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J. Patrick Raines
University of Richmond

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THE SOCIAL ECONOMICS OF FRANK H. KNIGHT

J. Patrick Raines

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THE SOCIAL ECONOMICS
OF
FRANK H. KNIGHT
by
J. Patrick Raines, Ph.D.
University of Richmond

Frank Hyneman Knight is well known for rehabilitating neoclassical economics with his 1924 critique of Pigouvian welfare economics. [Knight, 1924] In Knight's thirty years at the University of Chicago, he thoroughly developed the notion that economic freedom and market competition are essential to maximize society's welfare. However, Knight's belief in the superiority of the market mechanism does not preclude serious concern about issues of social justice and reform.

This study seeks to establish Frank H. Knight's contributions to social economics. Elements of Knight's work will be compared to commonly recognized characteristics of a social economist. [Angresano, 1986, p. 146; Gruchy, 1981, p. 243] Knight's prominence in the discipline of economics warrants an investigation of his contribution to the intellectual history of social economics. The following section outlines a framework for isolating contributions to the field of social economics. Then, the specific elements of Knight's social economics will be considered.

A Framework for Social Economics

Some consensus may be evolving with regard to the characteristics of a practitioner of social economics; if it is not a consensus, at least it is a well defined group of traits which provides a framework for analyzing one's qualifications as a social economist. The characteristics of social economics in Knight's work, which this paper focuses on are the following:

- a) his articulation of social goals for modern American capitalism;
- b) his multidisciplinary approach to social issues which emphasizes non-economic factors;

- c) his utilization of inductive reasoning and refutation of dogmatic, static neoclassical analysis; and
- d) his willingness to recommend policy and institutional reforms where he thinks social conditions can be improved.

The following section identifies and shows how Knight's work is compatible with these characteristics of a social economist.

Elements of Knight's Social Economics

Social Goals

In the view of the author, Knight advocated the highest ideals to which a society can aspire, namely, freedom and intelligent democratic initiative. Knight did not believe individual freedom would solve social problems. [1960, p. 112] Actually, some limitations on the exercise of freedom may be necessary. Unlimited social freedom would mean the right to use great economic power at will; to be able to use it indefinitely to get even more power. Thus freedom, particularly economic freedom, has to be supervised by rules which are made and enforced by social institutions acting in the general interest of society. Without such rules collusion and coercion exist and freedom is precluded.

In a metaphysical sense, one choice is just as free as any other choice. It is the reality of choices with which society must be concerned. In a market organization of economic cooperation, individuals effectuate freedom by their choices of alternatives offered to them and in what they offer to others. Freedom to make such choices with regard to production, employment and consumption is the ultimate economic freedom. Freedom in economic choices requires, in fact inculcates, responsibility of critical analysis - sizing up what's best for oneself. This characteristic serves citizens well who participate in political systems which require decisions as to what is best for society.

Knight's view is that "progress is to be achieved by freedom." [1960, p. 118] In a liberal dynamic society individuals must possess the requisite reasoning skills for carrying the social responsibilities of membership in such a society. Having been freed from rulership by the whip and custom or tradition, individuals are required to accept new economic, political and cultural responsibilities. Order and cultural inheritance must be preserved and progress achieved. In this sense, social change and progress is predicated upon freedom -- the condition which inspires and allows change. Ultimately, knowledge of social ideals achieved through free discussion is imperative for social progress.

At times, it appears that Knight does not contribute much to the definition of an ideal organization of society beyond recommending "playing the competitive game," being a good sport and trying to improve the rules of the game. [Raines and Jung, 1986, p. 438] However, Knight makes a very important contribution to the definition of a social ideal. His legacy is the true meaning of a liberal democracy, namely, democratic policy in a free society must be guided by a cooperative quest for truth, intelligent initiative, and critical intelligence. His steadfast refusal to accept or promote dogmatic philosophical or scientific guidance for individual action advances the fundamental proposition of liberal democracies; choices are complex, they must be made responsibly, and simple rules or formulas are inadequate for making reliable decisions. He insists that there should not be any such thing as a sacred truth or set of values which is not open to question or change in a free society. [1960, p. 129] Knight worries considerably about the effects of social change enacted on the basis of religious ethical principles. He argues that the greatest danger to social order is the enactment of economic

legislation inspired by the clamor of self-interested and/or naive preachers. He views a moralistic approach to public policy as especially hazardous because it is "the natural consequence of exhortation without knowledge and understanding of well meaning people attempting to meddle with the workings of extremely complicated and sensitive machinery which they do not understand." [1939, p. 418]

