In Defense of Henry Simons' Standing as a Classical Liberal

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Introduction

At a 1981 Los Angeles symposium, subsequently published in the *Journal of Law and Economics* as "The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1931–1970" (Kitch 1983), Ronald Coase challenged the standing of early Chicago school member Henry Simons as a classical liberal:

> I would like to raise a question about Henry Simons. . . . [His] *Positive Program for Laissez Faire* [1934] . . . strikes me as a highly interventionist pamphlet. . . . [I]n antitrust, [Simons] wanted to . . . restructure American industry. . . . [I]n regulation . . . he proposed to reform things by nationalization. . . . I would be interested if someone could explain. . . .[1]

Simons' former Chicago pupils, his successors as upholders of classical liberalism in economics, did not rise to his defense. Instead, they responded as follows: First, they acknowledged that Simons was not a pure liberal, but at best a mixed breed. "You can paint him with different colors . . . ," said Harold Demsetz. "It's quite a mixed picture," said George Stigler.

Second, they admitted that Simons *was* an "interventionist," that he did not believe that, in general, economic activity should be organized through free markets. "[H]e was the man who said that

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[1]Kitch (1983), pp. 178–79. Subsequent quotes from this symposium are from the same pages. The issues discussed here are related to the view of the decline in the "populist" strain of Chicago economics presented by Melvin Reder (1982) in his *Journal of Economic Literature* article on the Chicago school.

the Federal Trade Commission should be the most important agency in government, a phrase that surely should be on no one's tombstone," joked Stigler; "Everything Ronald [Coase] says is right." And Milton Friedman joined in: "I've gone back and reread the *Positive Program* and been astounded. . . . To think that I thought at the time that it was strongly pro-free market in orientation!"

Third, they argued that Simons should be read in historical context. Though he was not a consistent liberal, he was much closer to being one than the others then at Chicago. "[R]elative to the hectic, excited days of the thirties he was leaning [toward classical liberalism]," said Stigler. "By comparison with almost everybody else he was very free market oriented," said Friedman; "Remember. . . in 1934. . . I would say that close to a majority of the social scientists and students . . . at . . . Chicago were either members of the Communist Party or very close to it. . . Relative to that. . . atmosphere, the [*Positive Program*] was widely interpreted as being, if you want, reactionary."

Aaron Director alone spoke in defense of Simons' credentials as a classical liberal, but he defended Simons by trying to separate Simons' own views from those Simons expressed in the *Positive Program for Laissez Faire*: "One of [Simons'] interests in these interventionist programs was to make . . . private . . . production palatable to his colleagues."

The consensus assessment reached is clear. Henry Simons had some libertarian intuitions, but he also had many "interventionist" failings. His *Positive Program* is a piece in which libertarian and interventionist impulses uneasily coexist. Simons' reputation as a classical liberal is, therefore, based not on a true image of his beliefs but simply on the fact that he was the closest thing to a classical liberal present in the interventionist intellectual climate of the Depression.

This assessment is far from the one prevailing in 1947, when Director wrote the preface to Simons' *Economic Policy for a Free Society*[2] Then Simons was at the center of the nascent Chicago tradition:

> Professor Simons occupied a unique position in American economics. Through his writings and more especially through his teaching at the University of Chicago, he was slowly establishing himself as the head of a "school." Just as Lord Keynes provided a respectable foundation for the adherents of collectivism, so Simons was providing a respectable foundation for the older faith of freedom and equality [Director 1948, p. v].

[2]Director (1948) in Simons (1948). Simons' most famous articles in this collection include his "Political Credo," "Positive Program for Laissez Faire," and "Rules versus Authorities in Monetary Policy."

The preface leaves no clue that Simons' writings were corrupted by interventionist prejudices:

> With [the *Positive Program*] Simons found his work, which thereafter consisted of an ever more powerful defense of the direct relationship between the "precious measure of political and economic freedom" and the decentralization of power inherent in a free-market system and an elaboration of the program requisite for survival and proper functioning of such a system [Director 1948, p. vi].

