CHARITY AND ECONOMIC CALCULATION: WHY GIFTS NEED FREE MARKETSTHE

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Abstract

The relationship between charity and the market mechanisms has been controversial in social sciences. Fundamentally, gifts have been excluded from the market realm. In this paper, we argue that the existence of a free market is a condition for the emergence of charity as any other social system cannot discriminate between social goods and social bads. We conclude, however, that charitable acts should not be included in market transactions but be kept separated as economic calculation may be distorted.

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1. ETHICS IN CAPITALISM AND SOCIALISM

According to Hoppe, capitalism is "*a social system based on the explicit recognition of private property and of non-aggressive, contractual exchanges between private property owners*"[1]. Private property is an institution that fundamentally solves not only the economic but also the moral problem of allocating scarce resources towards potentially unlimited uses from the part of individuals in society. That is, the individual who succeeds in non-aggressively acquiring a resource – either through homesteading

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[1] *Hoppe* (1990), page 3.

or mutually agreed contractual exchanges – is the most morally legitimate person to use it – either for consumption or in a production process. The fact that he was willing to bid the highest price for such a resource, he was either the consumer who felt the most urgent need to consume the resource or the most efficient producer who could employ such a resource.

Private owners are, in the same time, the only category of economic participants who have the right incentives for preserving the capital value of an economic good while maximizing the current income that its use may generate. And such a participation of all owners and would-be owners of the economic goods on the market allows the emergence of free prices.

Free pricing is not only another way of determining the value of social transactions. It is the only mechanism that allows a rational allocation of resources to the most urgent desires for consumption in society. As Hoppe mentions, "*to the untrained observer unfamiliar with the action-coordinating function of prices, capitalism as based on private ownership of the means of production simply appears chaotic*"[2.]

When political authority alters the market allocation of resources either through interpherence in the free market pricing or the quantitative manipulation of production, planners have no criteria to assess whether their decisions have indeed maximized the welfare of citizens in that society or not. According to Mises, "*socialism is the abolition of rational economy*"[3.] Market pricing, which is a result of private property and the attempt of individuals to maximize their welfare (a profit-maximizing behavior) is not only the core mechanism that shows such individuals how they can allocate a resource towards the most desired end but also reveals how much such resources are needed in particular lines of production.

Free market pricing allows also market participants to be aware of what every individual "*deserves*" in that society. Under

[2] *Hoppe* (1990), page 20.
[3] *Mises* (1935), page 17.

such an institutional setting, any individual is prosperous only to the extent that he serves the needs of his fellows. By selling at market prices and getting a profit, such an individual knows that he is engaged in an efficient production activity and that he also provides a benefit to society. He is prosperous to the extent that he "*helps*" other people reach their needs.

On markets, the wealth of individuals is in accordance with their values and actions. Free prices show not only what individuals believe or value but they are also a consequence of their actual actions (selling or buying or abstaining from selling or buying). Action, and action on the market too, reveal what Rothbard called "*demonstrated preference*"[4]. Irrespective of mere talking and psychologizing, individuals prove by their participation in market exchanges the values they award to economics goods, to action versus non-action. The fact that an individual professes charity to the poor at conferences but refuses to give 10 dollars to a beggar on the street means that, for him, *ceteris paribus*, the principle is not worth 10 dollars at that particular moment.

2. CHARITY

2.1. A DEFINITION

An act of charity is an act of exchange as it always needs two parties. On the one hand, it is the benevolent who wants to make a „*good*" to somebody else and is ready to assume a cost while he is not apparently expecting an immediate tangible profit. On the other hand, it is the beneficiary who will experience an increase in his personal welfare as a result of the act of transfer for which he apparently didn't return any compensatory service. Without a willing beneficiary, there is no act of charity so this is not an unilateral act (as opposed, for example, to the act of abandonment

[4] *Rothbard* (1997b), page 212.

of an economic good). An act of gift from a thief may produce a loss of welfare for the beneficiary so potential beneficiaries may refuse it.

Exchange, as the manifest object of inquiry for economics (also called catallactics by Austrian economists[5]), has sometimes been reduced by some social scientists (non-economists but also economists alike) to „*material*" exchange. This is simply wrong as these economists argue that profit is not only tangible (the idea of profit-seeking individuals) but can be fundamentally defined in a psychic, subjective way.

The gift economy has been contrasted with the market economy by a large number of sociologists or antropologists. As has been argued before, "*gift exchanges in such societies are based on gratuity, generosity, and altruism as opposed to calculation, interest, and instrumentality*"[6]. In such an economy, "*goods and services continued to be transferred without the benefit of markets or prices, to be exchanged as gifts*"[7].

