Beyond *Economics* as Religion

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Robert Nelson has written an illuminating and carefully reasoned argument about the implicit normative assumptions of modern economics. He is surely correct that the discipline makes important assumptions about values in most of its analysis. Nelson calls these norms religion, and, to the extent that one considers all normative statements religious in nature, he is accurate. He is also accurate in his claim that the religious aspects of economics, particularly its faith in the "secular religion of economic progress," have proven inadequate to satisfy the deeper longings of the human heart for meaning and purpose in life.

But where do these views leave the modern social scientist? Is economics nothing more than sophisticated hand waving to justify certain normative assumptions? Or should it acknowledge its religious character and proceed forthwith? Unfortunately, Nelson is not clear whether it is desirable for economics to have religious content or not. Sometimes he seems to be arguing that economists should be more careful to separate their value assumptions from their positive analysis, while at other times, he seems to think no such separation is possible. And he closes his book with two somewhat contradictory themes: (1) a lukewarm endorsement of recent work in economics that explicitly acknowledges the normative content of its analysis and (2) a call for the discipline to accept the fact that its secular plan of salvation has failed.

I believe that one can recast and modify Nelson’s arguments in a way that not only reclaims much of the value of modern economic analysis but also explicitly acknowledges important ethical and normative considerations. Three tasks should concern economists as

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2 Most religions of the world deal with issues of worship, transcendence, and questions of eternity. Nelson could have called his book "ECONOMICS AS NORMS," perhaps a more accurate but less interesting title.


4 Id. at 229, 336.
they deal honestly with both the normative and positive aspects of their discipline. First, they should acknowledge that there are normative aspects of their work, and that such assumptions are important to resolving what Nelson finds to be paradoxes in economics. Second, economists should differentiate between personal relationships and impersonal exchange and should use the tools of their discipline to explain the workings of impersonal exchange. Third, economists should recognize the limits of their analysis, especially in the realm of human flourishing, and they should also recognize the interrelationship of the different realms (personal and impersonal) of human action.

I. ECONOMICS AS A POSITIVE AND NORMATIVE SCIENCE

Economics is, at its most basic level, an explanation of the economizing and exchange process. Since it postulates and tests refutable hypotheses with respect to these processes, it has strong positive elements. As Nelson points out, however, there are still normative judgments at several points in the analysis.

Economizing focuses on comparing costs and benefits. Exchange is the transfer of rights. But when one makes any arguments about costs and benefits, there is either an explicit or implicit judgment about costs and benefits to whom; in other words, who counts? Likewise, one cannot analyze exchange without a specification of the rights that are being transferred. This means that the analyst needs to specify the institutional framework underlying economic action, in particular, the rights framework that is operative. This is a task economists have often not done well.

This acknowledgement of the existing set of rights (and of norms, since rights are ultimately based on norms) solves two problems that concern Nelson. The first is what he calls the “market paradox” or the problem of deciding where self-interest can appropriately operate and where it cannot. The structure of property rights determines the legitimate and illegitimate operation of self-interest. The standard economics paradigm assumes that it is legitimate for a producer to harm her competitor by making and selling a cheaper product, but does not allow her to firebomb the physical facilities of her competi-

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5 Douglass North has argued that neoclassical economics “contained two erroneous assumptions: (i) that institutions do not matter and (ii) that time does not matter.” Douglass North, Economic Performance Through Time, 84 AM. ECON. REV. 359, 359 (1994).
6 NELSON, supra note 2, at 6.
We recognize that the second producer has a defensible property right in her physical facilities but not in her market share.

Specification of the rights structure also solves the second problem of why the psychic costs of change are not included in most economic calculations. For instance, according to Nelson:

When several smaller farms are consolidated into one larger and more productive farm, thus helping in fact to improve the overall efficiency of U.S. agriculture, economists do not consider the bruised feelings of the smaller farmers themselves, or the possible distress at their plight that might be felt by neighbors when the smaller farmers are forced out of business.  

Nelson suggests that the reason for omitting the psychic cost of such pain is the difficulty of measuring it. It is, however, more straightforward to recognize that people do not have a property right in the knowledge that small farms exist, and hence the loss of small farms, while perhaps imposing a real cost on certain members of the community, is not something that should be recognized in calculations of efficiency. If one were to include these costs in efficiency calculations, the entire rights framework would have to be reworked. Attempting to grant property rights in the existence of particular attributes of an economy (the presence of small farms, the friendliness of small towns, and the excitement of cities) would be fraught with enormous problems of definition and enforcement. Hence, granting rights to physical property and measuring a violation of those rights through evidence of physical invasion constitutes an eminently defensible rights framework.

