

THE “MISSING ELEMENT” IN MODERN ECONOMICS

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I'm honored, though I must admit also pleasantly surprised, to be invited to deliver the Lou Church Lecture in Religion and Economics at the 2015 Austrian Economics Research Conference. My first introduction to Austrian Economics came when I borrowed the well-thumbed copy of Ludwig von Mises's *Human Action* from my boss, then-Congressman Jack Kemp, for whom I worked as speechwriter and congressional staff economist before and during both presidential administrations of Ronald Reagan. While I have a high regard for what Austrian economics gets right that other economic schools do not, I consider myself a “Neo-Scholastic” economist, a term which I will try to explain.

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Today I would like to discuss the significance of what my book’s subtitle calls “The Missing Element” in modern economics. To address this central issue, I will begin with a question. I won’t ask for a show of hands, only that you think of the answer: Did you celebrate the most recent Christmas or holiday season by giving gifts?

According to a recent national survey conducted by the Pew Forum, “Nine-in-ten Americans say they celebrate Christmas, and three-quarters say they believe in the virgin birth of Jesus. But only about half see Christmas mostly as a religious holiday, while one-third view it as more of a cultural holiday. Virtually all Christians (96 percent) celebrate Christmas, and two-thirds see it as a religious holiday. In addition, fully eight-in-ten non-Christians in America also celebrate Christmas, but most view it as a cultural holiday rather than a religious occasion” (Pew Research Center, 2013).

The Pew Forum survey summary continues: “The way Americans celebrate Christmas present is rooted in Christmases past. Fully 86 percent of U.S. adults say they intend to gather with family and friends on Christmas this year, and an identical number say they plan to buy gifts for friends and family. Roughly nine-in-ten adults say these activities typically were part of their holiday celebrations when they were growing up” (Pew Research Center, 2013).

My working hypothesis is that economists in general, including those adhering to the Austrian School, are pretty much the same as other Americans, both in their attitudes and, more importantly, in their behavior. But rather than merely assuming that I am right, I have compiled an anonymous questionnaire drawn from the Pew Forum Christmas survey. It has no official relation to or sanction from the Mises Institute. But I’d be grateful if you would fill it out and return it to me.

Subject to contradiction by this mini-survey, I consider it likely that, though scholars adhering to the Austrian School may also be more inclined to view Christmas as a cultural rather than religious holiday, nevertheless—whatever their reasoning—they remain just as likely as other Americans to celebrate Christmas by giving gifts.¹

¹ The survey results, which are summarized in Appendix B, confirmed this hypothesis. The survey results show that Austrian economics scholars observe Christmas by gift-giving in even greater proportion than both the general population and than the same scholars’ memories of their own childhoods. The survey

But if so, this behavior creates an explanatory problem, because no school of modern economics, including the Austrian School, has an adequate theory of personal gifts.

How did this missing element go missing?

From the mid-nineteenth to the mid-twentieth centuries, even specialists in the history of economics viewed their subject much like Saul Steinberg's "View of the World from 9th Avenue": the famous poster which depicts Manhattan's Ninth and Tenth avenues in exquisite detail, right down to the fire hydrants, while across the Hudson River, the rest of the world consists of vast blank areas with labels like "Jersey" or "Japan." For years, any historical textbook would start with Adam Smith, while in the hazy middle distance were the eighteenth-century "Physiocrats" and "Mercantilists." Moreover, economics seemed a very cozy British affair, presented like a biblical genealogy: Adam Smith begat David Ricardo, who begat John Stuart Mill, who begat Alfred Marshall, who begat Arthur Pigou, who begat John Maynard Keynes, whom Keynesian economists consider the pinnacle of economics.

This view began to change radically in 1954, when Joseph Schumpeter's *History of Economic Analysis* was published. Schumpeter showed that it was not until 1848, when John Stuart Mill's *Principles of Political Economy* was published, that, as Schumpeter put it, Adam Smith was "invested with the insignia of 'founder'—which none of his contemporaries would have thought of bestowing on him—and... earlier economists moved into the role of 'precursors' in whom it was just wonderful to discover what nevertheless remained Smith's ideas." Schumpeter concluded: "The fact is that the *Wealth of Nations* does not contain a single analytic idea, principle or method that was entirely new in 1776" (Schumpeter, 1954, p. 184).

To their credit, Austrian School scholars stand in less need of such remedial history, thanks for example to the work of Murray Rothbard, who traced the development of Austrian economic

also suggests that in world views and practice, the Mises Institute might be called the Röpke-Mises Institute. That is, while nearly one-third are either atheist or agnostic like Mises, more than two-thirds identify themselves as Christians like Wilhelm Röpke, of which 59 percent practice their faith by weekly worship, a rate far higher than the national average.

theory back through the scholastic thinkers, particularly the late-scholastic School of Salamanca (Rothbard, 2006).

Despite this valuable contribution, it is necessary to correct Rothbard in one key aspect: when he summarizes,

In recent decades, the revisionist scholars have clearly altered our knowledge of the prehistory of the Austrian school of economics. We see emerging a long and mighty tradition of proto-Austrian Scholastic economics, founded on Aristotle, continuing through the Middle Ages and the later Italian and Spanish Scholastics, and then influencing the French and Italian economists before and up till the day of Adam Smith (Rothbard, 2006).

What is objectionable is the term “proto-Austrian Scholastic economics,” since it reads history—which runs only forwards—in the wrong direction, by choosing the Austrian School as the summit to which economics was always headed. Joseph Schumpeter similarly considered the scholastics to be “proto-Walrasians.” And I must admit that I also used to share such “Whig histories of economics.” But I had to abandon them about 15 years ago when I realized that they fail to wrap up all the “leftovers.” As Alex Chafuen documented in his excellent book *Faith and Liberty*, personal gifts and distributive justice were central to scholastic economic theory, early and late. (Chafuen, 2003, pp. 92–93, 101–103) Yet they are not taught in any neoclassical school, including the Austrian School (except by claiming them to be disguised exchanges).

