

## **Custom, Legislation, and Market Order**

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Social inquiry involves theorizing about mind and society and the interaction between the two. Ekkehart Schlicht's *On Custom and the Economy* is a perceptive and fruitful effort to plumb this interaction. There is always a strong temptation to reduce the one to the other, either by treating custom as derivative from interactions among maximizing minds or by treating the substantive content of mind as determined by custom. Schlicht seeks to advance an analytical framework that allows causation to run in both directions. He does this by postulating autonomy of the mind in terms of certain universal and formal characteristics. Hence, the substantive details of custom that arises through human interaction is limited by the requirements of mind. The mind is not a tabula rasa, but comes preset or hard-wired in terms of some universal principles of operation. Custom emerges through interaction among people, though just what emerges through that interaction is constrained by the requirements of mind.

In reflecting on Schlicht's contribution, I was drawn to earlier contributions by Vilfredo Pareto (1935), Maffeo Pantaleoni (1911), and Walter Eucken (1952). I shall not attempt to summarize the work of those scholars here, as that would require far more pages than the Editor has made available for this symposium. Rather, I shall explore briefly a possible line of inquiry that links themes found in those works to some of the possible implications for the relation between custom and legislation in a manner that seems broadly congruent with Schlicht's work.

## **From Mind to Custom in Pareto and Schlicht**

For Schlicht, custom is malleable in the long run, though only within the limit that is created by the autonomy of mind. To be sure, that autonomy resides in formal properties and not in substantive detail. Custom arises through interaction among people, and is described in terms of the substantive details of patterns generated through human interaction. Custom can vary widely across history and territory, despite the universal character of mind. That universal character implies form but not specific content. A drive for clarity, Schlicht argues, is a universal feature of mind that is independent of culture, and which Schlicht explores in quite illuminating ways. What might otherwise be a continuum is rendered discrete by the mind's search for clarity. This injects rigidity and autonomy into custom, even though the substantive features of the resulting custom can vary immensely through time and space. Yet, however immense that variation might be, it is constrained by the mind's universal search for clarity.

Like Schlicht, Pareto too thought mind was universal and permanent. Pareto distinguished between residues and derivations. Residues were the basic sentiments that Pareto thought were hard-wired in the mind. While Schlicht refers to such formal intellectual qualities as clarity and symmetry and not to such emotional qualities as sentiment, the one formulation can be assimilated to the other. In contrast to Schlicht's unified mind, however, Pareto articulated a vision of a bifurcated mind through his formulation of derivations. For Pareto, derivations were the intellectual justifications that the mind advanced to give an

appearance of rationality while simultaneously hiding the true sentiments that were at work.

Empirically, we observe actions and the justifications that people advance for those actions, Pareto's derivations. We do not observe the genuine residues that truly drive the actions. Thus ordinary communication is a deceptive and concealing activity, and is not one that reveals the truly motivating residues. This disjunction between residue and derivation, however, need not create any difficulties for communication and interaction so long as the residue-derivation gap is similar across those who interact and communicate. What would seem to be important for fluid social interaction is the predictability of expectation that people hold about one another. A debtor can tell a creditor that he just now put his check in the mail, even though he had not yet done so. The network of social relationships can nonetheless proceed smoothly so long the residue-derivation gap remains predictable. Difficulties of communication and the potential for conflict would seem to arise as predictability lessens through increased variability in the residue-derivation gap among different interacting persons. Social life may proceed differently, depending on the degree of similarity in the residue-derivation gaps at play within a society. This brings me to Pantaleoni.

### **Pantaleoni and the Parasitical Character of Political Pricing**

While Ludwig von Mises (1920) is widely credited with demonstrating the impossibility of genuine socialism, as distinct from market socialism, Maffeo Pantaleoni (1911) advanced much the same theme nine years earlier.

Pantaleoni recognized that what we now call mixed economies contained two incongruent pricing systems existing simultaneously within the same society.<sup>1</sup> One was a system of market pricing. The other was a system of political pricing. The political price system, moreover, could not exist alone, but could exist only as a parasite attached to a system of market prices. To call this relationship parasitical, however, is not to pass judgment but is only to describe the nature of the relationship between the two systems of pricing. Parasitical relationships may be mutually beneficial, in the social world as well as in the biological world. Too many parasites can kill a host in the biological world, and this can happen as well in the social world. Reality thus places a natural limit on the extent of political pricing, rendering impossible a system of complete political pricing. A system of political pricing can exist only so long as it remains attracted to a system of market pricing.

It is impossible to do justice to Pantaleoni's long and complex essay here, but a brief description can be presented in a manner that is sufficient for my purposes.<sup>2</sup> Consider a society where political pricing is injected into what had previously been purely a system of market pricing. The market-based stores and the politically-based stores offer competing services, but do so according to different pricing principles. A simple form of political pricing is a proportional tax on income. In the stores organized according to market prices, all buyers would pay the same price. With political pricing, however, prices would differ across

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<sup>1</sup> For some valuable subsequent treatments of this incongruity within contemporary mixed economies, see Littlechild (1978) and Ikeda (1997).

<sup>2</sup> For further elaborations of Pantaleoni's theme, see Wagner (1997)(1998).

buyers and would rise in proportion to income. A buyer with twice the income of another buyer would pay twice the price for the same item.