This shift in Simons' pupils' assessment of his work between 1947 and today raises two basic questions. First, which assessment is the correct one? Second, why has Chicago's assessment of Simons' underlying economic philosophy changed?

I claim that the early assessment is the more correct one and that Simons was indeed a pure, consistent, and thoughtful classical liberal. The policy prescriptions Coase identifies as "interventionist" are, in fact, derived from sound liberal principles. And they do not indicate any lack of faith in markets or any falling away from a pro-free-market orientation.

From Simons' perspective, the proper application of free-market principles required a proper assessment of the necessary role the government must play in laying the foundations of a free-market economy. No free-market order is possible without the establishment of property rights, of systems for dispute adjudication, and of rules for contract enforcement. Some instrumentality outside the market itself—which we call the state—must lay the foundations of a free-market order. Simons believed that economists should concern themselves with what the rules of the economic game should be and that the choice of appropriate rules was a complex and subtle matter. This strand of analysis has withered since his time. Stigler and Friedman today do not even recognize these concerns as a part of the Chicago tradition when they see it today in Simons' work.

This paper tries to reconstruct the logic of Simons' *Positive Program* and argues that it is—as Simons believed it to be—squarely in the center of the classical liberal tradition.[3] It then speculates on why the new Chicago school regards Simons as more of an interventionist than a classical liberal on many parts of his original *Positive Program for Laissez Faire.* My own view is that Simons does belong to the liberal tradition and should be confronted within that tradition—not dismissed as alien to it.

[3] I place to one side what is probably the most significant difference between Simons' economic philosophy and the economic philosophy of Chicago today. Simons was very much attached to the use of the tax system to level the distribution of income.

The answer given to Coase should have been that Simons was as committed to classical liberalism as his pupils are today, but that he saw "freedom," "authority," "intervention," and "market" in ways somewhat different from his successor; Simons places elements from real economies into conceptual boxes slightly differently. But the actual answer given was that Simons was not oriented in favor of free markets. This classification of Simons as a "them"—an interventionist—rather than as an "us"—a free-marketeer—reflects what I see as a weakness in the Chicago tradition. Economists should be grappling with the issues of the appropriate constitution for economic life that concerned Simons, not ignoring them.

The Economic Philosophy of Simons' *Positive Program*

In the opening of the *Positive Program for Laissez Faire*, Simons sounds two notes. The first note is that expanding the domain of the market is essential for the preservation of all kinds of liberty:

> [N]one of the precious "freedoms" which our generation has inherited can be extended, or even maintained, apart from an essential freedom of enterprise—apart from a genuine "division of labor" between competitive and political controls. The existence (and preservation) of a competitive situation in private industry makes possible a minimizing of the responsibilities of the sovereign state. It frees the state from the obligation of adjudicating endless, bitter disputes among persons as participants in different industries and among owners of different kinds of productive services. In a word, it makes possible a political policy of laissez faire. [Simons 1948, pp. 41–42.].[4]

Most to be feared, as Simons saw the world in 1934, are the interventionist policies of the left, technocratic wing of the Roosevelt coalition:

> If we dislike extreme inequality of power, it is appropriate to view with especial misgivings the extension of political (and monopoly) control over relative prices and incomes. Either socialization or the mongrel system of "national planning" implies and requires extreme concentration of political power [Simons 1948, p. 52].

The second note is that the United States in 1934 does indeed face a crisis requiring government action:

> The real enemies of liberty in this country are the naive advocates of managed economy or national planning; but with them we agree

[4]References to *Positive Program* (1934) are to the 1948 reprint in Simons' *Economic Policy for a Free Society*.

> . . . that there is now imperative need for a sound, positive program of economic legislation [Simons 1948, p. 41].

But government action should expand, not contract, the sphere controlled by competitive markets. In Simons' view, the United States in 1934 had been "ruined by banking and monopoly," and the excesses of the New Deal were simply extensions of the policy mistakes of Coolidge and Hoover:

> [O]ne must condemn the Democrats mainly for their wholesale extension of the worst policies of the past. The N.R.A. is merely Mr. Hoover's trust policy and wage policy writ large. The agricultural measures and many other planning proposals are the logical counterpart and the natural extensions of Republican protectionism [Simons 1948, p. 75].