To head in the right direction, we must begin with an important but widely overlooked fact: There have been three phases so far in the history of economics, and the logical and mathematical structures of scholastic, classical and today’s “neoclassical” economics differ fundamentally. Most students and even professors of economics are unaware of this fact because, starting in 1972 at the University of Chicago, George J. Stigler succeeded in the national campaign he started in 1954 to abolish the requirement that students of economics master its history before being granted a degree.² This is

² “In 1972, he [Stigler] successfully proposed that the history of thought requirement be dropped at Chicago. Most other economics departments later followed suit... At the same meeting Stigler unsuccessfully proposed that the economic history requirement also be dropped.” (Leeson, 1997, endnote 62). This paper later

why all of us, including (or especially) economists, require *a brief, remedial history of economics*.

Let's ask another simple question: What is economics *about*? It describes from one angle what we do all day. As Jesus once noted—I interpret this as an astute empirical observation, not divine revelation—since the days of Noah and Lot, we humans have been doing, and until the end of the world presumably will be doing, four kinds of things. He gave these examples: “planting and building,” “buying and selling,” “marrying and being given in marriage,” and “eating and drinking” (Luke 18: 27–28). In other words, we *produce* (that's the “planting and building”), *exchange* (that's the “buying and selling”), *give* (the “marrying and being given in marriage”), and *use* (the “eating and drinking”) our human and nonhuman goods.

That's the usual order in which we *act*: producing, exchanging, distributing, and consuming. But as Augustine first explained, in our *planning* we follow a different order: first, we choose *For Whom* we intend to provide, which we will express by the *distribution* of our goods among them; next *What* to provide to express our love for those persons; and finally *How* to provide those means—through *production* (almost always) and (usually) *exchange*.

So we might say that *economics is essentially a theory of providence*: It describes how we provide for ourselves and the other persons we love, using scarce means that have alternate uses. But economics has also concerned alternative theories of *divine* providence, two of which are contradict both reason and Christian faith.

became a chapter in Leeson (2001). In his earlier campaign for the change, Stigler rejected Aquinas' view that a scientist is defined by whether he understands his subject rather than having a degree. Stigler claimed instead that every science is continuously defined by a self-governing group calling themselves scientists. From this sociological definition, he said, it was obvious that “one need not read in the history of economics—that is, past economics—to master present economics.” Instead, “the young theorist... will assume... that all that is valid in earlier work is present—in purer and more elegant form—in the modern theory,” and that “the history of the discipline is best left to those underendowed for fully professional work at the modern level.” (Stigler, 1982). As my text indicates, the young economist who assumed that would be underendowed for fully professional work, because he wouldn't know his subject.

Scholastic economics (1250–1776) might be called “AAA”³ economics because it began in the mid-13th century when Aquinas first integrated these four elements (production, exchange, distribution and consumption), all drawn from Aristotle and Augustine, to describe personal, domestic and political economy within scholastic natural law⁴—all normatively measured by the Two Great Commandments: “You shall love God with all your heart” and “You shall love your neighbor as yourself.”⁵ The scholastic economic system is comprehensive, logically complete, can be stated mathematically, and suitably updated, is empirically verifiable.

The scholastic outline was taught at the highest university level for more than five centuries by Catholics and (after the Reformation) Protestants alike. Adam Smith himself was taught by his teacher, Francis Hutcheson,⁶ from Samuel Pufendorf’s (1991 [1673]) compendium *On the Duty of Man and Citizen According to Natural Law*—which, as with Aquinas and the earlier scholastics, contains all four basic elements of economic theory, organized at the levels of personal, domestic and political economy,⁷ and integrates normative with descriptive or “positive” theory by

³ Named for the originators and integrator of its four elements: Aristotle, Augustine and Aquinas.

⁴ Augustine’s theory of personal distribution: Augustine (397) I, 28 (see also Augustine [1953 (389)], cited below); Aristotle’s social distribution (distributive justice): Aristotle (1954 [350 BC]); Augustine’s theory of utility (consumption): Augustine, (1984 [413–426], XI, 16); Aristotle’s theory of production of people and property: Aristotle, (1962 [350 BC], I, 4); Aristotle’s justice in exchange (equilibrium): Aristotle, (1954 [350 BC], V, 5). In Aquinas, three of these four elements (the distribution function, the utility function, and the equilibrium conditions) are described (and the production function implied) in Thomas Aquinas (1993 [1271–1272a]). Personal distribution: Book V Lectures IV–IX, 293–318; social distribution: 294; the “equilibrium conditions”: 294–296 and 297–299, the “utility function” and analysis of money, 312–315. The production function is described in his commentary on Aristotle’s *Politics* (1962 [350 BC]), I, 2: Aquinas (2007 [1271–1272b]), pp. 19–24. The same analysis is also scattered throughout his *Summa theologiae* (Aquinas 1981 [1265–1272]), especially in his commentary on the seventh commandment.

⁵ Deuteronomy 6:5 and Leviticus 19:18; cf. Matthew 22:37–39 and Mark 12:29–31.

⁶ Ross (1995), pp. 53–54.

⁷ Personal distribution, 64–67; social and political distribution, 32 and 61–63; utility, 94–96; production of and by human and nonhuman factors, 84–89; society organized around family household, 120–131; justice in exchange or equilibrium equating product values and factor compensation, 31 and 94–95.

the Two Great Commandments.⁸ The fact that Pufendorf was a Lutheran who wrote a critical history of the Catholic Church and that his theories were taught at the generally Calvinist University of Glasgow, demonstrates that the scholastic outline of economic theory was broadly known and accepted by both Catholics and Protestants. Pufendorf was also widely read in the American colonies and recommended for example by Alexander Hamilton,⁹ who penned two-thirds of the *Federalist* papers (and who as first Treasury Secretary under George Washington would reject Smith's specific economic advice to the United States in the *Wealth of Nations*).¹⁰

Classical economics (1776–1871) began when Adam Smith drastically simplified the theory by cutting the four scholastic elements to two, trying to explain specialized production (which he poetically but inaccurately called “division of labor”) with the elements of production and exchange alone. Smith and his classical followers like David Ricardo undoubtedly advanced those two elements. But Smith also dropped Augustine's theory of utility (which is necessary to describe consumption) and replaced Augustine's theory of personal distribution (gifts and their opposite, crimes) as well as Aristotle's theory of domestic and political distributive justice with the mere (often false) assumption that “every individual...intends only his own gain,” as Smith put it in his famous “invisible hand” passage in the *Wealth of Nations*.¹¹ (In his earlier *Theory of Moral Sentiments*, Smith had already banished

⁸ *Ibid.*, 11–12.

