

Approved February 15, 1990  
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT

The meeting was called to order by Elizabeth Baker at  
Chairperson

3:40 ~~xxx~~ p.m. on Wednesday, February 7, 1990 in room 423-S of the Capitol.

All members were present except: Representatives Barkis, Goossen, J.W. Long, Kline, Dean and Mead. Excused.

Committee staff present:  
Lynne Holt, Research  
Elaine Johnson, Secretary

Conferees appearing before the committee:  
Roger Wolfe, President and General Manager of White Cloud Grain Company, Inc.  
Rich McKee, Kansas Livestock Association  
Chris Wilson, Director of Governmental Relations of the Kansas Grain and Feed Association  
Jerry Jost, The Kansas Rural Center, Inc.

The meeting was called to order at 3:40 p.m. by Chairperson Baker.

Representative Baker called for discussion of HCR 5035.

Representative Gjerstad made a motion that HCR 5035 be passed favorably and placed on the Consent Calendar. Representative Heinemann seconded the motion. Motion carried.

Representative Baker then opened the continued hearing on HB 2766 and recognized Roger Wolfe, President and General Manager of White Cloud Grain Company, Inc., Hiawatha, Kansas.

Mr. Wolfe testified that he stongly opposed this bill due to the devastating effect it would have on their business and their community. He urges rejection of HB 2766 which he feels would clearly have a devastating effect on economic development in Kansas. Attachment 1.

Mr. Wolfe responded to questions from the committee.

Rich McKee representating the Kansas Livestock Association testified in opposition to HB 2766. The reason they object to the bill is that the issues are national, if not international, in scope. The debate on these issues belongs in Congress, not the state legislature. He stated that during testimony on Monday it was admitted that no other state has passed similar legislation. If this legislation were to pass, those affected would likely move to another state. He stated that Kansas is not an island which can be insulated from changes in the structure of the livestock industry. Limiting who can own livestock, feedlots, or who can issue a forward contract would hurt the Kansas economy in general and Kansas agriculture specifically. Attachment 2.

Mr. McKee responded to questions from the committee.

Representative Baker announced that we would have to move the rest of the hearing along swiftly because the House was going back into session at 4:00 p.m. before recognizing the next conferee.

Chris Wilson, Director of Governmental Relations of the Kansas Grain and Feed Association stood and informed the committee that her testimony in opposition to this bill was in front of the committee and she would stand by that testimony. Attachment 3.

Jerry Jost testified on behalf of the The Kansas Rural Center, Inc. The Kansas Rural Center is a nonprofit organization which has provided research and public education on agriculture and natural resources for the past ten years. They encourage the passage of HB 2766 because it is in the interest of consumers and family farmers. They state that there are two main objectives behind this bill. First, a marketplace with many decisionmakers and players provides for the most healthy competition and stability of production. Secondly, retaining ownership in rural communities contributes most to the economic health and quality of life in the community. Attachment 4.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT,  
room 423-S, Statehouse, at 4:30 ~~am~~ p.m. on Wednesday, February 7, 1990.

Mr. LeRoy Bower, President of the Kansas National Farmers Organization requested that his statement in support of the bill be passed out to the committee and become a part of the permanent record. Attachment 5.

Attachment 6 is a copy of "The American Economic Review" which Dr. Helmuth made reference to during his testimony on Monday, February 5, 1990.

Representative Baker closed the hearing on HB 2766.

The meeting adjourned at 4:09 p.m.

*Elizabeth Baker*

Date: 2/7/90

GUEST REGISTER

HOUSE

Committee on Economic Development

<u>NAME</u>	<u>ORGANIZATION</u>	<u>ADDRESS</u>
Teresa Grogby		Ottawa, KS
Nancy deCourse		Princeton, KS
Byron deFreese		" "
Jerry Jost	KRC	Whiting, KS
LoRoy Bower	Kansas NFO	R.#5 Box 529 Pittsburg, KS
Chris Walker	Kansas NFO	Mayetta, KS
Neil Morrissey	Kansas NFO	Boyls, Kansas
Juan W. Wyata	Ks Farmers Union	McPherson, KS
Mac Cadli	Rep. John McCune	Topeka
Bruce Tarkie	Leg	
Alvin Parker	Kansas Farm Bureau	Manhattan
Nancy Kantola	CKFO	Topeka
Joe Lieber	KS Co-op Council	" " "
John Jay Mill	Leg. Futern	Lawrence
Don Kopp	Leg	Ozark
Chris Wilson	Jop K6FA	Jopoka
Loan Wolfe	White Cloud Broom	HIAWATHA
Mr. Jones	K PPC	Manhattan

Date: 2/7/90

GUEST REGISTER

HOUSE

Committee on Economic Development

NAME

ORGANIZATION

ADDRESS

Honey Lilliland

KL RD

Walter Ernst

Ks Farmer

Aina Bowman-Morrell

Jarmland

Rich McKee

ALA

STATEMENT OF ROGER WOLFE, WHITE CLOUD GRAIN COMPANY, INC.  
BEFORE THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE  
REP. ELIZABETH BAKER, CHAIRPERSON  
REGARDING H.B. 2766, ESTABLISHING THE PACKERS AND STOCKYARDS ACT  
FEBRUARY 7, 1990

MADAME CHAIRPERSON AND MEMBERS OF THE COMMITTEE,

My name is Roger Wolfe, and I am the President and General Manager of White Cloud Grain Company, Inc., in Hiawatha, Kansas. I greatly appreciate the opportunity to comment today on House Bill 2766, which would establish the packers and stockyards act, as I am strongly opposed to this bill due to the devastating effect it would have on our business and our community.