Simons thus rejects Republican, as well as Democratic, policies on the grounds that they have shrunk the scope of competitive markets. He calls instead for policies that will support the expansion of the competitive sphere.

How does Simons reconcile his belief that the market sphere ought to be expanded with his belief that a "positive program" of government action is needed? By arguing that the maintenance of competitive markets requires more than a withdrawal of government from the business of regulating prices and quantities. The growth of exploitation, authority, and monopoly in all spheres must be checked:

> [T]he great enemy of democracy is monopoly, in all its forms . . . corporations, trade associations . . . trade-unions—or, in general, organization and concentration of power in functional classes [Simons 1948, p. 43].[5]

Monopolies by definition engage in exploitation—the exchange of goods and services at other than competitive free-market prices. Monopolies create situations of personal domination and authority. In these situations one's course of action is determined not by one's assessment of the objective constraints and incentives imposed through competitive equilibrium market prices by natural resources and existing technologies, but by another's deliberate manipulation of incentives to induce obedience. For Simons the good society requires freedom from coercion, and coercion can come from either government decree, union persuasion, or private monopoly.

[5]Of all organizations that threatened to establish private monopoly, Simons hated and feared labor unions the most (see Simons 1948, p. 60). Nevertheless, his assessment of unions does contain some hints that unions could play a positive role analogous to that presented in Freeman and Medoff's (1984) discussion of the "voice" face of unionism.

In Simons' view, the belief that the government should set up markets so that they remain competitive is a completion of the idea of the night watchman state. The night watchman state enforces contracts and guards against explicit theft. A monopolist is also an implicit thief because his possession of market power leads to the exchange of commodities at prices that do not reflect underlying social scarcities.

Preventing the growth of monopoly is hard. In Frank Knight's terms, competition is a school for monopoly because nothing better persuades entrepreneurs and managers of the benefits of monopoly than exposure to competition (Knight 1935). A private market system, especially one with large firms, tends to drift toward monopoly. The preservation of a free-market order requires that thought and effort be put into establishing institutions to help markets be and remain competitive. Simons argues that in the past governments have erred by directly regulating relative prices, and that those governments should have laid the foundation of markets with an eye toward encouraging competition:

> The great errors of economic policy . . . may be defined . . . in terms of excessive political interference with relative prices, and in terms of disastrous neglect of the positive responsibilities of government under a free-enterprise system. Our governments have tinkered interminably with relative prices. . . . On the other hand, they have never . . . tried to maintain . . . competitive conditions in industry [Simons 1948, p. 42].

Thus Simons explicitly draws a distinction between action to "interfere" with markets by setting prices or quantities by administrative fiat—clearly bad—and government action to build the appropriate "foundation" for a market system by providing legal and institutional support for a system of market exchange that encourages competitive outcomes:

> The representation of laissez faire as a merely do-nothing policy is unfortunate and misleading. It is an obvious responsibility of the state under this policy to maintain the kind of legal and institutional framework within which competition can function effectively as an agency of control. The policy, therefore, should be defined positively, as one under which the state seeks to establish and maintain such conditions that it may avoid the necessity of regulating "the heart of the contract"—that is to say, the necessity of regulating relative prices. Thus, the state is charged, under this "division of labor," with heavy responsibilities and large "control" functions: the maintenance of competitive conditions in industry, the control of the currency . . . the definition of the institution of property . . .

> not to mention the many social welfare activities [Simons 1948, p. 42].

Simons argues that a government committed to *laissez faire* should lay down the rules of the economic game so as to encourage the development of a competitive instead of a monopolistic market economy. Simons then moves into specifics; the rest of the *Positive Program* consists of arguments about what laws and policies are most likely to encourage competitive outcomes.