⁹ Hamilton (1904 [1775]).

¹⁰ Smith (1904 [1776]), Hamilton (1904 [1791]).

¹¹ Smith (1904 [1776], Bk. IV Ch. 2; Vol. 2, p. 35). Though Smith discusses both benevolence and beneficence in *The Theory of Moral Sentiments* (TMS), in contrast to Augustine, he fails to distinguish them consistently and is concerned to show that benevolence is only a motivating feeling, not an act of the rational will. Without benevolence or beneficence, Smith argues, society “though less happy and agreeable, will not be dissolved,” because “it may still be upheld by a mercenary exchange of good offices according to an agreed valuation.” (Smith [1982 (1759), II.ii.iii.2]). A highly significant fragment from Smith's university lectures predating the *Theory of Moral Sentiments* also survives to reveal his early and consistent reduction of all justice to justice in exchange alone, omitting distributive justice. The fragment is discussed by Raphael and Macfie in appendix II of TMS (382–401) but is summarized succinctly by Ross:

benevolence and beneficence from rational economic theory to emotional psychology.) This is how classical economics began with only two elements.

Today’s *neoclassical economics* (1871–c. 2000) began in the 1870s when three economists dissatisfied with the failure of classical predictions (W.S. Jevons in England, Carl Menger in Austria, and Leon Walras in Switzerland) independently but almost simultaneously reinvented Augustine’s theory of utility, starting its reintegration with the theories of production and exchange. They abandoned Smith’s revised outline mostly for three related reasons: without the theory of utility classical economists were unable to answer some important questions; they made predictions about others that turned out to be spectacularly wrong; and Smith’s so-called “labor theory of value” directly fostered Karl Marx’s disastrously erroneous economic analysis. Though schools of neoclassical economics have since multiplied, all are derived from these three.

Personal gifts and distributive justice were central to scholastic economic theory, both early and late (Chafuen, 2003, pp. 92–93, 101–103). Yet they are not taught in any neoclassical school (except by claiming them to be disguised consumption, production, or exchanges).

In my book (Mueller 2014 [2010]), I note that *Neoscholastic economics* (c. 2000–?) is starting and predict that it will continue to revolutionize economics once again in coming decades by replacing its lost cornerstone, the theory of distribution: simply because, as with the theory of utility, including the essential element does a far better job of empirical description.

The lecture fragment indicates [erroneously] that “doing good according to the most perfect propriety” is known “in the Schools,” i.e., in the medieval Scholastic tradition thought of as descending from Aristotle, as “distributive justice.” *TMS* at VII.ii.I.10 shows how Smith had qualified this bald view. He added a footnote, citing the *Nicomachean Ethics* (5.2), to make clear that the “distributive justice of Aristotle is somewhat different... [consisting] of the distribution of rewards from the public stock of the community.” In the fragment, Smith expresses the view that commutative justice can “alone properly be called Justice,” by which he means the negative form of not harming a neighbour in person, estate, or reputation; and he holds this position throughout his career. (Ross, 1995, p. 119).

To go a bit deeper, let me explain the structure of scholastic economics in more detail.

Positive scholastic theory. To explain the Two Great Commandments,¹² Augustine had started from Aristotle's definition of love—*willing some good to some person*¹³—but he drew an implication that Aristotle had not: every *person* always acts for the sake of some *person(s)*. For example, when I say, "I love vanilla ice cream," I *really* mean that I *love myself* and *use* (consume) vanilla ice cream to express that love (and in preference, say, to strawberry ice cream or Brussels sprouts, which reflects my separate scale of preference according to utility).

Augustine also introduced the important distinction between "private" goods like bread, which inherently only one person at a time can consume, and "public" goods (like a performance in an ancient amphitheater, a modern radio or television broadcast, national defense, enforcement of justice—or even this lecture) which, at least within certain limits, many people can simultaneously enjoy because they are not "diminished by being shared."¹⁴ That is if the acoustics and technology are good enough, the fact that the people in the front row can hear what I am saying now does not diminish the ability of those in the back row also to do so.

In other words, Augustine's crucial insight is that we humans always act on not just one but two scales of value or preference—one for persons as ends and the other for other things as means: the scales of personal love and utility, respectively. Moreover, we express our inner preferences for persons with two kinds of external acts. Since man is a social creature, Augustine noted, "human society is knit together by transactions of giving and

¹² "You shall love... God with all your heart..." (Deut. 6:5) and "love your neighbor as yourself" (Lev. 19:18).

¹³ Aristotle (1932 [335–322 BC], pp. 2, 4, 102–103).

¹⁴ Augustine (1953 [389]; pp. 102–217; viii, 19, 146). Private goods are now sometimes called "rival" goods. The formulation "diminished by being shared" is from Augustine (397).

receiving.”¹⁵ But these outwardly similar transactions may be of two essentially different kinds, he added: “sale or gift.”¹⁶

Generally speaking, we *give* our wealth without compensation to people we particularly love,¹⁷ and *sell* it to people we don’t, in order to provide for those we do love.¹⁸ For example, if Joe Salerno on behalf of the Lou Church Foundation and the Mises Institute pays me an honorarium to present this lecture, it’s because our ends disagree—much as I esteem Joe, we each want to provide for ourselves and our *own* families, not each other’s—while the means of our exchange overlap.

Since it’s always possible to avoid depriving others of their own goods, this is the bare minimum of love expressed as *benevolence* or goodwill and the measure of what Aristotle called *justice in exchange*.¹⁹ But our positive self-love is expressed by the *utility* of the goods we provide ourselves (like my vanilla ice cream), and our positive love of others with *beneficence*: “doing good,” or gifts.