Many of the problems having to do with economic justice Knight attributes to ill-informed legislative action and the inherent difficulties of democratic politics. The main problems stem from the difficulty of intercommunication necessitated by a government of discussion and from society's aversion to the mental effort required for critical intelligence. Knight urges intelligent social action through acquiring "knowledge, particularly knowledge of the good, or ethical knowledge, the meaning of progress - and then knowledge of what is possible and how to achieve possible improvement." [1960, p. 119]

Knight's view of social ideals reflects his commitment to free choice and critical intelligence. He is wary of social reformers and doubts the efficacy of economic legislation. Ultimately he holds that society and policymakers in a capitalist economy must understand the fundamental laws of a free market system and seek to find "the best way to integrate tendencies of the free market system with political action." [1960, p. 111] Knight believes such enlightened policy would ensure efficiency in industry, freedom in democracy, and prosperous social and economic conditions.

Interdisciplinary Approach

Frank Knight begins his classic work The Economic Organization by stating:

It is somewhat unusual to begin the treatment of a subject with a warning against attaching too much importance to it; but in the case of economics, such an injunction is quite as much needed as an explanation and emphasis of the importance it really has. It is characteristic of the age in which we live to think too much in terms of economics, to see things too predominantly in their economic aspect; and this is especially true of the American people. There is no more important prerequisite to clear thinking in regard to economics itself than is recognition of its limited place among human interests at large. [1967, p. 3]

Knight's refusal to accept doctrinal statements of religion, philosophy and economics is inextricably linked to his Midwestern rearing, his early evangelical based education and his formal training in philosophy and economics at Cornell. In fact, the philosophy department concluded that his ingrained skepticism interfered with his study of philosophic doctrine to such an extent that they gladly accepted his transfer to the economics department. Under the direction of Allyn Young, Knight completed his prize-winning dissertation Risk, Uncertainty and Profits, and took his Ph.D. in economics in 1916. [Buchanan, 1964, p. 424]

Knight concedes that individuals generally know what gives them satisfaction and order their conduct with a view toward getting such things. However, he also recognizes that the romantic, the social animal, the prejudiced ignoramus exists alongside the calculating, self-interested individual. Thus, in economics, and in other areas of scientific inquiry, Knight attempts to expose the fallacies, nonsense and absurdities in what is passed off as sophisticated-scientific discourse.

It is ironic that Knight's neoclassical link to modern positivist economics is the reconstructed, rational economic man which Knight holds to be largely unrealistic. He recognizes that in order to build a rigorous and useful model of economic maximization, man must be described as purposely and consciously

utilizing means to attain predefined ends, i.e., the rational economic man. However, he is also aware no such man exists because human beings do not know what they want - not to mention what is "good" for them - and do not act very intelligently to get the things which they have decided to acquire. Besides, to act completely rational would require totally impersonal and non-romantic behavior which is not only irrational but impossible. Specifically, he notes: "Living intelligently includes more than the intelligent use of means in realizing ends; it is fully as important to select the ends intelligently...." and "Living is an art; an art is more than a matter of scientific technique and the richness and value of life are largely bound up in the 'more'." [1967, pp. 3-4]

Thus, Knight refutes the neoclassical rationality postulate by arguing that a science of conduct is an impossibility because the data of conduct is provisional, shifting, and individual-specific to such a high degree that generalization is relatively fruitless. [1935, p. 35] He holds:

"Man is certainly not the rational animal that he pretends to be.... He is very superior to other animals in reasoning power, but reason is not distinctive of man and is hardly his predominant trait; it is often used for irrational ends."
[1960, p. 52]

Knight actually rejects the view that economic theory can "be operational in the modern methodological sense" because economic theory can only be useful in predicting real-world events to the extent that agents act in conformity with idealized behavior. Further, he cautions against pushing theories too far which are based upon the rationally calculating economic since the nonrational behavior of individuals may be better analyzed by using assumptions more directly relevant to other social sciences. [Breit, 1971, p. 199]