The Policy Recommendations of Simons' *Positive Program*

This assessment of Simons—that he did indeed base his position on classical liberal principles—is identical with his own self-assessment. Consider his "Political Credo":

> I hope that [my comments] are fragments of one intelligible general position. . . . The underlying position may be characterized as severely libertarian or, in the English-Continental sense, liberal. The intellectual tradition is intended to be that of Adam Smith . . . Marshall . . . and Knight, and of Locke, Hume, Bentham . . . and Hayek. The distinctive feature of this tradition is emphasis upon liberty as both a requisite and means of progress [Simons 1948, p. 1].

Simons saw the central plank of this approach as a distrust of all large concentrations of power:

> A cardinal tenet of libertarians is that no one may be trusted with much power—no leader, no faction, no party, no "class," no majority, no government, no church, no corporation, no trade association, no labor union, no grange, no professional association, no university, no large organization of any kind [Simons 1948, p. 23].

This fear of power generates a love of markets. For markets replace situations of authority, situations where people are clearly under the command of and subject to the personal will of others, with situations of association where people are constrained only by the objective and impersonal workings of competitive equilibrium market prices that reflect social scarcities imposed on society by nature and the limits of technology. "A free society must," Simons thought, "be organized . . . around voluntary, free exchanges of goods and services (Simons 1948, p. 5).

Yet Simons interprets classical liberalism as requiring that great care be taken to prevent the reemergence of "authority" and "exploitation" either in the form of an intrusive state or of private monopoly. The replacement of command by market is not spontaneous. The

initial allocation of endowments, definition of property rights, and establishment of institutions of exchange must be conducive to competitive equilibrium or else the market system will fail to realize its promise:

> Libertarians would directly regulate or governmentalize only a small group of intractable "natural monopolies," leaving them largely to local bodies, and then seek, by innumerable policy devices, partly direct but mainly indirect, to render competition more and more effective everywhere else [Simons 1948, p. 30].

The conflict between Simons' own self-assessment and Coase's assessment of Simons is generated by Coase's belief that Simons' "policy devices . . . to render competition more . . . effective" are intrusive state interventions in the marketplace. Coase thus lumps Simons with those whom Simons feared most, those who strove to regulate "the heart of the contract"—relative prices—because they did not trust decentralized competitive markets.

But take a closer look at those of Simons' policy recommendations that Coase calls "interventionist": First comes Simons' assessment of utility regulation. The heart of his argument is that

> Public regulation of private monopoly would seem to be, at best, an anomalous arrangement, tolerable only as a temporary expedient. . . . Analysis of the problem, and examination of experience to date, would seem to indicate the wisdom of abandoning the existing scheme of things with respect to the railroads and utilities, rather than extending the system to incude other industries as well. Political control of utility charges is imperative, to be sure, for competition simply cannot function effectively as an agency of control. . . . In general, however, the state should face the necessity of actually taking over, owning, and managing directly, both railroads and the utilities, and all other industries in which it is impossible to maintain effectively competitive conditions. For industries other than the utilities, there still remains a real alternative to socialization, namely, the establishment and preservation of competition as the regulative agency [Simons 1948, p. 51].

Simons believed that government regulation as it had evolved in the United States was a disaster, yet his response was not to deregulate utilities but to nationalize them. As such, it appears that Coase was right. Nevertheless, Simons made his nationalization argument within the context of his broader liberal perspective on the role of government. He thought that a primary function of government in a free society is to maintain competition. Since it was commonly held that competition could not operate effectively in cases of utilities and natural monopolies, Simons held that the second-best solution was not regulatory pricing but outright nationalization. In his view, it is

not desirable to allow private monopolies (even if natural) to remain uncontrolled, and so their power must be controlled by political democracy—imperfect as that may be.

Simons' fear of private monopoly power and his proposal for the "elimination of private monopoly in all its forms" ([1934] 1948, p. 57) must be viewed within the context of the times. As Herbert Stein (1987, p. 334), in his *New Palgrave* essay on Simons, points out:

> Simons's concern about private monopoly had always been about its interaction with the state. He feared that government would support private monopolies and then have to become more powerful to control the warring monopolies it had created. The 1934 pamphlet was written at the time of Roosevelt's National Recovery Administration, which was promoting the universal cartelization of business under government aegis. But in 1945 all that was past and the political influence of business seemed too small to be a danger.