Conversely, hate or *malevolence* (ill will) is expressed by the opposite of a gift: *maleficence* (doing evil) or crime.

The image on the cover of my book is Gustave Doré’s engraving, “Arrival of the Good Samaritan at the Inn,” because transcending nationality and religion, the parable illustrates all the possible economic transactions we can have with our fellow man, as described by Augustine: the robbers beating a man and leaving him for dead illustrate crime; the priest and Levite who passed him by illustrate indifference; the innkeeper’s bargain with the Samaritan illustrates justice in exchange; and finally, the Samaritan’s devotion of time and money to restore the beaten man to life illustrates a gift. Crime, indifference, just exchange, and gift: this is the range of possible transactions.

¹⁵ Augustine (1953 [397], p. 398).

¹⁶ Augustine (1953 [389], p. 132).

¹⁷ To be more precise, love with both benevolence and beneficence.

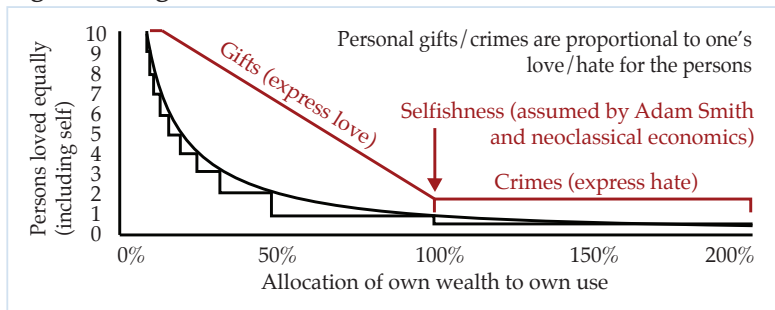
¹⁸ Or rather, love only with benevolence but not beneficence.

¹⁹ Aristotle (1954 [c. 350 BC], V, v; 117–122).

The social analog to personal gifts is what Aristotle called *distributive justice*,²⁰ which amounts to a collective gift: it's the formula social communities like a family or political community under a single government necessarily use to distribute their common (jointly owned) goods. Both a personal gift and distributive justice are a kind of "transfer payment"; both are determined by the geometric proportion that matches distributive shares with the relative significance of persons sharing in the distribution; and both are practically limited by the fact of scarcity.

These possible transactions are traced in the curve I have labeled Augustine's "personal distribution function" (Figure 1), which traces the relation between persons and things. This is "the missing element." The horizontal scale represents shares of our wealth, and the vertical scale represents the number of people among whom we share it. (For purposes of illustration I assume that we love others equally with ourselves, but in fact we can and do love them unequally.)

Figure 1. Augustine's "Personal Distribution Function"



Before my wife and I married, our individual behavior probably approximated the point that modern economics assumes for everyone, at which a person consumes all the goods purchasable with that income. After I got married, before our children were born and while they were young, I earned nearly all our family's income, and assuming we shared equally, it meant I was loving

²⁰ Aristotle (1954 [c. 350 BC], V, iii; 112–114).

two people equally with myself in economic terms. But then we had three children, and so our income had to be divided first three, then four, and then five ways. The more people among whom we share our scarce resources, the less we can use ourselves.

In the extreme, it is literally the case that no one has greater love than to lay down his life for his friends. True, it is something that can be done only once. Yet it is done almost every day, for example, in Iraq or Afghanistan when a soldier hurls himself or herself on an explosive device to save the lives of colleagues.

Now that our kids are grown and I retired from economic and financial forecasting, my wife’s and my incomes are more equal again. But at every stage, no matter where the income came from, my wife and I faced the same choice: how much money we would devote to each person’s needs—the kids’ play clothes, replacing my suit or my wife’s dress, or paying for tuition. This figuring out of the family budget is what Aristotle meant by “domestic distributive justice,” which amounts to a kind of joint gift. Likewise, what Congress is arguing about in setting the federal budget is a similar exercise in “political distributive justice.” In all cases, the question is, from whom does the money come, and to whom does it go?

By good fortune, a bright young Ph.D. candidate named Michael Szpindor Watson is presenting a paper tomorrow at a session on the history of economics, titled, “Mueller and Mises: Integrating the Gift and ‘Final Distribution’ within Praxeology” (Watson, 2015). I met Michael a couple of years ago in Krakow, when he participated in The Tertio Millennio Seminar, a two-week summer institute founded by George Weigel, the late Fr. Richard Neuhaus, Michael Novak, and Fr. Maciej Zieba, which each year produces some three dozen graduate-school-age participants from North America, Poland, and Eastern Europe (some 800 so far) in Catholic social doctrine. For the past several years I have been one of the faculty lecturers, having succeeded Michael Novak.

When I met Michael Watson, because of his interest in the Austrian School, I challenged him to show me where there is within it any theory of distribution properly so-called (personal gifts and their opposite, crimes, as well as the theory of what Aristotle called distributive justice).

Without prejudging Michael's attempt to show how a theory of gifts might be constructed within praxeology, his combing of Austrian School theory seems to confirm that I have identified a real gap in its economic theory. He summarizes, "I concede that Austrian literature neglects the gift and distributive economy, but [argue] that Ludwig von Mises gave us the concepts required to develop a theory of the gift: autistic exchange—from which I develop a theory of the gift" (Watson, 2015).

Perhaps an additional word of explanation is required about another apparent gap in Austrian economic theory. Earlier I showed a simplified version of the differences among different schools of economics, with a "yes" or "no" for each of the four basic elements. But a more nuanced classification indicates that Mises is widely interpreted as having dispensed with the theory of "equilibrium." The basic idea is that equilibrium implies an equality of values exchanged, when in fact each party engages in exchange because he believes he will gain by exchanging what he values less for what he values more. Thus exchange would seem to involve not an equality but an inequality.

I think that Philip Wicksteed adequately clarified this problem by carefully analyzing the dynamic nature of exchange. As Wicksteed noted, the demand for any exchangeable economic good comprises not only the potential consumers but also producers of that good. The purchase of milk for money, for example, while decreasing the marginal significance of milk to the buyer (by increasing his quantity), is at the same time increasing the marginal significance of milk to the seller (by reducing his quantity).

