**Reformation in economics?**

John D. Mueller: *Redeeming Economics: Rediscovering The Missing Element*
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Let us begin this short article, as in Catholic masses, with confession: we would have chosen another title if the 500th anniversary of the beginning of the Reformation did not fall just at the end of this month. We could have used the term "revolution," as there would be on a wide scale in John D. Mueller's thinking, radically changing many things not only in economic theory, but also in the practice of economic policy. Of course, as we will see, the term Reformation is not imprecise; as its essence is the return to the original idea of the Bible, so also in this volume, it is to the scholastic thought of St. Thomas Aquinas, and indeed even earlier: to Saint Augustine and to Aristotle. The essence of his thesis is that after St. Thomas had combined and developed the theories of his two predecessors, Adam Smith, though widely regarded as the father of economics, rather than developing this tradition further, omitted some central features. Let us also observe that Mueller, a committed Catholic, is a very serious writer in his scientific analysis, conclusions, and recommendations, so that readers need not fear that some kind of devotional "love fest" fills this volume of almost half a thousand pages! Of course, there can be no serious work in a Christian spirit, in which love does not play the leading role. According to the author, economics is beginning a new, now its fourth revolution, which "will (I hope) finish what the last one started, by reintegrating the most important original element: the one that accounts for the social relationships that define us, the loves (and hates) that motivate and distinguish us as human beings" (p. 12).

The lay reader (and here the word is used in the original sense) may be surprised as the author concludes: "The peculiar relationship between natural law and biblically orthodox religious faith can be expressed by noting that *economics is essentially a theory of providence*. It mostly concerns human providence, describing how we provide for ourselves and the other persons we love, using scarce means that have alternate uses….All serious attempts to explain the order in markets (which is a fact, not a theory) have been derived from some theory of divine providence. The most famous, of course, is Adam Smith's renowned 'invisible hand.' But the earliest and still the most coherent theory was Augustine's, who deliberately avoided the term *invisible hand* and called the order in markets the 'hidden equity . . . stamped upon the business transactions of men by the Supreme Equity'" (p. 13). And what is the main problem with Adam Smith, who, according to Schumpeter's estimate, "actually retarded the development of economic analysis by more than eighty years"? (p. 24) "...Rather than merely synthesizing the work of previous economic thinkers, as Schumpeter believed, Smith radically *simplified and rearranged* the whole outline of economic theory in a way that made it easier to develop two of its essential elements but harder or even impossible to develop the others. The simplicity of Smith's theory accounts for his appeal among classical economists; but because it was an *over*simplification, it necessitated another rearrangement of the outline of economic theory, a project begun but not completed by the neoclassical economists who followed" (ibid.). The two elements Smith retained are production and exchange, and the two omitted are consumption and final distribution. "Augustine, on the other hand, provided a theory of personal distribution in observing that every human person, by virtue of his natural interdependence with other persons, also has a principle for distributing the use of his wealth between himself and other persons: the degree of his love for other persons relative to himself" (p. 30). That is, the missing element in the volume's subtitle is final distribution, which is ultimately governed by love. By this we come to the most important Christian moral commandment, which is the essence of "the Revolution of Jesus": Love your neighbor as yourself! This requirement, which was considered impossible (both in and outside the church even today), the scholastics explained simply: "Augustine, followed by Thomas Aquinas…distinguished two ways in which we can love our fellow man: *benevolence*, or goodwill, which can be extended to everyone in the world, and *beneficence*, or doing good, which cannot" (p. 43). For this reason, "Augustine's theory also explains why the brewer or baker shares with his family or friends but not with his business customers: He loves his customers with benevolence (wishing good to them) but his family with both benevolence and beneficence (doing good to them)" (p. 62). The scholastics, however, are not only so abstract (or rather practical: these issues pervade everyday life) but also outlined the purpose of government, the principles of social order, private versus common ownership, care for the needy, "globalization" and foreign trade (!), domestic commerce, regulation of monopoly, monetary and fiscal policy principles (pp. 45-48).