I began White Cloud Grain Company 28 years ago with one small elevator, and today our company has grown to own and operate six grain elevators, which employ from 50 to 60 people, a 480 sow farrow to finish hog operation that produces between 9,000 and 10,000 hogs annually, and a tortilla chip plant, producing Santa Fe Tortilla Chips. We have worked hard to be a positive force in our community and to provide jobs and income to our local area. We have taken economic development seriously by working to develop businesses which add value to the raw agricultural products grown in our area. This benefits the local community, as you are all aware, in many ways, through jobs, taxes, and income which stays in our community. We are in no way, a huge corporation or conglomerate, but a locally owned and operated business working toward the betterment of our community.

*House Eco. Dev. Committee*

*Attachment 1*

*2/7/90*

House Bill 2766 would require that we stop producing hogs, causing a loss of 4 jobs that account for an annual payroll of \$71,773. It also terminates one position at the elevator making feed exclusively to feed our own livestock. We would no longer benefit the local community through the payment of property taxes or income taxes. The ripple effects of the loss of our hog operation would be felt throughout the community, since our business does business with other businesses in the area, as do our employees.

Our hog operation provides other benefits to the community as well. By being able to use the screenings from cleaning the grain at our elevators in feed for our livestock, we can afford to clean the grain we receive from the farm, providing a higher quality grain to the market. This is exactly the kind of business which state and federal leaders have been encouraging grainmen to undertake. Owning the hog operation makes it economically feasible for us to do so, and allows us to provide a better market for our local farmers' grain.

White Cloud Grain Company's hog operation was started in 1976 with an investment just short of \$1 million at risk. We have had both good and bad years since we began, weathering each storm as it blew in. Now our business is at the mercy of the legislature. Did our forefathers intend for the stroke of the legislative pen to force us out of business? If so, what's next? What business can we enter into with any feeling of confidence in it's longevity?

In closing, I hope the sponsor of this legislation did not intend for it to have a negative impact on my company and my community. I wish to again thank you for the opportunity to speak today, and strongly urge that you reject House Bill 2766, which would clearly be devastating to economic development in Kansas. I would be happy to respond to any questions you may have.



6031 S.W. 37th Street • Topeka, Kansas 66614-5128 • Telephone: (913) 273-5115  
FAX: (913) 273-3399

Owns and Publishes The Kansas STOCKMAN magazine and KLA News & Market Report newsletter.

*February 7, 1990*

**STATEMENT OF THE  
KANSAS LIVESTOCK ASSOCIATION  
TO THE COMMITTEE OF  
ECONOMIC DEVELOPMENT  
REPRESENTATIVE ELIZABETH BAKER, CHAIRMAN  
REPRESENTATIVE FRANK WEIMER, VICE-CHAIRMAN**

**WITH RESPECT TO HB 2766  
STATE PACKERS AND STOCKYARDS ACT**

*Presented by*

**Rich McKee**

*Executive Secretary, Feedlot Division*

*Mr. Chairman and members of the committee, I am Rich McKee, representing the Kansas Livestock Association. KLA speaks for a broad range of over 10,300 livestock and crop producers. Their operations can be found in virtually every geographic corner of the state.*

***KLA opposes House Bill 2766 for a number of reasons.***

*The main reason we object to this bill is the issues are national, if not international, in scope. The debate on these issues belongs in Congress, not the state legislature. Kansas is not an island which can be*

*House Econ. Dev. Committee  
Attachment 2 2/7/90*

*insulated from changes in the structure of the livestock industry. Limiting who can own livestock, feedlots, or who can issue a forward contract would hurt the Kansas economy in general and Kansas agriculture specifically.*

*As admitted during testimony Monday, no other state has passed similar legislation. Therefore, if this legislation were to pass, those affected would likely move to another state. This shift away from Kansas would have a negative effect on the local grain market, the trucking industry, labor, local banks, veterinarians, nutritionists, and all the other numerous business's which supply goods for the livestock industry.*

*On Monday this committee heard professors from foreign states give a lot of economic theories. One was that as the livestock industry becomes more concentrated, prices paid to producers for raw products (feeder cattle, grain, hay, etc.) decreases. Obviously those statements were generated by someone who hasn't paid much attention to the real world. To understand how wrong this theory is, stop by an auction market and try to buy some calfs and yearlings for 1980 prices. I dare say, few producers would trade today's price levels for those of ten years ago.*

