BOOK REVIEW

ECONOMICS IN TWO LESSONS: WHY MARKETS WORK SO WELL, AND WHY THEY CAN FAIL SO BADLY

JOHN QUIGGIN

PRINCETON: PRINCETON UNIVERSITY PRESS, 2019, XII + 390 PP.

DAVID GORDON*

The Australian economist John Quiggin is dissatisfied with Henry Hazlitt's great book *Economics in One Lesson* and in his new book endeavors to set its author straight. He says of Hazlitt. "His One Lesson contains important truths about the power of markets, but he ignores equally important truths about the limitations of the market." (p. 4) Learning about these limitations is the second lesson that Quiggin wants to teach us.

Quiggin's foray against Hazlitt misses its target, in no small part because of a problem with the key concept in the book, "opportunity cost," as he applies it to Hazlitt. He defines the concept in this way: "The opportunity cost of anything is what you must give up so that you can have it." (p. 3) So far, so good, but now the difficulty in his

* David Gordon (dgordon@mises.com) is Senior Fellow at the Mises Institute and editor of the *Journal of Libertarian Studies*.

case against Hazlitt arises. He applies the concept as it is used in neoclassical economics, but Hazlitt was an Austrian and does not use the concept in this way.

Quiggin takes as his benchmark a state of neoclassical equilibrium, or at least something close to this. He says, “Let’s restate Lesson One: Market prices reflect and determine the opportunity costs faced by consumers and producers.... But the simple story above embodies a lot of assumptions about the way markets work.” (pp. 40, 42). Under these assumptions, there are no mutual gains from trade.

In a perfect competitive equilibrium, prices exactly match opportunity cost. There are no “free lunches” left. More precisely, any additional benefit that can be generated for anyone in the economy must be matched by an equal or greater opportunity cost, where opportunity cost is measured by the goods and services forgone, valued at the equilibrium prices. (p. 43)

He explicitly applies his understanding of Lesson One to Hazlitt:

When economics is done properly, Hazlitt argues, the answer is always to leave the market alone. So, the One Lesson may be restated as: Once all the consequences of any act or policy is taken into account, the opportunity costs of government action to change economic outcomes always exceed the benefits.” (p. 3)

Quiggin’s strategy against Hazlitt is to argue that there are many cases where the neoclassical model fails to apply. In these cases, the opportunity cost to individuals deviates from the opportunity cost to society.

Quiggin has misunderstood Hazlitt’s argument in *Economics in One Lesson*. If we turn from Quiggin’s distillation of the book’s lesson to what Hazlitt actually says, we do not find the claim, based on the assumption that the economy is in neoclassical equilibrium, or close to it, that “the opportunity costs of government action to change economic outcomes always exceed the benefits.” To the contrary, Hazlitt discusses a number of particular cases in the real-world economy. In each of these, he shows that interfering with the free market often has bad consequences. For example, he says about minimum wage legislation:

Yet it ought to be clear that a minimum wage law is, at best, a limited weapon for combating the evil of low wages, and that the possible good to be achieved by such a law can exceed the possible harm only in proportion as its aims are modest. The more ambitious such a law is, the larger the number of workers it attempts to cover, and the more it attempts to raise their wages, the more likely are its harmful effects to exceed its good effects. (Hazlitt [1946] 1979, 134–35)

Hazlitt wrote his book for a popular audience, but Quiggin, a skilled and learned professional economist, does not understand it properly because he reads it through the blinders of an assumption about what Hazlitt “must” be saying.

Quiggin applies the concept of neoclassical equilibrium to Hazlitt’s most famous chapter, the parable of the broken window. In the parable, which Hazlitt took over from Bastiat, a young hoodlum throws a brick through the window of a baker’s shop. People in the crowd imagine that this will help business, since the baker, in order to replace the window, will give money to a glazier, who will spend it on things he wants, and so on. Hazlitt asks readers to remember that, had the window not been broken, the baker would have bought a new suit, so there is no gain to the economy in breaking a window.

