) pp. 128-131.

13. Peter Carlson, "A Few Blips in the Search for Unsung Life Forms" *Washington Post* (April 22, 2003) p. C1.
14. Janice Revell, "CEO Pensions: The Latest Way to Hide Millions" *Fortune* (April 28, 2003) p. 68.
15. At one point Samuelson does address the question of why "some top executives at poorly performing companies have received salaries and bonuses totaling \$50 million or more," and seems to realize that there might be more to income distribution than the automatic workings of the market. He explains that "insiders may vote themselves large salaries, expense accounts, bonuses, and generous retirement pensions at the stockholders' expense" (*Microeconomics*, p. 192). But Samuelson does not seem to let this disturb his comfortable belief that it is markets that determine incomes.
16. *An Inquiry in the Nature and Causes of the Wealth of Nations*, book I, chapter 2. In view of the great many editions of this work, I will cite only to the chapter number.
17. Paul Samuelson and William Nordhaus, *Macroeconomics* (Boston: Irwin McGraw-Hill) c. 1998, p. 5. Emphasis in original.
18. Cf. Thomas Aquinas, *Summa Theologiae* I-II q. 5, a. 8.
19. Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (New York : Charles Scribner's, c. 1958, originally published 1904-5), pp. 66-67.
20. In this connection, consider the statement of former Dutch Prime Minister Ruud Lubbers. "It is true that the Dutch are not aiming to maximize gross national product per capita. Rather we are seeking to attain a high quality of life, a just, participatory and sustainable society. While the Dutch economy is very efficient per working hour, the number of working hours per citizen are rather limited. We like it that way. Needless to say, there is more room for all those important aspects of our lives that are not part of our jobs, for which we are not paid and for which there is never enough time." Quoted in Anders Hayden, "Europe's Work-Time Alternatives" in John de Graaf, ed., *Take Back Your Time: Fighting Overwork and Time Poverty in America* (San Francisco: Berrett-Koehler, 2003) p. 202.
21. But even the very citadel of neoclassical thought can on occasion admit that their premises do not wholly agree with actual human behavior, and that the assumption of profit maximization is mostly a heuristic device. Cf. Laurence Miners and Kathryn Nantz, *Study Guide for Use With Microeconomics* (Boston: McGraw-Hill Irwin, 2001) p. 105.

22. "Private property has been the keystone of mainstream classical, neoclassical, and Chicagoan economic theory and ideology for more than two centuries. Yet, curiously, neither the classical nor neoclassical schools undertook a detailed analysis of the intricacies of existing property institutions, or the development of property institutions over time. It seemed that these economists were satisfied with a highly idealized concept of property; provided that property was in some sense privately owned and transferable, they were not especially curious about how existing property institutions might differ from that idealized concept." Alan Randall, "Property Institutions and Economic Behavior," *Journal of Economic Issues*, vol. 12, no. 1, March 1978, p. 2.
23. In *Centesimus Annus*, John Paul II remarks on the role of culture in consumer choice and in creating "*the phenomenon of consumerism*" (no. 36). In this encyclical John Paul offers several extended reflections on the relationship between culture and the economy. Cf. nos. 24, 36 and 50-51.
24. See Appendix for a discussion of the position of the Chicago School.
25. Clarence Ayres, Discussion of Kenneth Boulding, "A New Look at Institutionalism" *American Economic Review*, vol. 47, May 1957, p. 26.
26. Saeed Parto, "Economic Activity and Institutions: Taking Stock," *Journal of Economics Issues*, vol. 39, no. 1, March 2005, p. 24.
- For a discussion from an Institutional view of how cultural and legal factors can shape a market economy, see John Groenewegen, "Institutions of Capitalism: American, European, and Japanese Systems Compared," *Journal of Economic Issue*, vol. 31, no. 2, June 1997, p. 333-347.
27. F. Schinzingler, "German historical school" in *The New Palgrave: a Dictionary of Economics*, (London : Macmillan, 1987) vol. 2, p. 516.
28. Fred Block and Peter Evans, "The State and the Economy" in Neil J. Smelser and Richard Swedberg, eds., *The Handbook of Economic Sociology*, (Princeton : Princeton University, 2d. ed., 2005), p. 506. See this volume generally for economic sociology's approach to understanding economies and their formal and informal relations to society as a whole.
29. K. William Kapp, "The Nature and Significance of Institutional Economics," *Kyklos*, vol. 29, fasc. 2, 1976, pp. 212-13.
30. Rupert Ederer has noted that modern conventional economics texts "all too frequently substitute a pretentious resort to mathematical symbols falsely suggesting exactitude in areas which simply do not lend themselves to such precision. In the process, the distinction is blurred between a physical science where mathematics provides the appropriate