*On numerous occasions our membership has debated the structure of the industry. Out of this discussion there has been one consensus: Don't attempt to address structural changes in the livestock industry at the state level. For this and numerous other reasons we ask you to oppose this type of legislation which limits the freedom of who can participate in the livestock industry.*



STATEMENT OF THE KANSAS GRAIN AND FEED ASSOCIATION

TO THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE

REP. ELIZABETH BAKER, CHAIRPERSON

REGARDING H.B. 2766

FEBRUARY 6, 1990

Chairperson Baker and Members of the Committee, I am Chris Wilson, Director of Governmental Relations of the Kansas Grain and Feed Association (KGFA). Our over 1300 members constitute the state's grain handling, storage and processing industry. Our Association strongly opposes H.B. 2766, the proposed packers and stockyards act.

We do not have many members who would be affected by this legislation. Those who would be are primarily warehousemen who also have farming or ranching operations. Roger Wolfe, a past president of KGFA is a good example of the kind of individual whose business would be affected, and he will give you the details of his operation. Often in Kansas, a family has started out in a farming enterprise and later purchased grain storage facilities, as is the case with Irsik and Doll, another of our members which would be affected by this legislation. It does not take a very large grain warehouse operation to handle grains with an annual market value of \$10,000,000. As a result of this legislation, any such grain firm would be prohibited from owning livestock.

*House Eco. Dev. Committee*  
*Attachment 3 2/7/90*

Our members who have both grain warehouse and livestock operations are providing jobs and many benefits to local economies. They are adding value to locally produced grain and increased local markets for producers. To deny them of this right would be destructive to their local communities and economies. We believe the right for them to be involved in both the grain warehouse and livestock industries, so much a part of Kansas and communities throughout the state, should be preserved.

We urge you to reject H.B. 2766. Thank you for this opportunity to comment on the bill.

**THE KANSAS RURAL CENTER, INC.**

304 Pratt Street

WHITING, KANSAS 66552

Phone: (913) 873-3431

Testimony on HB 2766

The Kansas Rural Center is a non-profit organization which has provided research and public education on agriculture and natural resources for the past ten years.

We encourage passage of HB 2766 because it is in the interest of consumers and family farmers. Dr. Willard Mueller, economist at the University of Wisconsin, has estimated that the concentration in the food industry has cost consumers more than \$26 billion in 1987. A 1966 USDA study concluded that increases in cattle supply by meatpacker feeding has a ten-fold greater impact on depressing cattle prices than supply increases from independent feeders. Dr. John Helmuth, economist at Iowa State University, testified earlier before this committee that a chief motivation a few concentrated firms in the meatpacking industry is to "product the minimum quality meat the consumers will accept".

There are two main objectives behind this bill. First, a marketplace with many decisionmakers and players provides for the most healthy competition and stability of production. Secondly, retaining ownership in rural communities contributes most to the economic health and quality of life in the community. There are no better persons to determine the economic future of rural communities than the very Kansans who live in those communities. This is the essence of economic democracy.

Thank you for you attention.

*House Eco. Devo. Committee  
Attachment 4 2/7/90*



**KANSAS  
NATIONAL  
FARMERS  
ORGANIZATION**

Collective Bargaining  
FOR AGRICULTURE

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Greg Stephens  
842 South 10th.  
Salina, Ks. 67401  
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February 7, 1990

MEMBERS OF THE HOUSE ECONOMIC DEVELOPMENT COMMITTEE

ENDORSEMENT OF H.B. 2766

Please be advised that the National Farmers Organization of Kansas is in favor of the passage of H.B. 2766.

The Kansas NFO agrees with the statements presented during the testimony on Monday Feb. 5th.

We want to thank the Committee for this hearing and for their consideration of this bill.

*LeRoy Bower*  
LeRoy Bower, President

*House Eco. Dev. Committee*  
*Attachment 5 2/7/90*

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VOLUME XXXV SEPTEMBER, 1945 NO. FOUR

The Use of Knowledge in Society	F. A. Hayek	519
"Model-Building" and Fiscal Policy	A. G. Hart	531
Corporate Retained Earnings and Cyclical Fluctuations	S. P. Dobrovolsky	559
The Federal Trade Commission and "Unfair Competition" in Foreign Trade	R. S. Landry	575
Some Problems in the Development of the Communications Industry	Carrie Glasser	585
A Graphical Analysis of Personal Income Distribution in the United States	M. J. Bowman	607
Communications Employment Policy and Organization of Industry after the War	M. G. de Chazeau	629
The Financing of Employment-Maintaining Expenditures	A. N. McLeod	640
A Formula for Social Insurance Financing	S. J. Mushkin and Anne de Scitovsky	646
The Field of Labor Economics: A Review	C. R. Daugherty	652
Messrs. Mosak and Salant on Wartime Inflation: A Rejoinder	Clark Warburton	658
Revision or Reaffirmation of Marxism? A Rejoinder	Raya Dunayevskaya	660
Pragmatism and Economic Theory: Rebuttal	Dudley Dillard	665
Pragmatism and Economic Theory: A Final Word	Otto von Mering	667
Interest Rates and the Banks	S. E. Harris	667
A One Per Cent War?	G. W. Goleman	671
The Effect of Interest Rate Increases on the Banking System	P. A. Samuelson	674
The Turn of the Screw	• • • • •	• • • • •
Book Reviews ~ 677	• • • • •	• • • • •
Periodicals ~ 770	• • • • •	• • • • •
List of Doctoral Dissertations ~ 797	• • • • •	• • • • •
Titles of New Books ~ 748	• • • • •	• • • • •
Notes ~ 788	• • • • •	• • • • •