II. THE ETHICS OF DIFFERENT REALMS OF ACTION

A. Differentiating Between the Personal and the Impersonal

It is useful to recognize that ethical judgments pervade economic analysis. It is, however, also important to develop a more nuanced

7 The former can be justified and the latter condemned because of the total impact on society; in the first case, societal welfare is increased and in the second it is decreased. But even that analysis requires a normative judgment about who counts and who does not in determining overall welfare.

8 NELSON, supra note 2, at 66.

9 Rights to physical property are the starting point of our rights framework, but not the sum total of it. One can also have a property right in an idea (a patent) or in one's reputation, hence the existence of libel laws. Nevertheless, physical property and physical invasion serve as useful starting points for rights.
understanding of the differences in the ethical requirements of different types of human interaction. In the words of F.A. Hayek:

Part of our present difficulty is that we must constantly adjust our lives, our thoughts and our emotions, in order to live simultaneously within different kinds of orders according to different rules. If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilisation), as our instincts and sentimental yearnings often make us wish to do, we would destroy it. Yet if we were always to apply the rules of the extended order to our more intimate groupings, we would crush them. So we must learn to live in two sorts of worlds at once. To apply the name of ‘society’ to both, or even to either, is hardly of any use, and can be most misleading.¹⁰

I shall call the two orders Hayek is describing (1) the world of personal relationships and personal exchange (his micro-cosmos) and (2) the world of impersonal exchange (his macro-cosmos). Economists specialize in explaining the world of impersonal exchange,¹¹ and their efforts are important because, as put by Vernon Smith:

[T]here is a world of difference in people’s perceptions of the two forms of exchange. Everybody, except the sociopath, understands the former and can see that good comes from intending good in personal exchange. The overwhelming majority of people, however, do not understand markets, and the good that flows to others by working, performing and producing for yourself and family.¹²

¹¹ Economists have also extended their analysis to personal relationships. See GARY S. BECKER, A TREATISE ON THE FAMILY (1991). Such work is controversial and for purposes of this Essay, I will be concentrating on impersonal exchanges. The work on personal relationships has yielded some important insights, but two significant problems plague much of the research. Because of the difficulty of measuring many non-monetary aspects of personal relationships, the empirical work tends to collapse into measures of material well-being. While material well-being is of importance, many aspects of personal relationships are strongly driven by non-material considerations. Therefore, explanations tend to be only of secondary considerations in human action. For instance, one can explain changes in church attendance by changes in weather (and hence in costs), but it is more difficult to explain why people attend church at all through measures of material welfare. Additionally, when researchers have attempted to expand the explanations for human action beyond material measures, their explanations come close to being tautological; that is, people act in certain ways because we know they are utility maximizers, even though many arguments in the utility function are unquantifiable.
¹² Vernon Smith, Address to the Commonwealth North Forum (Oct. 21, 2003) (transcript
Thus, economists should take seriously the task of explaining both the ethics and the coordination process of this world of impersonal exchange. There are numerous insights to be gained from doing so. Several are listed below:

1. Perhaps most importantly, good intentions are not necessary for the functioning of the world of markets. This does not mean that people are necessarily selfish, but rather that they pursue ends that they define to be important. In such a world, person A can be advantaged by the actions of persons B and C through the process of production and exchange even if B and C do not necessarily intend A's well-being. This is in sharp contrast to a well-functioning world of personal relationships, which requires significant attention to intentions, strong agreement upon ends, a great deal of information about the moral character of the participants in social relations, and heavy emphasis upon the virtues of compassion and mercy. The world of impersonal exchange can operate with far fewer ethical requirements, although honesty, willingness to obey the generally accepted rules of behavior, and a willingness to keep promises, are important for the successful functioning of such a world.13 In other words, "[m]arkets economize on the need for virtue, but do not eliminate it."14

2. Prices are an important part of the world of impersonal exchange and allow information to be communicated across time and space.15 Again, there is a normative framework behind the price mechanism, because prices are simply options to transfer property rights, and the property rights framework is based upon certain normative claims. But the effort to understand how information is transferred by prices is largely a positive science.

3. Competition is a valuable force in a world of impersonal exchange. Again, this is when competitive forces are constrained by an appropriate property rights framework. Otherwise, competition is destructive of both wealth and the social order. But in a world of contract enforcement and secure property rights, competition is necessary in order to generate information about better ways of organizing the world and low cost means of production and exchange. Competition also provides rewards to those who find cheaper ways of accomplishing a task. In contrast, competition has less social utility in the world of personal exchange, since information about options is more readily available and nonmonetary rewards are more likely to motivate be-

Available at http://www.commonwealthnorth.org/transcripts smith03.html).

14 Id. at 466.
behavior. Families try to minimize competition among siblings, clubs look with disfavor on members who compete for personal glory, and religious organizations use peer pressure to constrain those who do not labor for the good of the whole.