The unequivocal "economic" explanation of human behavior as well as predictions of future economic events from idealized theoretical economic

models is particularly condemnable to Knight. He finds Marshallian definitions of economics, viz., "the ordinary business of life" or the "science of rational activity" to be useless and misleading. These definitions suggest that economics is the science of everything that generally concerns mankind. He points out that the scope of economics is not so broad and that life is much more than rational conduct or intelligent use of resources to achieve predetermined results. Ultimately, Knight cautions against the overzealous application of economic theory to sociological phenomena. He recommends: "If one wishes to study the concrete content of motives and conduct, he must turn from economic theory to biology, social psychology, and especially culture history.... [The Latter] gives a genetic, and not scientific account of its subject-matter." [1935, pp. 36-37]

Epistemological System

Frank Knight clearly favors a heterogeneous approach to the study of knowledge and society. He emphatically demonstrates dissatisfaction with the methodology of static equilibrium analysis in his essay "Statics and Dynamics." [1935, p. 161] In this work, he points out that even the terms, "static" and "dynamic," are poorly defined in economics and argues against using static models for public policy guidelines due to the evolutionary character of capitalistic enterprises.

Knight advocates deemphasizing mechanical analysis in economics by increasing the importance of force, resistance and movement in economic analysis. Instead of constantly assuming perfect knowledge in analyzing market prices, he suggests it is conceivable to study the role of resistance, ignorance, and prejudice in economic outcomes. This view is parallel to the Swedish social economist Gunnar Myrdal's notion that static models of price

determination overlook the role of fundamental social changes in the economic process. Myrdal emphasizes the inadequacy of static equilibrium analysis in explaining social change and popularized the view: Everything is cause to everything else. [Angresano, 1986, p. 153] Similarly, Knight discredits the traditional assumptions of static equilibrium analysis. He notes the interconnectedness of all growth elements involved in economic progress and specifically describes as misleading the assumption in models of price determination that population growth can be described as tending toward any describable state of equilibrium. He states: "Each changing economic element is a condition affecting the change of any other element or its ultimate stability of position, just as the features of the non-economic environment are conditions; but the former cannot be assumed equal." [1935, p. 179] The essential point is equilibrium must relate to economic progress as a whole and this must include elements of the social condition.

Knight also emphasizes the importance of psychological traits in explaining economic outcomes. Knowledge, skills, aptitudes, personal energy and morale affect production and, in fact, comprise much of the elements of technology and business enterprise. Consumption is also affected by psychic traits. Knight suggests that individual wants may stem more from the social implications of goods than the goods themselves, or their direct physical effect on an individual. The implication is that since psychological traits are both innate and social products they are difficult to discover empirically and, thus, theoretical economic models of behavior should be careful not to claim to definitively explain them.

With regard to the distribution of ownership of productive resources, which are specified as a constant in a static economy, Knight points out the

cumulative rather than equilibrating effects of economic forces over time. Knight theorizes that ordinary economic forces tend toward a progressive concentration; wealth does breed; "to him that hath shall be given, and from him that hath not shall be taken away." [1935, p. 184] He recognizes that the trend would be more empirically prominent if not for social action, accidents and other factors which make any large mass unstable. This process of income distribution tends over time to negate the proposition that "other things remain equal" as possessors of vast fortunes cannot be expected to have the same motives and interests as the less fortunate.

Positive economics of the sort where science is referred to as of it is spelled with a capital S particularly annoyed Frank Knight. [1956, p. 151] He warns society about those who speak of the omnipotence of scientific methodology in a manner similar to the awe-inspired tone primarily associated with public prayer. He contends that attempts to build a social science on a scientific foundation which deletes emotion and value judgements infers that human beings can be studied like natural objects and, thus, are not actuated by love, hate, capriciousness and contrariness.