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Annual Eco. Serv. Committee 2/1/90



# The American Economic Review

VOLUME XXXV

SEPTEMBER, 1945

NUMBER FOUR

## THE USE OF KNOWLEDGE IN SOCIETY

By F. A. HAYEK\*

### I

What is the problem we wish to solve when we try to construct a rational economic order?

On certain familiar assumptions the answer is simple enough. *If* we possess all the relevant information, *if* we can start out from a given system of preferences and *if* we command complete knowledge of available means, the problem which remains is purely one of logic. That is, the answer to the question of what is the best use of the available means is implicit in our assumptions. The conditions which the solution of this optimum problem must satisfy have been fully worked out and can be stated best in mathematical form: put at their briefest, they are that the marginal rates of substitution between any two commodities or factors must be the same in all their different uses.

This, however, is emphatically *not* the economic problem which society faces. And the economic calculus which we have developed to solve this logical problem, though an important step toward the solution of the economic problem of society, does not yet provide an answer to it. The reason for this is that the "data" from which the economic calculus starts are never for the whole society "given" to a single mind which could work out the implications, and can never be so given.

The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is thus not merely a problem

\*The author is Tooke professor of political economy and statistics at the University of London (London School of Economics and Political Science).

*F. A. Hayek*

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of how to allocate "given" resources—if "given" is taken to mean given to a single mind which deliberately solves the problem set by these "data." It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge not given to anyone in its totality.

This character of the fundamental problem has, I am afraid, been rather obscured than illuminated by many of the recent refinements of economic theory, particularly by many of the uses made of mathematics. Though the problem with which I want primarily to deal in this paper is the problem of a rational economic organization, I shall in its course be led again and again to point to its close connections with certain methodological questions. Many of the points I wish to make are indeed conclusions toward which diverse paths of reasoning have unexpectedly converged. But as I now see these problems, this is no accident. It seems to me that many of the current disputes with regard to both economic theory and economic policy have their common origin in a misconception about the nature of the economic problem of society. This misconception in turn is due to an erroneous transfer to social phenomena of the habits of thought we have developed in dealing with the phenomena of nature.

## II

In ordinary language we describe by the word "planning" the complex of interrelated decisions about the allocation of our available resources. All economic activity is in this sense planning; and in any society in which many people collaborate, this planning, whoever does it, will in some measure have to be based on knowledge which, in the first instance, is not given to the planner but to somebody else, which somehow will have to be conveyed to the planner. The various ways in which the knowledge on which people base their plans is communicated to them is the crucial problem for any theory explaining the economic process. And the problem of what is the best way of utilizing knowledge initially dispersed among all the people is at least one of the main problems of economic policy—or of designing an efficient economic system.

The answer to this question is closely connected with that other question which arises here, that of *who* is to do the planning. It is about this question that all the dispute about "economic planning" centers. This is not a dispute about whether planning is to be done or not. It is a dispute as to whether planning is to be done centrally, by one authority for the whole economic system, or is to be divided

among many individuals. Planning in the specific sense in which the term is used in contemporary controversy necessarily means central planning—direction of the whole economic system according to one unified plan. Competition, on the other hand, means decentralized planning by many separate persons. The half-way house between the two, about which many people talk but which few like when they see it, is the delegation of planning to organized industries, or, in other words, monopoly.

Which of these systems is likely to be more efficient depends mainly on the question under which of them we can expect that fuller use will be made of the existing knowledge. And this, in turn, depends on whether we are more likely to succeed in putting at the disposal of a single central authority all the knowledge which ought to be used but which is initially dispersed among many different individuals, or in conveying to the individuals such additional knowledge as they need in order to enable them to fit their plans in with those of others.

## III

It will at once be evident that on this point the position will be different with respect to different kinds of knowledge; and the answer to our question will therefore largely turn on the relative importance of the different kinds of knowledge; those more likely to be at the disposal of particular individuals and those which we should with greater confidence expect to find in the possession of an authority made up of suitably chosen experts. If it is today so widely assumed that the latter will be in a better position, this is because one kind of knowledge, namely, scientific knowledge, occupies now so prominent a place in public imagination that we tend to forget that it is not the only kind that is relevant. It may be admitted that, so far as scientific knowledge is concerned, a body of suitably chosen experts may be in the best position to command all the best knowledge available—though this is of course merely shifting the difficulty to the problem of selecting the experts. What I wish to point out is that, even assuming that this problem can be readily solved, it is only a small part of the wider problem.