When two individuals exchange apples for oranges, it is a double transfer of material wealth between the two. But the benevolent also experiences an increase in his welfare as the principles of praxeology stress that without such a gain – be it only a psychic gain – there would be no initiation of action. So he too gets a "*profit*", albeit a non-monetary – or even better, a non-material – one. It has been long forgotten that market exchanges imply, at a fundamental level, the same notions of generosity, altruism and reciprocity. The simple fact that violence and aggression is always an alternative to market exchanges is a proof in this respect.

So charity – when one party gives apples but receives no oranges – seems to be only a transfer from a party to another party. In some systems of law, market exchanges must involve a

[5] *Mises* (1996), page 232.
[6] *Marcoux* (2009), page 673.
[7] *Offer* (1997), page 450.

"*consideration*" (a compensatory transaction) in order to be legally binding while charity seems to not.

From this perspective, charity could be qualified as a particular subset of market exchanges, when the profit for a party is non-material or cannot be "*noticed*" by third parties, or, in other words, there is no "*consideration*" for the transfer. Both of these types of exchanges can be qualified as subsets of voluntary social exchanges (market exchanges when the profit is material for both parties and charity when the profit is non-material for one party).

We can also imagine acts of benevolence that do not involve market transactions and, in consequence, the apparent lack of any "*material*" transfer. For example, I see that another person is unaware of losing a glove while walking and I tell him of the loss. He avoided a reduction in his welfare and he didn't receive anything from me while I experience an increase in my psychic profit (otherwise, I wouldn't have told him of the loss). From my part, I experienced some costs (the costs of action of making the other party aware) in order to get a psychic profit while the other party avoided a loss in welfare by keeping an economic good. Other examples, each with its own discussions: I abstain from biding a good while I am aware that the other party seems to badly want it but does not have the ability to outbid me.

From a broad perspective, even market exchanges can be perceived as a subset of charity as both parties to a market exchange get for sure not only a material profit but also a non-material profit (like confidence building, the satisfaction that they pursued their goals through voluntary cooperation and not aggression[8] - what could be termed as "*positive externalities*"). What it is critical to stress is that charity and markets are not so clearly cut one from the other and, even more, are not in opposition. They are deeply inter-related. So, according to the basic principles of logic, if A is a subset of B and B is a subset of A, A is B. So charitable transactions are market transactions.

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[8] Obviously, if they value the non-aggression principle as the building block of ethics.

2.2. CHARITY AND ECONOMIC CALCULATION

Mises considered that in a more complex economy, where production leaves the state of autarchy or mere barter, the existence of a common medium of exchange – that is, money – is critical for the ability of individuals to engage in production. He stated that "*monetary calculation [...] affords us a guide through the oppressive plenitude of economic potentialities. It enables us to extend to all goods of a higher order the judgment of value, which is bound up with and clearly evident in, the case of goods ready for consumption, or at best of production goods of the lowest order. It renders their value capable of computation and thereby gives us the primary basis for all economic operations with goods of a higher order. Without it, all production involving processes stretching well back in time and all the longer roundabout processes of capitalistic production would be gropings in the dark*"[9].

A barter economy could also prevent the smooth operation of charity. In absence of a common medium of exchange, potential benefactors have to identify potential beneficiaries who are ready to accept the economic goods they want to offer as a gift. As in the case of exchange in a barter economy, there have to be a double coincidence of wants: when Robison Crusoe exchanges blackberries for fish with Friday, he values more a definite quantity of fish in comparison to a definite quantity of blackberries while Friday prefers a definite quantity of blackberries to a definite quantity of fish. Nobody can consider a „*gift*" an economic good which he/she cannot be aware whether the beneficiary really wants and has a „*positive*" utility for him.

[9] *Mises* (1935), page 11. According to Mises, the goods of the lowest order are consumer goods, whose value is directly awarded by consumers on markets according to their use while the goods of higher order are capital goods which are employed by producers in order to manufacture consumer goods (goods of the lowest order) or other capital goods.

The emergence of a common medium of exchange in a society largely facilitates the charitable acts as well as market exchanges as benefactors purely and simply may offer money as gift and the beneficiaries can use it in order to get any service or economic good they may prefer. So the double coincidence becomes unnecessary as the act of gift is separated into two acts: if I want to make a good for X, I won't give him oranges but I go and sell my oranges and give him, in a separate act, the money. Obviously, if oranges are an economic good in that particular society, they will have a positive market price. It is possible that X, if I would insist to give him the oranges, won't have any utility from oranges and will attempt at his turn to sell them on the market in order to get the money and buy what he really needs. So as long as the good that is the object of charity is an economic good (is perceived by society to be scarce), charity is possible.

Moreover, economic calculation in general (and especially monetary calculation in a market economy) is critical for any rational – and, arguably, welfare maximizing – allocation of resources. The relative structure of prices in an economy signals the relative scarcity of the economic goods in different uses towards which it can be allocated. The rise of the price of a good in a particular use will signal the increase in demand for that good in that use and, in consequence, will offer the incentive for its producers to allocate capital goods towards its production. That is why free pricing of goods allows a dynamic adjustment of the allocation of resources in order to maximize the most stringently needed desires.