In a review of T.W. Hutchinson's treatise on methodology, The Significance and Basic Postulates of Economic Theory, Knight points out the "superficiality and dogmatic oversimplification" of economic theory which ignores broad-based human or social data. Specifically, he points out "Concrete and positive answers in the field of economic science or policy depend in the first place on judgements of value and procedures, based on a broad general education in the cultural sense, and on "insight" into human nature and social values rather than on the findings of any possible social science." [1956, p. 177] The significance of Knight's view is that social action

to ameliorate economic problems should only be taken after a full consideration of the principles of relevant social disciplines. This approach is warranted because no problem which affects society is purely economic except by abstraction and only an extremely limited part of human problems can be treated by positive science.

This view of scientific methodology influenced Knight's model of effectuating social reform. The logical process for social change which Knight develops is not formulated to bring about a transformation of capitalism. Rather, his system for social reorganization is primarily intended for moralistic social reformers and positivist scientists whom he contends are largely responsible for much of the extant confusion about the nature of social problems.

The Process of Social Reform

In Knight's system, the first step to "scientifically" solving socioeconomic problems is to acquire knowledge about current socio-economic conditions. Naturally, this has to be undertaken prior to action, and necessitates an understanding of both economic theory and the features of contemporary social and economic systems. Only after such information is assimilated, is it possible to speculate on the difference between reality and the theoretically ideal.

The next step of the analytical process of social reform is to formulate a sense of direction toward a desired end. Knight submits it is not necessary to have a detailed view of the ideal society before action is undertaken because elements of uncertainty are present in all action, and ends are never completely foreseen prior to action. However, social ideals must come from criticism of what is and rational discussion on the possibilities of improvement. [1939, p. 412]

Finally, the appropriate means for social change must be determined. Knight avers that change can be induced by economic decisions of individuals or by politico-legal social organization. He warns against the latter as most political action aimed at improving economic conditions involves a transfer of responsibilities from individuals to the State and "tends to aggrandize the latter at the expense of the former, and morally to weaken both." [1939, p. 416]

The disdain for righteous social reformers which Knight holds is clearly and famously articulated in his 1950 presidential address to the American Economic Association. He laments the tendency in society to legislate positive social action which is characterized by "passing laws and employing policemen." Knight states "I mistrust reformers," and clarifies with one of his most well-known comments:

When a man or group asks for power to do good, my impulse is to say, "Oh, yeah, who ever wanted power for any other reason? and what have they done when they got it?" So, I instinctively want to cancel the last three words leaving simply, "I want power;" that is easy to believe. And a further confession: I am reluctant to believe in doing good with power anyhow. [1951, p. 29]

According to Knight, capitalistic monopolies and business cycles are the "chief mechanical defects" in a market economy. He considers business cycles to be the more serious of the two defects and declares that the public grossly exaggerates the extent and power of business monopolies. He argues that the economic power which may result from the freedom to use one's resources to achieve desired ends is generally beneficial to society; a stimulus to devising and introducing new products and technologies. Knight does not see a lack of competition as the cause of economic injustice in American capitalism. In fact, he holds that if modern capitalism performs near to the competitive ideal it would be "socially quite intolerable." Further, he reminds society that the

enormous increase in economic efficiency resulting from large-scale production has created economic conditions that have led to the liberal revolution in the political system. Knight recognizes the likelihood of "treatment" for conditions popularly considered to be social problems, but is skeptical of the prescriptions of "social doctors." In the case of monopolies, he points out the difficulties of measuring the short-run costs and potential long-run benefits of monopoly power. Thus, he recommends against using simple legal formulas or definitions to remedy the complex situation of economic power and argues, instead, for carefully considered and enforced legislation to achieve a socially beneficial competitive balance. [Raines and Jung, 1988]

Summary and Conclusions

Throughout his writings, Frank Knight urges society to develop and exercise the capacity for truth seeking. A free society must seek ethical knowledge and work to promote social justice through informed economic and political action. Critical intelligence, the requisite for Knight's intelligent democratic initiative, is attainable only by a multidisciplinary understanding of society. All conduct is not economic in nature, and action to correct socio-economic problems should consider broad-based human and social information, namely, cultural considerations, human nature and social values. Since Knight doubted the ability of a benevolent and powerful government to optimally order economic affairs, he encouraged individuals to help find solutions to social problems by looking to combine the characteristics of a free market system with intelligent democratic action. Knight's consistent advocacy of an informed, prudent approach to socio-economic problems is certainly a worthy ideal for contemporary societies.

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