Simons' second heresy, his desire to break up large corporations, follows the same underlying logic. He begins by describing where the corporate form of organization is and is not useful:

> The corporation is a socially useful device for organizing the ownership and control in operating companies of size sufficient to obtain the real economies of large-scale production under unified management. It should not be made available, however, for financial consolidation of operating enterprises which are (or which, without serious loss of efficiency, might be) essentially independent as to production management. Horizontal combination should be prohibited, and vertical combinations (integration) should be permitted only so far as clearly compatible with real competition. Few of our gigantic corporations can be defended on the ground that their present size is necessary to reasonably full exploitation of production economies [Simons 1948, p. 59].

This claim (that large firms capture no economies of scale in production) is subject to attack, for if large firms do not capture such economies of scale, why do they exist? This is a powerful objection. One possibility is that large firms capture large (although hard to pin down) economies of scale in distribution. Simons agrees that giant firms do owe their existence to economies of scale in marketing and distribution. But he claims these economies of scale are not social economies.

> There are grave productional diseconomies in giant enterprises; but these are compensated by larger artificial, private "economies" which wise public policy may and should cut away. Notable are the "economies" of national advertising and vast sales organizations (a problem of consumer education, consumer-goods standards, and

> technical information), of differential access to technical knowledge (patent-pooling and research), and differential access to new capital funds (inordinate centralization of securities markets). All these merely private advantages of great, monopolistic size present challenges which can be met. Reasonable access to markets, to technology, and to capital funds, on the part of new and moderate-sized firms, would mean an end of serious enterprise monopoly [Simons 1948, pp. 34–35].

Today many economists might argue that such information-related economies of scale really are social economies—that a decentralized market finds it difficult to rapidly transfer large amounts of complex information, and that large organizations are better at avoiding research and development duplication and at conveying information about product quality through the development of national brands and their associated reputations. A firm that expects a substantial amount of repeat business from a consumer has a large incentive to try to establish a reputation as a quality producer. But Simons would disagree and might argue that the large firm's reputational advantage is due to the government's failure to provide quality inspections and thus to provide the appropriate underpinnings for a competitive market.

Henry Simons versus Oliver Williamson

I believe that Simons' argument is best understood by considering what was to become the Coase theorem. In the absence of "transactions costs" in the broadest possible sense, the distribution of property rights—rights to perform and to prohibit specific concrete actions—is relevant only for the distribution of wealth and not for whether the market outcome will attain the Pareto frontier. The outcome reached will be Pareto optimal by the definition of a transaction cost as something that blocks a mutually beneficial exchange.

A natural step to take from this starting point is to argue that, in a world *with* transaction costs one ought to draw the lines that separate collections of property rights off from other rights into those bundles of powers and entitlements called "commodities" in such a way as to make the resulting equilibrium distribution of productive activity as close as possible to the zero-transaction costs outcome. The legal system ought to naturally bundle together two rights: where the exercise of one spills over to significantly affect the utility of the other, and where the transactions costs required to strike a bargain would be large if the rights were not bundled together. Liability for accidents on any icy sidewalk should be bundled with occupancy of a neighboring single-family house, and not with possibly absentee

juridical ownership of property; the liability should especially not fall on the contractor who laid the sidewalk.

Simons' argument can be understood as centered around this point. Where spillovers are substantial, but narrow, and transactions costs are high, rights should be bundled together into a single commodity. When spillovers are substantial and extend to an entire industry, the solution is less obvious. Confronted with the choice of either (a) allowing private internalization of externalities through the formation of monopoly, or (b) pulling the externality-generating activities into the public sector, Simons chooses (b). He sees transfer of the activity to the public sector as the only way to constrain individual discretion and monopoly power—even if such a constraint is weak and imperfect.

Simons, in short, can be interpreted as seeing three possible outcomes to the drawing of the lines determining what commodities should be traded on the market and what commodities should be left to the public sector. First, the legal order can help determine the proper private-public commodity mix. It can make liabilities fall on least-cost risk avoiders, tie rights that have spillovers together in the same commodity, and have private provision whenever feasible and public provision elsewhere. Atomistic markets and a few forms of contract will together suffice for an efficient distribution of productive activity.