So we can further stress that charity without markets is difficult to pursue as individuals cannot be aware whether they exchange general conditions of the environment versus economic goods or, even more, economics goods for economics bads: offering a tiger as a gift to another person is not always a charity for some intended beneficiaries.

3. CHARITY AND MARKETS

3.1. CHARITY MIXED WITH MARKET EXCHANGES

A further issue to inquire emerges when individuals do not separate charitable acts from market exchanges. Sometimes, they attempt to combine them. For example, if the market price for horses is 10 ounces of gold and I offer a horse to my neighbor for 5 ounces (ignoring potential differences in quality), then an act that involved both a market exchange and charitable act emerges. This means that, in fact, I just offered him a gift of 5 ounces of gold. If my neighbor is aware of the market price of horses and he receives my offer, he will be impressed by my friendship and charity.

But if my neighbor is not aware of the market price of horses (or, for example, the last price of horses he was aware was 3 ounces), he may even live with the impression that the price of 5 ounces is too high and that, in fact, I gouge him. When somebody offers someone else an economic good at a double price than the second person could meaningfully obtain on the market, the latter person will feel being a victim of trickery.

Very interestingly, economists have used the concept of surplus in order to name the value that market participants gain from buying a product at a price below the price at which he was willing to pay (or selling at a price above the price at which he was ready to sell). For the benefactors, charity begins exactly where surplus stops. We can call it consumer or producer super-surplus. It is the amount of money they paid in addition to the price they were ready to pay for the product. Only for the consumer with a zero surplus, charity begins at the market price. Any price above this price implies charity. On the other hand, for the beneficiary, anything that is received with a market price is a gift and implies a surplus. So charity transforms the super-surplus of the benefactor in the surplus of the beneficiary.

The emergence of markets allow not only an allocation of resources according to the criteria of the individuals who are participating into these markets (or who have the immediate possibility of doing so) but also the emergence of common values and ethical standards. By allowing charity, markets allow the building of social ties based on morality.

3.2. USE VALUE VERSUS EXCHANGE VALUE

Classical economists have differentiated between the use value and the exchange value of an economic good. The first one is the value that a person derives from the consumption of the good. The other one, is the value that a person derives from the exchange of that particular good, even in the case that such a person has no consumption value for that particular economic good[10]. Modern economists have somehow minimized such a distinction as it is difficult to trace a very clear line between them but the distinction seems to help us understand sometimes the behavior of individuals.

In a society where every economic good has a market price, individuals can ascertain whether exchanges of that particular good has meant a market exchange or has involved a gift component. In consequence, the paradox of capitalism as a system based on private property and free markets is that it is the only social system where charity can correctly be ascertained and individuals know with confidence who their benefactors are.

In a socialist system based on politically administered prices, nobody can know for sure the real value (that is, the demand for) the economic good he is attempting to sell. And what is even more important, nobody knows the real economic value of his good in relationship with the other goods which are transferred in society.

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[10] Examples could be the case of a vegetarian who does not consume meat but he is however engaged in meat production in order to sell it to the market and get a living. Other examples may be a drug dealer who does not consume the drugs he trades or a prostitute that does not enjoy his activity of making sex for dollars.

That is, the structure of relative prices. If the price of oranges I attempt to sell is fixed by political authority, I won't know whether this price reveals the true scarcity of my good and especially the relative scarcity of my good in comparison with other goods produced in that particular society. As an university professor, I do not know whether my wage compensates the real service I bring to society. And I do not know for sure whether my wage should be bigger or smaller than a doctor's.

Moreover, those ends followed by individuals which do not involve maximizing the monetary profit also allow a proper assessment of the value of such non-monetary gains. For example, the choice of a wealthy merchant in a city to buy a piece of land, plant some decorative trees with his own hand and keep it open to all the citizens of the city has a market value that could allow a calculus of the sacrifice (that is, the cost) of the merchant and how much value he awards to the welfare of his co-citizens. That is fundamentally different from the decision of a despot to expropriate the real estate of some individuals, plant some vegetation stolen from other individuals with the use of slave labor and keep it open to all the citizens of the city. What was the sacrifice of the despot? Can it be compared to that of the merchant?

3.3. CHARITY IN MARKET TRANSACTIONS?

What the same economic theory can also indirectly tell us is that individuals should keep their economic calculation intact and possibly separate the profit-seeking behavior from the charitable one. Obviously, it can mathematically be the same thing whether a benevolent merchant agrees to let 10% discount[11] to every of his business partners in order to offer them "*gifts*" or he engages in

[11] We take in consideration, for the sake of simplicity, only the prices at which such a merchant sells his products. The case of the prices at which he buys products or services is the same.

exchanges at market prices and, at the end of the period, donates 10% of his income to the same business partners.