But what about someone who both produces and consumes a commodity? For example, let's suppose that that a family operates a dairy farm and also likes to drink milk. To earn its living, the family sets out deliberately to produce far more milk than it could possibly consume, on the expectation that it will be able to sell the surplus to others for whom milk stands higher in their scale of preferences than it does on the scale of the producing family.

Thus, both the quantity of the milk the dairy-farm family sells, and the quantity that it keeps for its own use, are a single continuous function of the marginal significance of milk to the family, relative to the market price.

It is part of the definition of a “perfect” or “competitive” market that no single consumer or producer can significantly affect the price of a commodity. But in fact every individual purchaser or seller in a competitive market *does* affect the market price, if only imperceptibly. This is why all consumers together, and all producers together, can affect the price noticeably. The process by which all the parties adjust their holdings of certain goods, through exchange, in light of prevailing market prices is what makes the market as a whole tend toward “equilibrium”—a state in which everyone in the community who owns any of the desired and exchangeable goods comes to share exactly the same relative preferences. If that point were ever actually achieved, exchange would cease, because no one could further improve his position by exchanging goods that he values less at the prevailing market price for goods that he values more. But because most human needs are dynamic (however sated we become by eating and drinking, everyone gets hungry and thirsty again sooner or later), most markets never reach that point, but rather are always tending toward it.

Let me switch my hats for a moment, to ask, “What caused the Great Recession?” I retired in January after 26 years of crunching the numbers for an economic and financial market forecasting firm, LBMC LLC.²¹ Basically, after failing to persuade U.S. policymakers to reform monetary and fiscal policy, four of us started a business to predict the market consequences of those mistakes.

So what caused the Great Recession? The world-wide real-estate and commodity boom and bust was caused by the dollar’s role as the world’s chief official reserve currency. The great French economist Jacques Rueff (1896–1978) was the first economist to describe the drawbacks of John Maynard Keynes’s plan to use one nation’s domestic currency, like the U.S. dollar, as an international reserve asset.²² Predicting episodes of commodity-price inflation using the World Dollar Base (the sum of U.S. domestic and foreign

²¹ Mueller (2015).

²² Rueff (1964 [1932], pp. 30–61).

official monetary liabilities) based on Rueff's economic theory has been my bread and butter until I retired from forecasting.²³ But I've noted similar peculiarities when monetary authorities issuing currencies not typically used as official reserve currencies borrow from other central banks—for example, the implosion of the European monetary system in 1992, the collapse of the Mexican peso in 1996 and hyperinflations in Israel several times since the Second World War.

The same was true also of Argentina's 2001 peso crisis, which scarred a generation of Argentines, including then-Cardinal Jorge Bergoglio—now Pope Francis. Argentina erred by trying to peg its peso to the U.S. dollar, not by *acquiring* but rather *borrowing* official dollar reserves—using the proceeds to finance domestic lending, chiefly to the government.

Therefore, I repeat here a proposal which Lewis Lehrman and I have made for the last few decades: All countries seeking to end the boom-bust cycle should join in supporting a reform of the international monetary system, which would repay all outstanding dollar and other official reserve currencies and restore prompt settlement of payments in gold: a system that worked well for hundreds of years and can do so again.

In other words, both the Great Recession of 2007–2009 and the Argentine peso collapse of 2001 were caused by the same kind of bad economic policy (which means by bad economic policymakers). And such monetary crises will continue until policymakers end the official reserve currency system, which Rueff aptly called the “monetary sin of the West.”²⁴

Scholastic economics and Catholic Social Thought. This brings us to my final set of considerations. I'd like to discuss Pope Francis's economic ideas. But to do so we need first to understand the relation between scholastic economics and Catholic social thought. In considering this question, I think it's helpful to distinguish the history of economics—the economic theory used by economic thinkers to describe any economic activity—from economic

²³ Mueller (2015)

²⁴ Rueff (1972).

history—how the economic aspect of society develops: for example, the progressive transition of the United States since its founding, and in fact most countries, from agriculture to industry to services.

Roughly speaking, scholastic economic theory is the analytical toolkit that the popes have used in Catholic social doctrine to discuss the new pastoral challenges of economic history as it unfolds.

Catholic social thought is relatively recent. It may seem that encyclicals on economics are abstract, but in fact they are always tied to an analysis of some concrete historical event. The first encyclical of the Church’s modern social thought, in 1891, was called *Rerum Novarum*—literally, “of new things—in which Pope Leo XIII (1810–1903) dealt with the new social and political challenges raised by industrialization. While affirming the right of private property, and predicting the failure of communism, he insisted on the dignity and rights of workers and the need to protect the weakest, by government intervention if necessary. Several subsequent encyclicals further developed and applied this analysis as conditions changed.

In the 1960s, after the decolonization of much of Africa, Asia and Central and South America following the Second World War, the horizons of the Church’s social thought widened to embrace the emerging so-called “Third World.” Moved by the poverty he witnessed on his travels, Pope Paul VI argued in *Populorum Progressio* (“The Development of Peoples”) that “the social question has become worldwide.”

Pope John Paul II published three major encyclicals on economic matters. *Laborem Exercens*, his encyclical on the dignity and vocation of work, and two others that began by looking back at an earlier papal encyclical. *Sollicitudo Rei Socialis* (“The Church’s Social Concern”) was published on the 20th anniversary of *Populorum Progressio*, and was intended to fill “the need for a fuller and more nuanced concept of development” than had previously been put forward. In it, he argued that the terms “poverty” and “development” mean poverty or development of the whole person, not just the economic or political system.

Centesimus Annus, as the title indicates, was issued on the 100th anniversary of *Rerum Novarum*. In it, John Paul II looked back at what remains valid in the social thought begun in that encyclical,

but also took note of the “new things” which had emerged, such as changes in the nature of Western economies and the collapse of communism. Its particular merit is to bring both strains of the Church’s social thought into a single unified framework.