Today it is almost heresy to suggest that scientific knowledge is not the sum of all knowledge. But a little reflection will show that there is beyond question a body of very important but unorganized knowledge which cannot possibly be called scientific in the sense of knowledge of general rules: the knowledge of the particular circumstances of time and place. It is with respect to this that practically every individual has some advantage over all others in that he possesses unique information of which beneficial use might be made, but of

which use can be made only if the decisions depending on it are left to him or are made with his active coöperation. We need to remember only how much we have to learn in any occupation after we have completed our theoretical training, how big a part of our working life we spend learning particular jobs, and how valuable an asset in all walks of life is knowledge of people, of local conditions, and special circumstances. To know of and put to use a machine not fully employed, or somebody's skill which could be better utilized, or to be aware of a surplus stock which can be drawn upon during an interruption of supplies, is socially quite as useful as the knowledge of better alternative techniques. And the shipper who earns his living from using otherwise empty or half-filled journeys of tramp-steamers, or the estate agent whose whole knowledge is almost exclusively one of temporary opportunities, or the *arbitrageur* who gains from local differences of commodity prices, are all performing eminently useful functions based on special knowledge of circumstances of the fleeting moment not known to others.

It is a curious fact that this sort of knowledge should today be generally regarded with a kind of contempt, and that anyone who by such knowledge gains an advantage over somebody better equipped with theoretical or technical knowledge is thought to have acted almost disreputably. To gain an advantage from better knowledge of facilities of communication or transport is sometimes regarded as almost dishonest, although it is quite as important that society make use of the best opportunities in this respect as in using the latest scientific discoveries. This prejudice has in a considerable measure affected the attitude toward commerce in general compared with that toward production. Even economists who regard themselves as definitely above the crude materialist fallacies of the past constantly commit the same mistake where activities directed toward the acquisition of such practical knowledge are concerned—apparently because in their scheme of things all such knowledge is supposed to be “given.” The common idea now seems to be that all such knowledge should as a matter of course be readily at the command of everybody, and the reproach of irrationality leveled against the existing economic order is frequently based on the fact that it is not so available. This view disregards the fact that the method by which such knowledge can be made as widely available as possible is precisely the problem to which we have to find an answer.

#### IV

If it is fashionable today to minimize the importance of the knowledge of the particular circumstances of time and place, this is closely connected with the smaller importance which is now attached to change

as such. Indeed, there are few points on which the assumptions made (usually only implicitly) by the “planners” differ from those of their opponents as much as with regard to the significance and frequency of changes which will make substantial alterations of production plans necessary. Of course, if detailed economic plans could be laid down for fairly long periods in advance and then closely adhered to, so that no further economic decisions of importance would be required, the task of drawing up a comprehensive plan governing all economic activity would appear much less formidable.

It is, perhaps, worth stressing that economic problems arise always and only in consequence of change. So long as things continue as before, or at least as they were expected to, there arise no new problem requiring a decision, no need to form a new plan. The belief that changes, or at least day-to-day adjustments, have become less important in modern times implies the contention that economic problems also have become less important. This belief in the decreasing importance of change is, for that reason, usually held by the same people who argue that the importance of economic considerations has been driven into the background by the growing importance of technological knowledge.

Is it true that, with the elaborate apparatus of modern production, economic decisions are required only at long intervals, as when a new factory is to be erected or a new process to be introduced? Is it true that, once a plant has been built, the rest is all more or less mechanical, determined by the character of the plant, and leaving little to be changed in adapting to the ever-changing circumstances of the moment?

The fairly widespread belief in the affirmative is not, so far as I can ascertain, borne out by the practical experience of the business man. In a competitive industry at any rate—and such an industry alone can serve as a test—the task of keeping cost from rising requires constant struggle, absorbing a great part of the energy of the manager. How easy it is for an inefficient manager to dissipate the differentials on which profitability rests, and that it is possible, with the same technical facilities, to produce with a great variety of costs, are among the commonplaces of business experience which do not seem to be equally familiar in the study of the economist. The very strength of the desire, constantly voiced by producers and engineers, to be able to proceed untrammelled by considerations of money costs, is eloquent testimony to the extent to which these factors enter into their daily work.

One reason why economists are increasingly apt to forget about the constant small changes which make up the whole economic picture is probably their growing preoccupation with statistical aggregates, which

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show a very much greater stability than the movements of the detail. The comparative stability of the aggregates cannot, however, be accounted for—as the statisticians seem occasionally to be inclined to do—by the “law of large numbers” or the mutual compensation of random changes. The number of elements with which we have to deal is not large enough for such accidental forces to produce stability. The continuous flow of goods and services is maintained by constant deliberate adjustments, by new dispositions made every day in the light of circumstances not known the day before, by *B* stepping in at once when *A* fails to deliver. Even the large and highly mechanized plant keeps going largely because of an environment upon which it can draw for all sorts of unexpected needs; tiles for its roof, stationery for its forms, and all the thousand and one kinds of equipment in which it cannot be self-contained and which the plans for the operation of the plant require to be readily available in the market.