Second, the arrangement of property rights can be in some sense "wrong." Strategic behavior and transactions costs can generate positive and negative externalities that are not in any decisionmaker's private calculus. The wedges between private cost and social cost create inefficiencies and a possible role for government provision.

Third, the arrangement of property rights can be wrong, but can be partially compensated by private action. Private agencies can expand to incorporate a wide range of spillovers and externalities. Thus, real costs are incorporated into some private decisionmaker's incentive calculus. But the expansion of the organization's size implies that economic agents are no longer atomistic—that they have market power, and this situation creates another wedge between private and social cost.

This third arrangement can be seen as either a success or a failure. On the one hand, externalities have been internalized; on the other hand, market power has been created. Current fashion is to take the emergence of large-scale organizations as a sign that the market is working, that hierarchies are reaching their optimal size (Williamson 1986). Simons' view was, instead, that the emergence of large-scale

organizations was a sign that the initial distribution of property rights was wrong.

Where Williamson (1986) would celebrate the elimination of internal transactions costs and dismiss as unimportant the creation of market power, Simons would argue that we need not face the choice between accepting externalities and accepting monopoly. Rather, if the initial distribution of property rights had assigned liability efficiently and those productive activities with large and widely dispersed spillovers had been transferred to the public sector, then the inefficiencies that large organizations are designed to work around would never have arisen. Where Williamson would celebrate how large organizations remove potential market failures, Simons would mourn that the inappropriate size of the public sector and the inappropriate distribution of property rights have created these potential market failures in the first place.

An example may be helpful here. Consider the standard Pigovian railroad that sporadically sets fire to the crops alongside its tracks. Let there be one railroad line, which connects the agriculture region to the city it supplies, and 100 family farms. Each family farm suffers an additional $10 worth of fire damage as a result of the introduction of faster trains that reduce the railroad's costs by $600. What do the three possible outcomes look like?

First, the right to farm the land can be bundled as part of a single traded commodity with the right to collect damages caused by fires set by the passing locomotives. In this case the underlying legal order has gotten the property rights "correct": The outcome generated by the market is efficient if the legal system works cheaply, because the costs saved by running faster locomotives do not balance the liability that the railroad bear for fires generated by those faster locomotives.

Second, the corporate charter of the railroad company can have attached to it an immunity against damages arising from the normal operation of the railroad. In this case it is likely that the railroad will run faster trains and that the fields will burn, because assembling a coalition of farmers who will pay more than $600 to the railroad to "purchase" the right to collect fire indemnification will be difficult. The problem is that farmers who do not join the coalition will, nevertheless, gain their share of the benefits of the coalition's action. This case exhibits a classic Pigovian externality: The social costs of faster trains—the $1,000 value of farm production forgone—exceed the private costs to the railroad.

Third, the railroad can threaten to run faster trains, buy up the farmland at a discount, and then operate as a railroad/agribusiness conglomerate that will internalize the fire externality. This approach

is efficient—but an unintended consequence is the emergence of market power in the urban food market.

Williamson might applaud the third arrangement as an example of the efficiency of a large hierarchy that internalizes an externality. But would it not be better to have gotten the initial distribution of property rights correct and to have settled for the first arrangement? This is Simons' underlying point. He believes that one rarely has to choose between monopoly and externality and that, instead, externalities can be eliminated by operating directly on the order of property rights and the boundary between the public and private sectors.

Simons sees the emergence of stable private oligopoly or monopoly as a sign that property rights are improperly structured. Sometimes his solution is that the government should step in to make information more widely available: by grading and evaluating commodities, by requiring the licensing of patents, or by establishing clearer standards of liability. Sometimes his solution is that governments should act to provide a stable framework within which exchange can take place. In particular, governments should ensure that property rights are drawn clearly to minimize spillovers and to help set expectations about what kinds of bargains are to be made, thereby reducing wasteful information asymmetries.