This is also Mueller's approach, who not only addresses issues of national or even world economy in the second half of his book, but also illuminates the benefits of neo-scholastic theory in quite simple, everyday examples. "The modern economist's embarrassment can perhaps best be illustrated by observing that the current state of economic theory cannot adequately describe, let alone solve, the simplest economic problem that a typical mother faces—and solves—at least a dozen times each day" (p. 90). One such problem, which Philip Wicksteed posed around 1910, was nothing else than how a mother shares the milk among members of the family, including their cat. This is also a good starting point for characterizing larger economic entities, because "the neo-Scholastic approach suggests . . . that both the business firm and nonprofit foundation can best be understood as specialized offshoots of the family household. The modern household specializes in producing and maintaining people, the modern business firm in producing and maintaining property, and the modern nonprofit foundation in distributing household gifts beyond the household" (p. 113).

The first quarter of the four-part volume – "The Birth, Death and Resurrection of Economics" – Is actually a large-scale (and therefore necessarily broad) overview of the history of economic theory, which is divided into four periods of development: 1. Scholastic economics played a formative role between about 1250 and 1776. 2. 1776-1871 is the era of classical economics. 3. The neoclassical decades followed from the last quarter of the 19th century until about 2000. Mueller considers the main accomplishment of this school to be restoring the economic element of consumption lost by Smith's turn, brought about by marginal theory. However, this school was not able to restore the element of final distribution. 4. At the turn of the millennium, supplanting neoclassical economics, neo-scholastic economics emerges, which in the author's opinion already has great results, but even bigger tasks ahead: "Above all, neo-Scholastic economics will devise a modernized mathematical version of the Scholastic theory of final distribution—specifically, one that incorporates descriptions of personal gifts (and crimes) and of distributive justice in the family, business firm, charitable foundation, and government" (p. 109). And how will this theory surpass what came before? "The conceptual problem with all varieties of the neoclassical approach is that love cannot be based on utility (as Augustine was the first to explain), for the simple reason that utility is derived from love. The neo-Scholastic approach will be based on the premise that all human action is ultimately motivated not by utility but by love for some person or persons" (pp. 109-110).

The second part, titled "Personal Economy", addresses everyday issues. Here you can read more about the daily task of distributing milk, but also about the well-known example of altruistic love: the parable of the Good Samaritan. Mueller uses the latter to illuminate, for example, why the Second Great Commandment does not necessarily demand that the whole of our wealth be distributed to the poor (as Christ called upon some disciples): noting that the Samaritan in the parable gave perhaps half of his weekly income to help the roadside victim (pp. 185-195). We can also read the interesting discussion of the relation between the birth rate and crime rates, reversing their claimed directional relationship. Mueller criticizes one famous example of earlier research with ruthless consistency. That research argued that in the United States the rate of crime has been declining due to legalizing abortion in the 1970s. Rather than presenting the whole argument, we will confine ourselves to the author's conclusion. According to this, "Most violent crimes are committed by men the age of the fathers of aborted children; and it stands to reason that a man who has been party to killing his own child, and is not constrained by the bonds and obligations of fatherhood, is much more likely to harm other human beings" (p. 177). These examples of lessons learned are preceded a few pages earlier in the book by his observation that "Far from being a vast new empire, economic theory always has been, and will always remain, a colony of moral philosophy. [...] *All human action, including economic activity, is done by persons and for persons*. Human economic activity is not ultimately undertaken by 'individuals' for 'utility'" (129). In defining the purpose of economics, Mueller therefore proposes to modify a well-known definition thus: "Economics is the science of human providence—personal, domestic, and political—for oneself and other persons, using scarce means that have alternate uses" (p. 129). This seems to make the definition of economics also its strength: "both Augustine's and Becker's theories can explain the behavior of people who are selfish, but only Augustine's can explain the behavior of people who aren't" (p. 183).

In the third section of "Domestic Economy," it becomes apparent that Mueller is strongly associated with tradition; his traditional – he even uses the term 'transcendent' – family advocacy: "This is where domestic peace starts, the ordered harmony about giving and obeying orders among those who live in the same house. . . . But in the household of the just man 'who lives on the basis of faith' and who is still on pilgrimage, far from that Heavenly City, even those who give orders are the servants of those whom they appear to command. For they do not give orders because of a lust for domination but from a dutiful concern for the interests of others, not with pride in taking precedence over others, but with compassion in taking care of others," he quotes Augustine (p. 204).