This is, perhaps, also the point where I should briefly mention the fact that the sort of knowledge with which I have been concerned is knowledge of the kind which by its nature cannot enter into statistics and therefore cannot be conveyed to any central authority in statistical form. The statistics which such a central authority would have to use would have to be arrived at precisely by abstracting from minor differences between the things, by lumping together, as resources of one kind, items which differ as regards location, quality, and other particulars, in a way which may be very significant for the specific decision. It follows from this that central planning based on statistical information by its nature cannot take direct account of these circumstances of time and place, and that the central planner will have to find some way or other in which the decisions depending on them can be left to the “man on the spot.”

## V

If we can agree that the economic problem of society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them. We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating *all* knowledge, issues its orders. We must solve it by some form of decentralization. But this answers only part of our problem. We need decentralization because only thus can we ensure that the knowledge of the particular circumstances of time and place will be promptly used. But the “man on the spot” cannot decide

solely on the basis of his limited but intimate knowledge of the facts of his immediate surroundings. There still remains the problem of communicating to him such further information as he needs to fit his decisions into the whole pattern of changes of the larger economic system.

How much knowledge does he need to do so successfully? Which of the events which happen beyond the horizon of his immediate knowledge are of relevance to his immediate decision, and how much of them need he know?

There is hardly anything that happens anywhere in the world that *might* not have an effect on the decision he ought to make. But he need not know of these events as such, nor of *all* their effects. It does not matter for him *why* at the particular moment more screws of one size than of another are wanted, *why* paper bags are more readily available than canvas bags, or *why* skilled labor, or particular machine tools, have for the moment become more difficult to acquire. All that is significant for him is *how much more or less* difficult to procure they have become compared with other things with which he is also concerned, or how much more or less urgently wanted are the alternative things he produces or uses. It is always a question of the relative importance of the particular things with which he is concerned, and the causes which alter their relative importance are of no interest to him beyond the effect on those concrete things of his own environment.

It is in this connection that what I have called the economic calculus proper helps us, at least by analogy, to see how this problem can be solved, and in fact is being solved, by the price system. Even the single controlling mind, in possession of all the data for some small, self-contained economic system, would not—every time some small adjustment in the allocation of resources had to be made—go explicitly through all the relations between ends and means which might possibly be affected. It is indeed the great contribution of the pure logic of choice that it has demonstrated conclusively that even such a single mind could solve this kind of problem only by constructing and constantly using rates of equivalence (or “values,” or “marginal rates of substitution”), *i.e.*, by attaching to each kind of scarce resource a numerical index which cannot be derived from any property possessed by that particular thing, but which reflects, or in which is condensed, its significance in view of the whole means-end structure. In any small change he will have to consider only these quantitative indices (or “values”) in which all the relevant information is concentrated; and by adjusting the quantities one by one, he can appropriately rearrange his dispositions without having to solve the whole puzzle *ab initio*, or without needing at any stage to survey it at once in all its ramifications.

A-6-5  
2/1/90

Fundamentally, in a system where the knowledge of the relevant facts is dispersed among many people, prices can act to coordinate the separate actions of different people in the same way as subjective values help the individual to coordinate the parts of his plan. It is worth contemplating for a moment a very simple and commonplace instance of the action of the price system to see what precisely it accomplishes. Assume that somewhere in the world a new opportunity for the use of some raw material, say tin, has arisen, or that one of the sources of supply of tin has been eliminated. It does not matter for our purpose—and it is very significant that it does not matter—which of these two causes has made tin more scarce. All that the users of tin need to know is that some of the tin they used to consume is now more profitably employed elsewhere, and that in consequence they must economize tin. There is no need for the great majority of them even to know where the more urgent need has arisen, or in favor of what other needs they ought to husband the supply. If only some of them know directly of the new demand, and switch resources over to it, and if the people who are aware of the new gap thus created in turn fill it from still other sources, the effect will rapidly spread throughout the whole economic system and influence not only all the uses of tin, but also those of its substitutes and the substitutes of these substitutes, the supply of all the things made of tin, and their substitutes, and so on; and all this without the great majority of those instrumental in bringing about these substitutions knowing anything at all about the original cause of these changes. The whole acts as one market, not because any of its members survey the whole field, but because their limited individual fields of vision sufficiently overlap so that through many intermediaries the relevant information is communicated to all. The mere fact that there is one price for any commodity—or rather that local prices are connected in a manner determined by the cost of transport, etc.—brings about the solution which (it is just conceptually possible) might have been arrived at by one single mind possessing all the information which is in fact dispersed among all the people involved in the process.