Similarly, Benedict XVI’s (2009) encyclical *Caritas in Veritate* (“Charity in Truth”) was originally intended for 2007, the fortieth anniversary of Paul VI’s 1967 encyclical *Populorum Progressio*. It was notable for emphasizing the “gratuitousness”—the gift-ness, if you will—of Creation and even in the economy. But *Deus Caritas Est*, which was drafted under John Paul II and published by Benedict XVI, is quite valuable for its concise description of the relation among the natural law, Catholic social doctrine, the roles of the Church and secular politics.²⁵

In light of the history of economics I have recounted, I have suggested two simple changes regarding the teaching of economics: First, that every university economics department restore the previous requirement that to get a degree in economics you have to master its history. No matter how badly the history of economics was taught, no competent textbook now begins any

²⁵ From *Deus Caritas Est*:

Thus far, two essential facts have emerged from our reflections:

a) The Church’s deepest nature is expressed in her three-fold responsibility: of proclaiming the word of God (*kerygma-martyria*), celebrating the sacraments (*leitourgia*), and exercising the ministry of charity (*diakonia*). These duties presuppose each other and are inseparable. For the Church, charity is not a kind of welfare activity which could equally well be left to others, but is a part of her nature, an indispensable expression of her very being.

b) The Church is God’s family in the world. In this family no one ought to go without the necessities of life. Yet at the same time *caritas-agape* extends beyond the frontiers of the Church. The parable of the Good Samaritan remains as a standard which imposes universal love towards the needy whom we encounter “by chance” (cf. Lk 10:31), whoever they may be. Without in any way detracting from this commandment of universal love, the Church also has a specific responsibility: within the ecclesial family no member should suffer through being in need. The teaching of the Letter to the Galatians is emphatic: “So then, as we have opportunity, let us do good to all, and especially to those who are of the household of faith” (6:10) (Ratzinger, 2005, at 25).

later than Aristotle or excludes the scholastics. Separately, I have suggested to American Catholic bishops and educators that every Catholic educational institution, at every level, refamiliarize itself with scholastic economics. The teaching of economics is in a sorry state among Catholic colleges because most simply copied the deliberate amnesia of secular institutions.

I predict that the first change would go a long way toward curing what’s wrong with secular economics today. And that the second would make Catholic economists competitive and remove Catholic social doctrine from the sidelines and place it at the center of the national and international debate.

Pope Francis and economics. Though it seems to be a minefield, I don’t see how I can avoid commenting on Pope Francis’ views on economics. Last year, Judge Napolitano, a fellow Catholic, delivered this lecture, and he opened by remarking that in confession he had just received a penance of five rosaries; which, since each rosary comprises more than 100 separate prayers, is unusually severe. The judge explained that his offense was wishing that Pope Francis be delivered speedily to heaven.

Pope Francis has not yet issued a social encyclical, though he has addressed economic subjects, especially in his Apostolic Exhortation *Evangelii Gaudium*, in which he argued that “Inequality is the root of social ills (202).” Pope Francis is first of all a pastor, and a good one. But as my colleague George Weigel has noted, his pontificate resembles a “gigantic Rorschach test, in which various commentators inside and outside the Catholic Church have ‘seen’ their dreams and fears realized” (Weigel, 2013). I consider it possible that Pope Francis will never publish a social encyclical. The main reason begins not with Jorge Bergoglio as pope or priest, but rather with Jorge Bergoglio the man.

The national Catholic newspaper *Our Sunday Visitor* noted recently that “He is, and always will be, simply himself. The truth is that Pope Francis is simply 78-year-old Jorge Bergoglio. As he said in an interview with the Argentine newspaper *La Nacion* in December, upon his election he told himself, ‘Jorge, don’t change, because to change at your age would be to make a fool of yourself.’”²⁶

²⁶ (Our Sunday Visitor, 2015, p. 19).

There seems to be little disagreement about Jorge Bergoglio's Myers-Briggs personality type.²⁷ Pope Francis is an ESFJ: an extrovert ("I cannot live without people. I need to live my life with others"²⁸) who with a prodigious memory masters the details about people, a feeler rather than a thinker, who is also decisive.

Although all Jesuits aspire to be "contemplatives in action," in Biblical terms, rather than a contemplative like Mary of Bethany, Pope Francis is like Mary's sister Martha: something of a bossy-boots or control freak. Martha memorably tried to apply guilt and shame to Jesus himself. According to the evangelist Luke, "Martha was distracted with much serving; and she went to him and said, 'Lord, do you not *care* that my sister has left me to serve alone? Tell her then to help me.'" (Luke 10:40 RSV)

"'The irony,' says a well-placed Jesuit at the Vatican [quoted by Austen Ivereigh in his biography *The Great Reformer*], 'is that this pope, great agent of decentralization in the church, is personally the most centralized pope since Pius the Ninth [1792–1878]. Everything has to cross his desk.'"

Pope Francis is not unreflective of his personality's tendencies, particularly acting without adequate deliberation and without adequate consultation. As he told one interviewer, "the first thing that comes to my mind if I have to make a decision... is usually the wrong thing. I have to wait and assess, looking deep into myself, taking the necessary time." He similarly remarked that while head of the Argentine Jesuits, "I did not always do the necessary consultation.... My authoritarian and quick manner of making decisions led me to have serious problems."²⁹

Pope Francis has called his hyperactivity in trying to micro-manage every situation "playing Tarzan.... saying to myself, 'Look... how many things I can do'" (Ambrogetti and Rubin, 2010, p. 71).

However, fideism and introspection are insufficient basis for reflection on either economics or Catholic social doctrine.

²⁷ Briggs Myers (1980), Quenk (2009).

²⁸ Spadaro (2013).

²⁹ *Ibid.*

As Benedict XVI noted in *Deus Caritas Est*, “Faith by its specific nature is an encounter with the living God—an encounter opening up new horizons extending beyond the sphere of reason. But it is also a purifying force for reason itself.” Moreover, “The Church’s social teaching argues on the basis of reason and natural law, namely, on the basis of what is in accord with the nature of every human being.”³⁰

Pope Benedict’s immediate predecessor, John Paul II, memorably noted that “Faith and reason are like two wings on which the human spirit rises to the contemplation of truth; and God has placed in the human heart a desire to know the truth—in a word, to know himself—so that, by knowing and loving God, men and women may also come to the fullness of truth about themselves” (Wojtyła, 1998).