language, and a social science where it is unsuitable because of real-life complexity which simply cannot be depicted in such simplified terms.” “Translator’s Forward” to Heinrich Pesch, *Lehrbuch der Nationalökonomie/Teaching Guide to Economics*, (Lewiston, N.Y. : Mellen, 2002) vol. I, bk. 1, p. ii.

31. *Quadragesimo Anno*, nos. 41-42.

32. Also worthy of note is the diffuse approach to economic analysis employed by Heinrich Pesch, who considered historical, legal, geographical, technological and numerous other factors in his economic theory. Cf. his *Lehrbuch der Nationalökonomie/Teaching Guide to Economics*, especially vol. I, book 2, pp. 253-388, in which he discusses methodology and critically examines the work of other economists and economic schools.

33. Perhaps a point of departure for new thinking about the foundations of economic science could be Aristotle’s distinction between wealth-getting which is limited by its natural end of providing for man’s needs, and wealth-getting which is not related to man’s needs and is potentially unlimited. Cf. *Politics*, I, 8-10.

34. Heinrich Pesch recognized that economics is a true science, that is, “a knowledge of things traced to their causes and certified by proofs,” but that “economics...takes its place as a partial discipline in the overall area of the social and political sciences.” *Lehrbuch der Nationalökonomie/Teaching Guide to Economics*, vol. I, bk. 2, pp. 258 and 303.

35. In considering the Chicago School, I will confine myself to its most famous spokesman, Milton Friedman, and to his seminal essay “The Methodology of Positive Economics,” in *Essays in Positive Economics* (Chicago: University of Chicago, 1953), pp. 3-43. But this should not be a distortion of their doctrine, since that School’s “internal differences are less marked than its differences with the outside world [and] under scrutiny, many of the [internal] differences tend to disappear.” Charles K. Wilber and Jon D. Wisman, “The Chicago School: Positivism or Ideal Type,” *Journal of Economic Issues*, vol 9, no. 4, December 1975, p. 666.

36. Friedman, “The Methodology of Positive Economics,” p. 3 (quoting John Neville Keynes).

37. *Ibid.* pp. 5-6. Incidentally, this notion of the effects of wage increases goes back to Smith and even more to David Ricardo. Cf. chapter five, “On Wages,” in Ricardo’s *Principles of Political Economy and Taxation*.

38. Friedman’s statement of his methodological approach has been often criticized for contradiction, incoherence, vagueness and other defects. However, it is beyond the scope of this paper to deal with most of these

questions. For a discussion of some of these criticisms, see Thomas Mayer, "Friedman's Methodology of Positive Economics: a Soft Reading," *Economic Inquiry*, vol. 31, April 1993, pp. 213-223.

39. Charles K. Wilber and Jon D. Wisman, "The Chicago School: Positivism or Ideal Type," p. 674.

40. "The Methodology of Positive Economics," p. 22.

41. Ibid.

42. Moreover, even apart from specific counterexamples, in order for a firm to remain in business, it is not necessary that it *maximize* its returns. It suffices if its income is greater than its expenditures.

43. "The Methodology of Positive Economics," p. 22.

44. Ibid., p. 32.

45. Ibid., see for example pages 14-16, 21-23, 30-34.

46. Ibid., p. 31.

47. Charles K. Wilber and Jon D. Wisman, "The Chicago School: Positivism or Ideal Type," p. 673.