4. The system of transferable property rights results in a self-organizing society, what Friedrich Hayek has called a "spontaneous order." Social cooperation occurs without central direction; the interaction of buyers and sellers leads to coordination across time and space without the explicit intention of anyone to produce an ordered society.

5. The economic model of rational actions by individuals can also be applied to collective choice, especially the actions of government. The field of Public Choice has yielded numerous insights about the workings of government, including the divergence between the stated goals of government action and the actual results. The importance of not relying just on good intentions to get good results has been an obvious implication of this work. Instead, looking at the incentives decision-makers face and the information generated by various institutions, has improved our understanding of collective choice and why many government programs do not deliver what they promise.

6. The principle of comparative advantage means that there are numerous opportunities for gains from trade. Although this principle is operative in personal relationships and personal exchange, it is much more difficult for people to understand the gains from trade across time and space. Economists have labored long and hard to convince politicians and the general public that there are gains from trade with strangers and across borders. They must continue to explain comparative advantage, the primary driving force in those gains.

7. All of the above contributions of economics to the understanding of impersonal exchange form a framework for understanding another important issue, namely the causes and consequences of economic growth. Sometime between 1700 and 1820, a dramatic shift occurred in the world and certain societies were able to sustain economic growth—growth that had an impact on the overall well-being of almost all of the population. Explanations of the working of im-

18 It would be a mistake, however, to see Public Choice as simply explaining why government does not work well. A substantial portion of the field is devoted to finding ways to improve the institutional environment by altering incentive structures or placing limits on the use of coercion.
19 Of course, transaction costs can keep such production and trade from occurring.
20 The numbers are overwhelming. In the countries that first experienced growth, the life
personal exchange are at the heart of understanding these rising incomes and life expectancy, because it is the extension of the world of impersonal exchange that has been largely responsible for these improvements in human well-being.21

B. Economics as Science

Cast in the above light, Nelson is accurate in describing twentieth-century economics as having a strong normative element, but his claim leaves out important parts of the work of economists. He starts his discussion with the normative assumptions implicit in the work of Paul Samuelson, but one can also see Samuelson’s textbook, Economics, as an important step in understanding the workings of the world of impersonal exchanges. Samuelson organized a great deal of thinking about this world into a coherent whole that explained how the economic coordination process works. His analysis was incomplete, however, in that his failure to apply the tools of economics more generally to both private and government action led him to be too sanguine about the possibility of government intervention to correct market shortcomings.

The Chicago school, the next target of Nelson, advanced Samuelson’s work with vigorous testing of numerous hypotheses about human action in the micro and macro spheres. Likewise, the new institutional economics, another school Nelson discusses, further extended our understanding of the world of exchange.

The major contribution of the new institutional economists has been in explaining why certain societies have grown and others have not. William Easterly has shown that most other theories of growth are incomplete and efforts to create growth in the less developed parts of the world have resulted in failure.22 On the other hand, explanations that rely upon the institutional framework are much more powerful than competing theories. Institutions do vary across societies and the evidence is quite convincing that the rule of law (especially equality before the law) and enforcement of property rights for a broad cross-section of the society are of crucial importance in creating the conditions necessary for economic growth.23

expectancy has risen from approximately thirty-five years to seventy-seven years and per capita income has increased by about twenty times. ANGUS MADDISON, THE WORLD ECONOMY: A MILLENNIAL PERSPECTIVE 30 tbl.1-5a, 28 tbl.1-2 (2001).

21 North, supra note 5, at 359 (arguing that the wealth of nations grew as a result of more interdependent and complex institutions).


This literature depends heavily upon the concept of transaction costs, namely the costs of defining, enforcing, and exchanging property rights. As Nelson points out, the introduction of transaction costs has greatly expanded the economic model and has yielded powerful insights into the reasons for economic growth and the institutional barriers to such growth.\textsuperscript{24} The concept of transaction costs, however, also has forced economists to explicitly acknowledge the importance of norms and ideology.\textsuperscript{25} While this has given greater relevance to economics, it has also reduced its precision somewhat in that its analysis of trust, the influence of religion, and the importance of certain basic virtues has not been easy to formalize and test.

\textbf{C. Responding to the Critics}

Social ethicists and theologians have been quick to criticize modern market economies because of the paucity of their moral content. Economists have an important role to play in responding to many of these criticisms. One must go back to the distinction between personal relationships and impersonal exchange, drawn earlier, to understand how economists can shed light on the debate about the ethics of markets. Many of the critics believe the more limited role for ethics in impersonal exchange to be the very root of the problem. For instance, Adrian Walker argues that markets are ethically flawed because “contractual exchange [is] formally indifferent to the objective good of the person.”\textsuperscript{26} Others have argued that the modern liberal economy is characterized by “homelessness,”\textsuperscript{27} and that an ethical economics would see economic activity through the lens of gift rather than through the lens of exchange.\textsuperscript{28} And Wendell Berry, a frequent critic of modernity, argues that “[i]f you are dependent on people who do

\textsuperscript{24} See, e.g., HERNANDO DE SOTO, THE MYSTERY OF CAPITAL (2000) (discussing how institutions and legal rights that create transaction costs are key to the success of a capitalist system).