But in the first case, he somehow contributes to a falsification of market prices. And there are several arguments in this respect.

First of all, buyers will tend to come to such a merchant to buy the product which has a price with a charitable component (we assume no differences in quality). If such a merchant is ready to expand his production, it will be almost impossible to differentiate between such a charitable merchant and a merchant that only uses discounting in order to expand his sales.

It is needless to say that such a merchant could sooner or later go bankrupt (if profit in his branch is under 10%) or accept fundamentally a smaller rate of profit. That choice may have two more consequences: he will be less able to attract capital to finance his business (if he needs such outside capital) and that will keep his business small. He will expand only to the extent of the availability of his own capital. Such a charitable merchant may be in the position, at one moment in time, to eliminate all his competitors by outbidding them with smaller prices (due to the charitable component). The challenge for such a merchant will be in the moment that he will become a monopolist as there won't be any competitor to compare his own prices with. We cannot say about a monopolist that he is a charitable merchant because there is no market price at which his good can be transacted at. Without an independent price, the lower rate of profit cannot be a proof of his charity. Being ready to record a lower rate of profit is not, by itself, a proof of charity as it may be the result of a lower efficiency in production. While monopolists could increase their prices in order to reestablish the "*normal*" rate of profit, elasticity of demand and also technological restraints in the process of production could limit their liberty. Moreover, the fact that the monopolist accepts a lower rate of profit does not mean that the final price is economically competitive. Another competitor could have improved the efficiency and offered a smaller price.

Second of all, other market participants, who are not aware of the charitable character of our merchant, may have wrong signals as regards scarcity of at least some of the resources in society. Other entrepreneurs will base their business decisions on the price of such a merchant. For example, if they increase the size of the activity of production that uses the product of our merchant, they may face two dilemmas: in the first case, the merchant does not have the capital to increase his own production. In such a case, the limited supply of a product may trigger for a transitional period a shortage which cannot be eliminated by the movement of price. In such a case, additional producers will emerge in that particular industry in order to increase the physical output, even if they will demand different (that is, higher) prices than the charitable entrepreneur. A two level pricing will emerge on that market, with a lower level demanded by the charitable entrepreneur and a normal or competitive level demanded by other producers.

3.4. CHARITY AND THE RATE OF INTEREST

Any time an individual engages in a charitable act, he demonstrates that he is ready to give up something of economic value now in order to experience an increase in his subjective or psychic personal welfare, present or future. The gains from charitable acts are subjective and difficult to be noticed by third parties. Moreover, a benefactor could purely and simply enjoy the act of giving or prefer what he could perceive as an increase in his reputation or social image[12].

Charity may also reveal a low time preference from the part of the benefactor. As Mises put it, "*the valuations resulting in the emergence of originary interest prefer satisfaction in a nearer period of the future to satisfaction of the same kind and extent in a*

[12] Interestingly, if such an increase in reputation and social image will be used by such a benefactor in order to get material gains in the future, charity is only a form of investment, albeit maybe a more speculative or uncertain one.

remoter period of the future"[13]. Obviously, he refers to the valuation of the same product or service.

Charitable businessmen who are ready to assume a smaller rate of profit by "*transferring*" wealth to their clients or business partners will, in fact, induce a strong pressure towards the reduction in the rate of interest in that particular society. Rothbard defined the natural or original rate of interest as "*the social time preference*"[14]. Anytime an individual is ready to accept a smaller rate of profit, he demonstrate a lower time preference and that will send signals in the society.

Interestingly, through the process of competition on the market for the final products he manufactures (where he could get a higher market shares by demanding lower prices) where he squeezes out competitors that demand higher rates of profit, such charitable producers will induce incentives for a society-wide restructuring of the stock of capital goods. On the one hand, consumers who will pay smaller prices will have a higher disposable income. That additional income will be allocated either to saving (and generate an additional pressure towards the reduction of the rate of interest) or to consumption. On the other hand, capital which was employed in that particular industry will search for other more profitable opportunities in other sectors of the economy. Not the least, the industries that use the discounted product will expand till the point they will offer the same return as the entire economy[15].

CONCLUSIONS

While charity has long been strictly separated from markets, we have argued that, in fact, they are deeply ingrained. From a general perspective, the gift economy is the same as a market

[13] *Mises* (1996), page 56.
[14] *Rothbard* (2004) page 735.
[15] *Mises* (1996), page 56.

economy as they are both dependent on free pricing. Moreover, gifts should not be combined with market transactions as there is a risk regarding the maintenance of the economic calculation intact. Businessmen and businesswomen should engage in charity only after they record their profits.

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