Pope Francis presents himself as an outspoken anti-rationalist; he distrusts reason: “The worst that can happen to a human being,’ he said, ‘is to allow oneself to be swept along by the ‘lights’ of reason” (Bergoglio, 2013a, p. 28). Yet equating reason with rationalism is like equating science with scientism. As a result, while he is strong on moral theology (that is, revealed theology), Pope Francis is much weaker on natural-law moral philosophy. And to follow John Paul II’s metaphor, it is simply not possible to fly with only one wing, except perhaps in circles.

“Economically ignorant moralism is as objectionable as morally callous economism,” as the German economist Wilhelm Röpke observed. (Röpke was the first economist kicked out of Germany when the Nazis took power.) “Ethics and economics are two equally difficult subjects, and while the former needs discerning and expert reason, the latter cannot do without humane values” (Röpke, 1960, p. 104). Pope Francis’ excoriation of morally callous economism, though often justified, has occasionally fallen into economically ignorant moralism.

Yet his main point is still a good one: “The church’s ministers must be merciful, take responsibility for the people and accompany

³⁰ Ratzinger (2005). Pope Benedict added, “It recognizes that it is not the Church’s responsibility to make this teaching prevail in political life. Rather, the Church wishes to help form consciences in political life and to stimulate greater insight into the authentic requirements of justice as well as greater readiness to act accordingly, even when this might involve conflict with situations of personal interest.”

them like the good Samaritan, who washes, cleans and raises up his neighbor. This is pure Gospel" (Spadaro, 2013, p. 31).

One must make allowances for the fact that Pope Francis is not an economist. He said in *Evangelii Gaudium* that "Business is a vocation, and a noble vocation, provided that those engaged in it see themselves challenged by a greater meaning in life; this will enable them truly to serve the common good by striving to increase the goods of this world and to make them more accessible to all" (Bergoglio, 2013b, p. 203).

I think that Madeline Del Brel expressed Pope Francis' concern when she wrote decades earlier, "It is possible to be an excellent theologian and still live God's love very poorly; we can know quite well what the church is while still being only an anemic cell within her" (Del Brel, 2000). Pope Francis recognizes that his chief task is not to analyze the church, but lead it.

Finally, an observation of per capita income by country and region strikingly illustrates the stark difference in living standards between the United States or the European Union and those whom Pope Francis calls the "marginalized." Though it must also be noted that this marginalization results partly from failure of the "periphery" to observe certain basic principles, like civilian control of the military, due process, and the rule of law (at which Argentina itself has failed for decades).

I'm afraid I have covered a lot of ground. I hope, first, to have explained the significance of the fact that the "missing element" is missing from all schools of modern neoclassical economics including the Austrian School. Second, wearing my forecaster's hat, I have also suggested the monetary flaw that caused the worldwide Great Recession of 2007–2009 as well as the 2001 Argentine peso crisis. Third, I hope also to have shed some light on the mutual incomprehension of Pope Francis and economists of nearly all schools: On one hand, the "missing element" is necessary to explain our interpersonal relations of love and hate, which are expressed by individual or collective gifts (or their opposite, crimes). On the other hand, this missing element is also necessary to understand and explain Catholic social doctrine, of which scholastic economics is the analytical toolkit. Finally, I hope that my explication of the parable of the Good Samaritan may shed light on the practical implications of what Pope Francis has called a "Samaritan church."

APPENDIX A

This statement of the neoscholastic model is adapted from Mueller, *Redeeming Economics*, 422–425n, where it is applied initially to the example of a children's lemonade stand, taking their parents into account, then generalized into accounts for each person, marriage, family, business firm, nonprofit foundation and government.

Equations beginning with "1" denote the "two-factor, one-good" model, and those beginning with "2" denote the "two-factor, two-good" model. We can typically use the first for the discussion of employment, but the second is necessary for the discussion of fertility. All the actions described are understood to have the dimension of time; for example, consumption, C , should be understood as $\delta C / \delta t$, or additional consumption *per unit of time*—the notation for which is usually omitted in this presentation for simplicity.

$$(1.1) C_{Qi} = Y_i D_{ii} / \Sigma D_{ij} \text{ [personal final distribution function],}$$

where C_{Qi} represents the use ("consumption") by Person i of the good Q ; Y_i is total compensation of Person i ; D_{ii} is the significance of i to himself; ΣD_{ij} is the significance to i of all persons.

$$(2.1) C_{Ki} + C_{Li} = Y_i D_{ii} / \Sigma D_{ij} \text{ [final distribution function],}$$

where C_{Ki} and C_{Li} represent the use ("consumption") by Person i of the services of "human capital," L , and "nonhuman capital," K ; Y_i is total compensation of Person i ; D_{ii} is the significance of Person i to himself; and ΣD_{ij} is the significance to Person i of all persons.

For clarity and simplicity, we will define:

$$(1.5) \text{ and } (2.5) Y_i = rK_i + wL_i,$$

meaning that Y_i is the total factor compensation of Person i ; and

$$(1.6) \text{ and } (2.6) T_i = (1 - Y_i) D_{ii} / \Sigma D_{ij}.$$

By substituting (1.6) and (2.6), (1.1) and (2.1) may be restated as

$$(1.1a) C_{Qi} = Y_i - T_i \text{ and}$$

$$(2.1a) C_{Ki} + C_{Li} = Y_i - T_i$$

making clear that the difference between Person i 's total consumption, C_{Qi} or $C_{Ki} + C_{Li}$, and total compensation, Y_i , is equal to T_i —(net) personal, domestic, and political "transfer payments" from Person i to other persons.

By “net,” I mean that personal gifts made are offset by gifts received, while taxes are treated as political transfers paid and balanced against political transfers received. Equations (1.1) and (2.1) are the simplest and most general forms of the final distribution function for an individual person. The refinements necessary to specifically describe gifts within marriage, from parents to children and vice versa, as well as accounting for taxes and government benefits, are considered below.