This is easy to grasp, but here is what Quiggin does with it:

The argument is compelling at first, but there’s a subtle problem. Implicit in the crowd’s reaction is the assumption that glaziers are short of work. If... glaziers have more jobs than they can handle, then there is no extra window—at best, the shopkeeper’s order simply displaces some other, less urgent, repair. Similarly, for Hazlitt’s riposte about the tailor to work, there must exist unemployed resources in the tailoring industry, so that the shopkeeper’s suit represents an addition to output. If not, the additional demand from the shopkeeper will raise the price of suits marginally, just enough to lead some other customer to buy one less suit. That is, the story implies that the economy is in recession, with unemployment across a wide range of industries. (p. 167)

In other words, there are only two possibilities: either there is a neoclassical equilibrium, with its stringent conditions, or there is a recession. Quiggin misses entirely the Austrian view of the process by which entrepreneurs adjust production to meet consumers’ changing demands. The absence of a neoclassical equilibrium is

not a recession, but the ordinary course of the economy. Unless the hoodlum can anticipate consumers' demands better than capitalist entrepreneurs, breaking the window will not better serve consumers.

But what if the economy really is in a recession or depression? Do we not then need increased spending to stimulate the economy? Quiggin, an ardent Keynesian, certainly thinks so, and if he is right, Hazlitt's argument fails under these conditions and the crowd is right about the broken window.

Here we confront an odd fact. Hazlitt wrote a large book, *The Failure of the "New Economics"* ([1959] 2007), in the course of which he criticizes the Keynesian view that recovery from depression depends on an increase in consumers' spending. Hazlitt in particular challenges the Keynesian "multiplier," about which Quiggin observes, "It's difficult to get an intuitive sense of the numbers involved in fiscal policy. The key idea is that of the 'multiplier.'" (p. 292) Quiggin has read the book and criticizes some of the contentions in it, but he never addresses these central points.¹

In more than one respect, Quiggin's knowledge of Austrian business cycle theory is lacking. He tells us that "Hayek was not particularly notable among the critics of *The General Theory*. The supposed Hayek-Keynes contest really reflects Hayek's latter-day reputation as the prophet of market liberalism and the 'Austrian school' of economics." (p. 36, note 5) Quiggin is correct that Hayek, to his later regret, did not write a response at the time to *The General Theory*, but there was indeed a contest between the two economists. Hayek wrote a devastating critical review of Keynes's *A Treatise on Money*, and Keynes criticized Hayek's view of the business cycle and encouraged Piero Sraffa to do so as well.

Not done with his criticism of Hazlitt, Quiggin raises another point as well.

Hazlitt doesn't spell out the starting point for his analysis. However, his analysis is based on the implicit claim... that there is a natural distribution of private property rights, and that this natural distribution exists prior to any government activity such as taxation and the payment of welfare benefits. This is nonsense. It is impossible to disentangle some

¹ Quiggin does not cite or list in his bibliography the collection of essays Hazlitt edited, *The Critics of Keynesian Economics* [1960] 1995.

subset of property rights and entitlements from the social and economic framework in which they are created and enforced. (p. 138).

Hazlitt was a rule utilitarian who did not accept natural rights. For him, it is essential to a free and prosperous economy that people have stable legal rights to property, but he does not make the assumption Quiggin attributes to him.

Quiggin says that we should learn a Second Lesson besides the lesson Hazlitt taught, but this second lesson to a large extent consists of casting Hazlitt's lesson aside. Readers would be well advised to stick to Hazlitt. He does not require emendations that reinstate the interventionist fallacies he challenged.

REFERENCES

- Hazlitt, Henry. [1946] 1979. *Economics in One Lesson*. New York: Three Rivers Press.
- . [1959] 2007. *The Failure of the "New Economics."* Auburn, Ala.: Ludwig von Mises Institute.
- , ed. [1960] 1995. *The Critics of Keynesian Economics*. Irvington-on-Hudson: Foundation for Economic Education.