## VI

We must look at the price system as such a mechanism for communicating information if we want to understand its real function—a function which, of course, it fulfills less perfectly as prices grow more rigid. (Even when quoted prices have become quite rigid, however, the forces which would operate through changes in price still operate to a considerable extent through changes in the other terms of the contract.) The most significant fact about this system is the economy of knowledge

with which it operates, or how little the individual participants need to know in order to be able to take the right action. In abbreviated form, by a kind of symbol, only the most essential information is passed on, and passed on only to those concerned. It is more than a metaphor to describe the price system as a kind of machinery for registering change, or a system of telecommunications which enables individual producers to watch merely the movement of a few pointers, as an engineer might watch the hands of a few dials, in order to adjust their activities to changes of which they may never know more than is reflected in the price movement.

Of course, these adjustments are probably never “perfect” in the sense in which the economist conceives of them in his equilibrium analysis. But I fear that our theoretical habits of approaching the problem with the assumption of more or less perfect knowledge on the part of almost everyone has made us somewhat blind to the true function of the price mechanism and led us to apply rather misleading standards in judging its efficiency. The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; *i.e.*, they move in the right direction. This is enough of a marvel even if, in a constantly changing world, not all will hit it off so perfectly that their profit rates will always be maintained at the same constant or “normal” level.

I have deliberately used the word “marvel” to shock the reader out of the complacency with which we often take the working of this mechanism for granted. I am convinced that if it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind. Its misfortune is the double one that it is not the product of human design and that the people guided by it usually do not know why they are made to do what they do. But those who clamor for “conscious direction”—and who cannot believe that anything which has evolved without design (and even without our understanding it) should solve problems which we should not be able to solve consciously—should remember this: The problem is precisely how to extend the span of our utilization of resources beyond the span of the control of any one mind; and, therefore, how to dispense with the need of conscious control and how to provide inducements which will make the individuals do the desirable things without anyone having to tell them what to do.

The problem which we meet here is by no means peculiar to economics but arises in connection with nearly all truly social phenomena, with language and most of our cultural inheritance, and constitutes really the central theoretical problem of all social science. As Alfred Whitehead has said in another connection, "It is a profoundly erroneous truism, repeated by all copy-books and by eminent people when they are making speeches, that we should cultivate the habit of thinking what we are doing. The precise opposite is the case. Civilization advances by extending the number of important operations which we can perform without thinking about them." This is of profound significance in the social field. We make constant use of formulas, symbols and rules whose meaning we do not understand and through the use of which we avail ourselves of the assistance of knowledge which individually we do not possess. We have developed these practices and institutions by building upon habits and institutions which have proved successful in their own sphere and which have in turn become the foundation of the civilization we have built up.

The price system is just one of those formations which man has learned to use (though he is still very far from having learned to make the best use of it) after he had stumbled upon it without understanding it. Through it not only a division of labor but also a coördinated utilization of resources based on an equally divided knowledge has become possible. The people who like to deride any suggestion that this may be so usually distort the argument by insinuating that it asserts that by some miracle just that sort of system has spontaneously grown up which is best suited to modern civilization. It is the other way round: man has been able to develop that division of labor on which our civilization is based because he happened to stumble upon a method which made it possible. Had he not done so he might still have developed some other, altogether different, type of civilization, something like the "state" of the termite ants, or some other altogether unimaginable type. All that we can say is that nobody has yet succeeded in designing an alternative system in which certain features of the existing one can be preserved which are dear even to those who most violently assail it—such as particularly the extent to which the individual can choose his pursuits and consequently freely use his own knowledge and skill.

## VII

It is in many ways fortunate that the dispute about the indispensability of the price system for any rational calculation in a complex society is now no longer conducted entirely between camps holding different political views. The thesis that without the price system we

could not preserve a society based on such extensive division of labor as ours was greeted with a howl of derision when it was first advanced by von Mises twenty-five years ago. Today the difficulties which some still find in accepting it are no longer mainly political, and this makes for an atmosphere much more conducive to reasonable discussion. When we find Leon Trotsky arguing that "economic accounting is unthinkable without market relations"; when Professor Oscar Lange promises Professor von Mises a statue in the marble halls of the future Central Planning Board; and when Professor Abba P. Lerner re-discovers Adam Smith and emphasizes that the essential utility of the price system consists in inducing the individual, while seeking his own interest, to do what is in the general interest, the differences can indeed no longer be ascribed to political prejudice. The remaining dissent seems clearly to be due to purely intellectual, and more particularly methodological, differences.

A recent statement by Professor Joseph Schumpeter in his *Capitalism, Socialism and Democracy* provides a clear illustration of one of the methodological differences which I have in mind. Its author is pre-eminent among those economists who approach economic phenomena in the light of a certain branch of positivism. To him these phenomena accordingly appear as objectively given quantities of commodities impinging directly upon each other, almost, it would seem, without any intervention of human minds. Only against this background can I account for the following (to me startling) pronouncement. Professor Schumpeter argues that the possibility of a rational calculation in the absence of markets for the factors of production follows for the theorist "from the elementary proposition that consumers in evaluating ('demanding') consumers' goods *ipso facto* also evaluate the means of production which enter into the production of these goods."