An expansion in the output of political stores is both self-limiting and involves the generation of social discord. As political pricing expands, standards of living equalize. In Pantaleoni's framework, complete political pricing would involve full equality. Whatever differences in earnings that might be generated through factor markets would be eliminated through political pricing on the product market. Far before this limiting case had been reached, however, the political price system will have dissolved through its inability to supply the goods that can only be supplied when accompanied by differences in standards of living.

Pantaleoni's model of two pricing systems can be joined to Pareto's distinction between residues and derivations. What is needed to do so is to claim that the gap between residue and derivation varies with the pricing system and the set of property relationships within which one participates. In a system of market pricing, it is reasonable to use arguments based on money as derivations to justify actions. Whatever the gap between residue and derivation that may characterize the participants within a system of market pricing, that gap would surely widen when a system of political pricing is injected into a society. Money becomes less reasonable to use as a justification, even if as a residue its place has not budged one millimeter. The variance between derivation and residue widens within a society, and with this variance accompanied by increased conflict

within a society. This claim about conflict I shall now explain by addressing Eucken's formulation of ordnungspolitik.

### **Eucken and the Choice of Principles for Governance**

Walter Eucken (1952) articulated a central distinction between those policy measures that conform to the central operating principles of a market economy and those measures that do not.<sup>3</sup> A market economy is framed by the legal principles of property, contract, and liability. A conformable policy measure is one that is consistent with those principles, while a non-conformable policy measure is one that clashes with them.

As an illustration of this distinction, Eucken (1952, pp. 267-68) offered a comparison between a tariff, which is broadly consistent with the principles of a market economy, particularly at low rates, and a quota, which is not.<sup>4</sup> It is, of course, a simple blackboard exercise to illustrate the equivalence of a tariff and a quota. In what would otherwise be an openly competitive market, suppose a tariff is imposed that reduces the sale of imported bicycles by 50 percent. It might seem as though a quota that limited imports to 50 percent of their pre-quota level would accomplish the same thing. This is not true, however, because the tariff and quota involve different forms of property relationship, and with the quota involving a greater extent of what Pantaleoni called political pricing. The tariff leaves allocative outcomes to be determined by the market principles of

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<sup>3</sup> For careful expositions of the themes and approaches taken by the subsequent literature on ordnungstheorie, see Leipold (1990), Streit (1992), and Vanberg (1988).

<sup>4</sup> It should be noted that Eucken was not a proponent of tariffs. A comparison of tariffs and quotas does, however, offer a convenient vehicle for illustrating his theme.

property, contract, and liability, while the quota uses planning principles of force and venality in the determination of allocative outcomes. To be sure, the tariff, like any tax, creates incentives for avoidance and evasion whose intensity varies directly with the size of the tax. The higher the tax on imported bicycles, the stronger will be the incentive for people to smuggle bicycles and the more fully people will seek to discover and exploit such interpretative issues as what truly constitutes an imported bicycle when only part of the bicycle is foreign made. The more heavily market transactions are taxed, the more strongly people will seek to substitute transactions that bypass ordinary market channels. This is true for all taxation, and comprises the reason why smuggling and other forms of tax evasion are at least as much problems of heavy taxation as problems of weak law enforcement.

Whatever the rate of tariff, however, market outcomes are still determined in an openly competitive process where buyers are able to buy the bicycles they most prefer and producers are able to choose their prices and offerings. In sharp contrast, a quota replaces market principles with planning principles. In the case of a quota on bicycles, a prior decision must be made to restrict the importation of bicycles to some explicit amount. Neither producers nor consumers can choose their best responses in light of some tax on market transactions. Rather market processes are blocked, and a state-determined outcome is set in its place. A quota, moreover, cannot stop simply with a declaration that only a certain number of bicycles can be imported. For a quota to be effective, the state must shift to a system of import licenses, whereby the state determines what



share of a quota is granted to different foreign sellers. Who produces what items for import, and in what amount, is determined not through the choices of buyers and sellers within market processes, but is determined by state officials.

With the rejection of open market processes, quotas increase the scope for venality. Which foreign producers shall sell in the domestic market, and to what extent, do not emerge out of some decentralized market process, but are dictated by some government agency. Favorable decisions can be highly valuable, just as unfavorable decisions can be highly costly. As the economic theory of rent seeking explains in various ways, there will tend to be an indirect market for such decisions. In some cases and places, those decisions may be made by bribery, sometimes in the open but more commonly in secret. In other cases they might be made on the basis of judgment about good character, and with the goodness of character demonstrated by such things as contributions to electoral campaigns or political action committees, through the hiring of particular legal or lobbying firms, or through the mounting of public relations campaigns.

Custom, as the constellation of actions and derivations, changes in response to legislation and its impact on entitlements and obligations. This occurs even as residues remain unchanged. In the absence of market conformability, it seems plausible to think that legislation will increase the variability in the residue-deviation gaps that are present within a society. By restricting the legislative injection of sources of conflict among customs that could otherwise emerge through ordinary political processes, a principle of market conformability might serve to promote a civil order that involves a higher ratio of

concord to discord, as compared with what might result without market conformability. This, anyway, seems to me to be a plausible line of inquiry, as based on my reflections on Schlicht's insightful effort.

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