Of course, the family is one of the most important social units. Its mission is to provide children existence, rearing and instruction. People may have children because they love the children for their own sakes, but also when parents intend them to provide old-age support for themselves. The birth rate typically decreases when there is lower child mortality (so that fewer surviving children need to be born) and, on the other hand, as social benefits increase.

"To the extent that people have children . . . for the benefits they personally receive from the children [...] both private saving and government social insurance will reduce fertility. This is because in the latter case, both private saving and government social insurance act as economic substitutes for children" (p. 228). That is why "...to prevent fertility from declining as it is doing in most of Europe and Asia, total social benefits must not be permitted to increase as a share of national income beyond the 2001 level" (p. 269).

Well, that's pretty unexpected, though a logical conclusion ... It is shocking to see Mueller's data that "On average, in countries where the rate of weekly worship is close to zero, the TFR [Total Fertility Rate] is approximately 1.25. The relationship in all countries suggests that 100 percent weekly worship is associated with a net TFR of about 2.1 children higher than that, or about 3.4" (p. 232), and is characteristic across countries, regardless of the dominant religion.

In the fourth section entitled "Political Economy," the author discusses general macroeconomic principles and formulates economic policy proposals. Mueller says that revenues from income taxes should cover the costs of operating the government (not including transfers here) and these taxes should be minimized. Revenues should be re-structured from net income and wealth taxes to sales taxes because both taxpayers and tax authorities would have to deal with fewer entities (p. 268). In general, less government absorption of national income is needed: when a pay-as-you-go pension scheme is in surplus, the surplus should be returned to the contributors (p. 270). The rate of increase in public spending on health should also be reduced: "Rather than allowing current spending per recipient to drive the programs' shares of national income, the calculation must be reversed by starting with the current total shares of social benefits in national income and dividing by the number of eligible beneficiaries" (ibid.). According to Mueller, the following four principles of successful (and popular) economic policy can be distilled from United States history:

"1. Current peacetime consumption of goods and services should be funded by current taxation, not money creation, with borrowing to fund only government-owned investments of equal or lesser duration than the loan's duration (Washington/Hamilton).
"2. Current consumption of public goods—e.g., defense and administration of justice—should be funded by taxing labor and property income equally (Lincoln).
"3. More narrowly targeted 'quasi-public' goods require dedicated funding (FDR). This means that:
"a. Personal transfer payments—e.g., Social Security, Medicare, and Medicaid—should be financed by payroll taxes, not income or property taxes;
"b. Subsidies to property owners—e.g., product subsidies, tax-free savings accounts—should be financed by taxes on property income, not payroll or income taxes.
"4. Government's size and methods must be limited to prevent either general unemployment or disinvestment in people or property (Reagan)" (p. 271).

From these principles the author's philosophy and of course political engagement are clearly outlined. They are also reflected in a brief biography on the book's back cover: Mueller, who has run a consulting business, was also an adviser to Congressman Jack Kemp and the Republican Party congressional caucus - largely during the presidency of Ronald Reagan.

People familiar with the practice of Eastern European countries will wonder – together with the reviewer - about Mueller's proposed reform of the tax system, reading his proposal that "The fairest, simplest, and most efficient way to reform the tax code, therefore, would involve not only treating labor and property income exactly alike but also simplifying the means of collection so that taxes were filed mostly by employers (business, government, nonprofit, or the self-employed) rather than by individuals" (p. 286). We tried to put an end to this latter system in the last years of the 1980s, also in the name of a kind of justice. But several types of justice may exist side by side ... What the writer of these lines sees in the first part of the proposal, however, is that the system would be more fair than taxing labor income (this is the purpose of the Earned Income Tax Credit in a number of countries, including the United States) if only because of the substantial payroll taxes. At first sight it is also surprising that Mueller favors a pay-as-you-go pension scheme as more effective than a fully funded system. In fact, this is logically true to the "person-centered" approach: "Pay-as-you-go Social Security solved the retirement problem by providing an asset that the private financial markets cannot. While a financial account is essentially a claim on property, a pay-as-you-go Social Security retirement pension amounts to a share in a diversified human capital mutual fund." (pp. 287-288).