Toward Laissez Faire

Simons, therefore, regards the emergence of multiplant, multiproduct, multistate manufacturing firms in the United States around 1900 as a sign that markets are not properly set up to maintain competitive conditions. He hoped to correct this situation by breaking up existing oligopolies and, more important, by restructuring markets so that competition could thrive. According to Simons (1948, p. 60): "Some direct dismantling of corporate empires seems indispensable. The main concern of policy, however, should be that of facilitating new enterprise and multiplication of moderate-sized firms."

Simons' ideas on how to facilitate competition are complex. First come measures to get information about product quality out to the consumer.

> Enterprises like Consumers Research, Inc., may represent the beginnings of an almost revolutionary development. We may hope that such undertakings may flourish and that their growth may be promoted through private endowment. . . . Perhaps we shall see the establishment of endowed, nonprofit-making institutions, of unimpeachable disinterestedness, which will offer to manufacturers . . . the use of the institutions' certification . . . in the labeling of approved products. Ultimately, we may see the labeling and classi-

> fication of the more staple goods on the basis of Bureau of Standards specifications, so that consumers may know (and insist on knowing) which brands of goods meet requirements for government purchase [Simons 1948, p. 73].

Simons (1948, p. 57) also calls for a "limitation upon the squandering of our resources in advertising and selling activities." It is not clear what Simons is aiming at here. He himself agrees that his position must be "left somewhat imprecise," but argues that "the possibility of profitably utilizing resources to manipulate demand is, perhaps, the greatest source of diseconomy under the existing system" (Simons 1948, p. 71). Possibly he means that some widespread advertising expenditures are intended to greatly degrade the quality of information that consumers obtain. Possibly he rejects consumer sovereignty on the grounds that advertising pushes people's market choices away from their "true" interests. Simons also presses for the compulsory licensing of technology. And he argues that the peculiar centralization of American finance in New York has created a socially wasteful large-firm advantage in obtaining access to capital markets.

Conclusion

In retrospect, given the developments in industrial organization and public choice, Simons now appears to have been wrong in believing that (1) government ownership of utilities may be better than government regulation, and (2) large corporations do not reflect genuine economies and should be broken up. This fact, however, is not a sufficient basis for concluding that he was not a consistent classical liberal in terms of his own understanding of the issues of his time. Subsequent developments in theory and evidence are not a basis for concluding that the perceptions of Simons (or Smith) were not consistent or liberal.

Simons clearly opposed the type of detailed intervention in the economy initiated by Hoover and Roosevelt. He believed, maybe incorrectly, that some restructuring of property rights was necessary to avoid this type of intervention, but this does not seem a sufficient basis for labeling him as an interventionist, as that term was then or is now interpreted.

We should not retroactively condemn Simons (among others) as a heretic from the true doctrine of classical liberalism because later evidence suggests that he was empirically wrong. Classical liberalism is a way of thinking about the government and the economy, not a perfect guide to understanding all political and economic phenomena. By this standard, Simons was a consistent classical liberal of his times, even if, in retrospect, he may now appear to have been wrong in his judgment on specific issues.

Why, then, does Stigler say that Simons' position is an "interventionist" position—analogous to demands for mandatory airbags, for direct effluent limits as opposed to effluent taxes, for direct oil price controls? Why is it not acknowledged that Simons' position is a "restructuring" position—defining property rights and establishing public enforcement mechanisms for contracts, attempting to set up a legal system that meets as closely as possible the requirements that Coase would suggest? In Simons' mind, his policy recommendations would "intervene" in the market only in the sense that police forces, property rights, and contract enforcement "intervene" by providing the framework necessary for competitive markets to function.

There appear to be three possible answers, all of which certainly contribute to some degree but which, even taken together, appear inadequate for a full explanation. First, the Chicago position today appears to be that all markets are contestable—competitive enough, that is, for practical purposes—except for those that the government has closed down. Stigler and Friedman today see the primary danger coming not from large corporations that exploit purely private economies of scale to gain monopoly power but from interest groups that enter a symbiotic relationship with a government that purports to "regulate" them. Stigler's position leads one to be much more hostile toward the idea of government action: Whenever the government does something, it probably acts in the interest of some powerful and monopolistic interest group. Attempting to restructure markets to aid competition is politically impossible. It is, in fact, a miracle that the underlying system of contract and property rights is as favorable to competition as it is: The best we can do is to slow further deterioration.