Marital and domestic distributive justice: In the *Nicomachean Ethics*, 214, Aristotle notes that a household, say, J_1 , is created by the marriage of a man, M_1 , and a woman, F_1 , and that its wealth, W_{J_1} , is initially acquired by their “throwing their peculiar gifts into the common stock” of household wealth: $W_{J_1} = K_{M_1} + K_{F_1} + L_{M_1} + L_{F_1}$. This means that each spouse, M_1 and F_1 , starts marriage with an initial personal gift or transfer, $T_{M_1:J_1}$ and $T_{F_1:J_1}$, to the new joint family partnership, J_1 , consisting of all his or her human and nonhuman wealth:

$$(1.6a) T_{M_1:J_1} = K_{M_1} + L_{M_1}$$

$$(1.6b) T_{F_1:J_1} = K_{F_1} + L_{F_1}$$

For the marriage partnership to continue and flourish, the initial gifts must be followed by a series of gifts by which any new income realized separately by each spouse (particularly from “human capital,” since it is not alienable) is put into the “common stock”:

$$(1.6c) T_{M_1:J_1} = Y_{M_1} \text{ and}$$

$$(1.6d) T_{F_1:J_1} = Y_{F_1}$$

according to a new joint family distribution function, D_{J_1} . For example, the woman’s share in the use of total current family income becomes:

$$(1.1b) C_{QF_1} = Y_{J_1} D_{J_1:F_1} / \Sigma D_{J_1:i} \text{ and}$$

$$(2.1b) C_{KF_1} + C_{LF_1} = Y_{J_1} D_{J_1:F_1} / \Sigma D_{J_1:i}$$

A similar formula applies to every other family member—and, in fact, to everyone else in the world, for most of whom the distributive share in the family’s resources is zero.

For example,

$$(1.6e) \text{ and } (2.6e) T_{J_1:M_2} = (1 - Y_{J_1}) D_{J_1:M_2} / \Sigma D_{J_1:i}$$

which means that the gift or transfer from the parents, $J_{1'}$, to dependent son, $M_{2'}$, is determined by his relative significance, $D_{J_{1':M_2}} / \Sigma D_{J_{1':P}}$ out of his parents' total distributed income, Y_{J_1} .

Political distributive justice. Apart from debt service, government outlays are devoted to current consumption of goods and services, investment, and transfer payments, while government cash flow includes tax receipts (which consist, in the United States, chiefly of the personal and corporate income taxes and the payroll tax), borrowing, and creation of fiat money:

(1.7) and (2.7) $C_G + \Delta K_G + T_L + T_K = \tau(w\Sigma L + r\Sigma K) + pw\Sigma L + kr\Sigma K + \Delta B_G + \Sigma K_{GMI}$ [government budget], where C_G is current consumption (including capital consumption) of government goods and services, T_L is government transfer payments to persons, T_K is government subsidies to property owners, τ is the income tax rate (assumed to be equal for labor and property income), p is the payroll tax rate, k is the tax rate levied only on property income, B_G is government debt, and ΣK_{GMI} is the issue of government fiat money. In the section on political economy, I show that to maximize both fairness and economic efficiency, the sources and uses of government funds should be paired and restricted in this way: government should not be funded by fiat money creation; general consumption of government-provided goods and services should be funded by an income tax falling equally on labor and property income; transfer payments to persons funded by payroll taxes and subsidies to property owners by taxes on property income; all of which further implies that government borrowing should be confined to funding investment in government-owned assets. That is, $\Sigma \Delta K_{GMI} = 0$; $\Sigma C_{Gi} = \tau(w\Sigma L_i + r\Sigma K_i)$; $\Sigma T_{Li} = pw\Sigma L_i$; and $\Sigma T_{Ki} = kr\Sigma K_i$; implying $\Delta B_{Gi} \leq \Delta K_G$.

APPENDIX B

The Röpke-Mises Institute?

2015 Austrian Research Conference Christmas Survey

Survey:	Mueller	Pew Forum
Date:	3/12/2015	12/3-8/2013
	N=60	N=2001

These questions were drawn from a recent national Pew Forum survey. They are intended for comparison with the results of that survey. This survey is for private research by John D. Mueller, as explained in his Lou Church Memorial lecture, not the Mises Institute.

1. Did you celebrate this past Christmas or not?

97%	92%
-----	-----

2. Did you either buy* or make Christmas presents to give?

93%	86%*
-----	------

(Pew Forum survey asked separate questions about buying and making gifts)

3. For you personally, is Christmas more a cultural or religious holiday?

Cultural	37%	32%
Religious	40%	51%
Both equally	23%	9%

4. Did you attend religious services on Christmas Eve or Day?

40%	54%
-----	-----

5. Did you attend religious services the previous week?

42%	na
-----	----

6. Do you believe in the virgin birth?

53%	73%
-----	-----

Now, thinking about your childhood, usually:

7. Did you buy* or make Christmas presents to give?

90%	89%*
-----	------

8. Did you attend religious services Christmas Eve or Day?
70% 69%

9. Whether or not you celebrated this past Christmas, in the past year, did you make or buy birthday presents to give?
72% na

Demography

10. What is your age?

18-29	17%	14%
30-49	34%	26%
50-64	29%	30%
65+	19%	27%

11. Are you male?

88% 48%

11. Are you female?

12% 52%

12. Are you white?

98% 74%

12. Are you black?

2% 10%

12. Are you Hispanic?

0% 10%

13. What is your religion?

100% 100%

Christian

68% 53%

Protestant

37% 23%

Evangelical

17% 17%

Mainline

13% 7%

Other

7% 17%

Catholic

22% 21%

Orthodox

7% 1%

Messianic

3% na

Jewish

0% 1%

Muslim	0%	1%
Atheist/agnostic	32%	5%
Atheist	20%	2%
Agnostic - not sure	12%	3%
Other/unaffiliated (*Volunteered answers listed above)		
	0%*	17%

(Results may not add up to 100%, because some respondents did not answer all questions.)

Pew Forum Survey: Pew Research Center (2013).

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