Mueller pays particular attention to the primary distribution of national income and its calculation. The author has made significant corrections on the net share of labor income in GDP, and states that "... take-home pay generally rose from 2000 to 2009 as a share of national income, while the conventional calculation showed the labor share declining—a fact that was made the basis of much ill-informed controversy and many well-intended but misguided policy recommendations" (p. 303). We are not equipped to check these calculations, but must point out that the opposite of this statement is widespread – at least regarding the US economy, if we consider the articles published in the newspaper The Economist in the last decade. The author's following thoughts are not only economically, but also theoretically important: "We have found that economic policies (or any other circumstances) that alter the net shares of total national income between workers and property owners have two effects, which work in opposite directions. On the one hand, reducing the relative income share received by property owners necessarily increases the relative remaining share, which goes to employed workers and recipients of transfer payments. (I will call this combined share 'net labor cost' for simplicity.) On the other hand, reducing the relative share of net income received by property owners raises the unemployment rate and lowers total actual national income, including the labor compensation of employed workers, in absolute terms" (p. 307). We - on the basis on the macroeconomic profit theory - see the relationships as follows: when expectations are unfavorable, investment declines more sharply than the total GDP (or its growth rate), and *therefore* profit drops, thus increasing the 'net labor cost' ratio in GDP; that is, the causal relationship is reversed.

We agree, however, with the author that the US (federal) debt is alarming and poses an unbelievable threat to both the United States and the world economy. "So if we ask why consumer prices have more than quintupled since 1971, the nontechnical answer is that the banking system has 'monetized' more than $8 trillion in federal debt since then. And if we ask why federal deficits have mushroomed in the meantime, the answer is that our legislators have gotten used to a monetary system that permits public debt to be monetized on such a vast scale. In a word, the banking system has issued new money to the Treasury to finance its deficits without an associated production of new wealth, increasing demand without supply and setting off a secular, worldwide inflation" (p. 338). The latter statement is more valid for the past – and we can only hope that this will not recur in the future either, causing an explosion in the world economy. Mueller warns of the dangers of over-demand in other respects. Foreign central banks have thrown hundreds of billions into the dollar market for mortgage-backed bonds - this is why the crisis exploded in 2007-2008 (p. 338).

The reason for the large energy price fluctuations (i.e. the rise) was supply-side events (p. 340). Of course we cannot know in what shape the developed world in general and the US in particular would be today...without the help of liquidity and demand creation used as means of crisis management.

The author sees how much risk is entailed in the dollar's reserve currency role: should foreign central banks sell US government securities from their portfolios, it would trigger the collapse of the world's leading economy. That is, there is still a Triffin dilemma (although the author does not call it by that name), somewhat different than in the Bretton Woods system: the American dollar is held in reserve because everyone accepts it as a means of payment, but if you accumulate too much, you lose your confidence. "How to fix the "reserve currency curse?" Mueller asks. His suggestion is simple, though difficult to achieve. Jacques Rueff among others proposed his preferred solution: that the international gold standard should be restored and official foreign exchange reserves should be abolished.

Of the many benefits of this plan, perhaps the most important might be that "... ending the dollar's reserve-currency 'privilege' and its inflationary financing of the federal budget would make it not only necessary to limit budget deficits—which could no longer be financed by foreign central banks—but also for the first time politically and economically practicable to do so. The best strategy would be to combine a low-rate, broad-based income tax with a balanced, pay-as-you-go Social Security system" (p. 343).

The last part of the book, "Divine Economy," provides a very brief review of the development of economics. The conclusion - let's say this – is quite "normative": "I confidently predict that in coming decades, neoclassical economists now advocating the 'economic approach to human behavior' will become—or be supplanted by—'neo-Scholastic' economists, who understand the original 'human approach to economic behavior' of Aristotle, Augustine, and Aquinas" (pp. 350-351).

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Mueller did not act as a historian of economic theory, nor even a theoretical economist, for most of his career. This makes the volume, imposing in its size and content, especially valuable. Exemplary erudition, thoroughness, numerous illustrations - unfortunately in black and white – and innumerable notes to the text (comprising almost one-fifth the scope of the book!), the fifty-page index with bibliography, clearly indicate: a book of serious scientific value was produced and published in two English editions too. In our place and time, we sigh: we envy that country and age where and when such intellectual capacities were based in the legislature, and the Members' speeches were drafted in such high-quality skulls!

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