But this line of thought paints a picture of a 19th-century Eden of laissez faire from which we have been driven by a government that responds to political pressure exerted by organized interests seeking monopoly. But history did not begin with the formation of the ICC. The then-existing order had been created and managed by a democratic government that was as imperfect and as responsive to interests seeking monopoly as government today. How then did it get so close, and how have we remained so close, to the libertarian ideal?

Pursuing this line of thought would lead to the view that there are two levels of government action: (a) There is action directed at establishing the foundations of free markets—specifying forms of property, rules of exchange, endowments, and rules of evidence for dispute resolution. (b) There is government action directed at creating and supporting private monopoly. Clearly, we wish for government to have as high a ratio of activity (a) to activity (b) as possible. Consideration of the concept of government failure could lead to a position like Simons',

which is that government must be active in laying the foundations of a market economy and that the dangers of government are best provided against by restraining government with a higher constitutional law that commits it to maintaining competition and prohibits it from committing random acts of intervention. Or such a consideration could lead to a position like Stigler's. Both positions come out of the classical liberal tradition. Simons' belief that the proper constitution of economic policy can be an effective check to "government failure" does not seem grounds for revoking his classical liberal credentials.

The second potential explanation is that research during the past 40 years has shown that economies of scale (and scope) in distribution and research are *social* economies. Large firms are thus optimal in the sense of Coase (1937), not inefficient in the sense of Simons.

The third possible explanation is that the underlying conception of liberty to be guarded has changed. Old-style Chicago—Simons, Knight, and Hayek—tended to fear every exercise of authority, every situation where one person told another what to do. Chicago today worries less about the exercise of authority within private organizations. As long as the organization itself is subject, at some point and some level, to the discipline of the market, they are satisfied.

None of these possible explanations seems to justify the answer that Coase received in Los Angeles. The conflict between Chicago then and Chicago today is about what the necessary foundations for a competitive free-market economy are, and not about the desirability of such an economic order. And the existence of such a conflict within the community of libertarians is denied when Simons is labeled an "interventionist."

This failure to recognize that Chicago's conception of the necessary public foundation of a competitive free-market economy has shifted is regrettable, for there is an ambiguity at the heart of economists' conceptions of the state that should be debated and that is thrown into relief by a comparison between Simons then and Stigler now. State action is to be feared: The state is easily corrupted by rent-seeking interest groups. But the establishment of property rights and of contract enforcement procedures fundamental for the existence of a market economy is itself state action of a sort. There are different ways in which property rights could be defined; there are many possible sets of "rules of the game" for a market economy. The government *acts* when we citizens use it to choose one of these sets. If, as Simons argues following a long tradition that includes Frank Knight, Joseph Schumpeter, and Adam Smith, competitive markets are fragile in the sense that they often contain the seeds of their collapse into monopoly, then the particular "foundations" chosen for the market are of prime importance. One

would hope to find that set of rules of the game most hostile to the development of private monopoly and to the capture of the government by interests that push for publicly supported monopoly. Fear of government action that "interferes" with relative prices thus leads an economist to embrace government action that provides proper "foundations" for the marketplace. This dilemma may be important, but it remains unrecognized if classical liberals who hold positions like Simons' are mislabeled as "interventionists."

Perhaps Simons' work is best understood as Stein (1987, p. 334) described it:

> The response of a free society liberal—or, as he preferred, "libertarian"—to the rise of totalitarianism in Europe, to the worldwide depression and to the attempt in the democracies, including the United States, to cope with the depression in ways that Simons regarded as threats to freedom.

The failure to acknowledge that Simons is—by his own admission, at least—a consistent classical liberal hinders our understanding of what the real answer to Coase's question should have been, and hinders our understanding of the shift in the application of liberal principles that has taken place between Simons' day and our own.

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