Taken literally, this statement is simply untrue. The consumers do nothing of the kind. What Professor Schumpeter's "*ipso facto*" presumably means is that the valuation of the factors of production is

<sup>1</sup>J. Schumpeter, *Capitalism, Socialism, and Democracy* (New York, Harper, 1942), p. 175. Professor Schumpeter is, I believe, also the original author of the myth that Pareto and Barone have "solved" the problem of socialist calculation. What they, and many others, did was merely to state the conditions which a rational allocation of resources would have to satisfy, and to point out that these were essentially the same as the conditions of equilibrium of a competitive market. This is something altogether different from showing how the allocation of resources satisfying these conditions can be found in practice. Pareto himself (from whom Barone has taken practically everything he has to say), far from claiming to have solved the practical problem, in fact explicitly denies that it can be solved without the help of the market. See his *Manuel d'économie pure* (2nd ed., 1927), pp. 233-34. The relevant passage is quoted in an English translation at the beginning of my article on "Socialist Calculation: The Competitive 'Solution,'" in *Economica*, New Series, Vol. VIII, No. 26 (May, 1940), p. 125.

O-6-7  
2/7/90

implied in, or follows necessarily from, the valuation of consumers' goods. But this, too, is not correct. Implication is a logical relationship which can be meaningfully asserted only of propositions simultaneously present to one and the same mind. It is evident, however, that the values of the factors of production do not depend solely on the valuation of the consumers' goods but also on the conditions of supply of the various factors of production. Only to a mind to which all these facts were simultaneously known would the answer necessarily follow from the facts given to it. The practical problem, however, arises precisely because these facts are never so given to a single mind, and because, in consequence, it is necessary that in the solution of the problem knowledge should be used that is dispersed among many people.

The problem is thus in no way solved if we can show that all the facts, if they were known to a single mind (as we hypothetically assume them to be given to the observing economist), would uniquely determine the solution; instead we must show how a solution is produced by the interactions of people each of whom possesses only partial knowledge. To assume all the knowledge to be given to a single mind in the same manner in which we assume it to be given to us as the explaining economists is to assume the problem away and to disregard everything that is important and significant in the real world.

That an economist of Professor Schumpeter's standing should thus have fallen into a trap which the ambiguity of the term "datum" sets to the unwary can hardly be explained as a simple error. It suggests rather than there is something fundamentally wrong with an approach which habitually disregards an essential part of the phenomena with which we have to deal: the unavoidable imperfection of man's knowledge and the consequent need for a process by which knowledge is constantly communicated and acquired. Any approach, such as that of much of mathematical economics with its simultaneous equations, which in effect starts from the assumption that people's knowledge corresponds with the objective facts of the situation, systematically leaves out what is our main task to explain. I am far from denying that in our system equilibrium analysis has a useful function to perform. But when it comes to the point where it misleads some of our leading thinkers into believing that the situation which it describes has direct relevance to the solution of practical problems, it is time that we remember that it does not deal with the social process at all and that it is no more than a useful preliminary to the study of the main problem.

## "MODEL-BUILDING" AND FISCAL POLICY

By ALBERT GAILORD HART\*

A number of recent writings on fiscal policy<sup>1</sup> draw important policy inferences directly from "models" showing hypothetical values for the main components of the national product. These "models" on examination turn out to be equilibrium positions of systems of static relationships, of much the same sort teachers of economics have been accustomed to use in the classroom—with the important difference that in classroom discussions concrete magnitudes need not come in question, whereas these fiscal-policy model-systems are aimed to give a realistic quantitative picture.

These model-systems are set up on the hypothesis that the major components of the national product are determined by the scale and character of the government's fiscal operations—in a setting, of course, of relationships among the components expressing other economic forces.<sup>2</sup> The system may be thought of as involving four classes of magnitudes:

(1) "Active variables"—government expenditures; revenues (or

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<sup>1</sup>See in particular National Planning Association, *National Budgets for Full Employment* (Washington, March, 1945); "Forecasting Postwar Demand" (papers by Morris Livingston, Arthur Smithies and Jacob Mosak, in *Econometrica*, January, 1945); the appendix (C) by Nicholas Kaldor in Sir William Beveridge, *Full Employment in a Free Society* (New York, Norton, 1945, pp. 344-401); and R. A. Musgrave, "Alternative Budget Policies for Full Employment," *Am. Econ. Rev.*, Vol. XXXV, No. 3 (June, 1945), pp. 387-99.

The present discussion is not aimed to cover the "projections" of the national product accounts through the transition period which are being worked out in various quarters. These have of course a related economic logic, differing chiefly in being tied to immediately antecedent history at one end, and in dealing with the shortest of short-run effects.

<sup>2</sup>This way of viewing the problem emphatically does not commit the model-build to the assumption that government fiscal policy is the only motive power in the economy. It merely brings a particular set of variables into the foreground for closer study.

9-6-8  
2/7/90