\textsuperscript{25} See, e.g., DOUGLASS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 84-91 (1990) (exploring the relationship between prices and ideological and behavioral norms).


\textsuperscript{27} David Schindler, “Homelessness” and Market Liberalism, in WEALTH, POVERTY, AND HUMAN DESTINY, supra note 26, at 351 (describing homelessness as the “fundamental problem of a liberal economy”).

\textsuperscript{28} D. Stephen Long, Catholic Social Teaching and the Global Market, in WEALTH, POVERTY, AND HUMAN DESTINY, supra note 26, at 87 (discussing John Milbank’s assertion that “[t]he Christian life requires a gift economy in which a return is always expected”).
not know you, who control the value of your necessities, you are not free, and you are not safe."

Each of these critiques, however, confuses the two realms of action, the personal and the impersonal. It is simply impossible to have economic production and exchange across time and space (the realm of impersonal exchange) and also have agreement upon a common good in that realm. The information requirements and the coordination problems of agreeing on common ends would render the system inoperable. Also, for someone who focuses on the ethics of personal relationships, it is hard to accept the importance of competition as a social good. Again, F.A. Hayek is the most eloquent exponent of differentiating between the realms of action:

This application of the same rules of just conduct to the relations to all other men is rightly regarded as one of the great achievements of a liberal society. What is usually not understood is that this extension of the same rules to the relations to all other men (beyond the most intimate group such as the family and personal friends) requires an attenuation at least of some of the rules which are enforced in the relations to other members of the smaller group.

... Such an order which relies on people working with the effect of satisfying the wants of people of whom they do not know presupposes and requires somewhat different moral views, from one in which people serve visible needs.

Economists cannot serve as final arbiters between those who want society to agree on an objective good and those who believe such an agreement is not feasible if markets are going to operate. But, as ethically informed social scientists, they can point out the lesser ethical requirements of the world of impersonal exchange and the material benefits of such exchange. And, they can be helpful in making clear the costs of moving to a world of completely personal exchange, the world that people like Adrian Walker, David Schindler, and Wendell Berry seem to favor. Such a move would drastically impoverish mil-

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30 It is very difficult to determine if these critics of markets would use coercion to enforce their more rigorous ethics. Most do not explicitly advocate coercive enforcement, but they are also quite unhappy with the modern liberal order, which limits coercive power to the enforcement of negative rights.
31 2 *Hayek, supra* note 16, at 144.
lions of people, shorten life expectancy, and cause great human suffering. It is in this sense that the task of explaining the world of impersonal exchange is incumbent on the economics profession.

Economics is also helpful in pointing out some of the counterintuitive results of attempting to regulate markets to achieve ends other than those captured by the self-interest of market participants. For instance, many governments in the world regulate labor markets by requiring mandatory payment for certain nonworking days, restricting the flexibility of contracts with regard to time of employment and enacting minimum wage legislation. A recent World Bank study, though, finds that more heavily regulated labor markets substantially limit job creation. Higher rates of female unemployment also correlate with greater labor market regulation as does a higher degree of participation in the informal sector. Almost none of these effects were those that were predicted or argued for by the advocates of the labor market regulation. Therefore, economists have much to contribute to the ongoing discussion of the efficacy of regulation and government intervention in the realm of impersonal exchange.

III. THE LIMITS OF ECONOMICS

A. The Importance of Not Claiming Too Much

I have argued above that an ethically aware economist has important contributions to make, both in understanding and articulating the different norms that are necessary for different arenas of human action and in expanding our understanding of the process of impersonal exchange. This is in response to Nelson's argument that there are normative assumptions implicit in economic analysis. This, however, is not the sum total of Nelson's claim that "economics is religion."

When Nelson says that "[e]conomic progress is so important because progress is seen as the path to the attainment of a new heaven on earth, to a secular salvation," he is articulating a different argument. He is moving beyond his first thesis and suggesting that economists have replaced traditional religious claims about human flourishing with their own materialistic explanation of what leads to human happiness.

It is here that Nelson's arguments are the most powerful and the most troubling. If it is the case, as he argues, that economists have used the doctrine of efficiency and economic progress to answer the

33 Id.
34 NELSON, supra note 2, at 9.
ultimate questions of meaning and purpose for humans, this is a strong and damning indictment. I do not read the economists Nelson cites as making this a part of their explicit argument, but they could well be implicit coconspirators in the overall secularization of society and the replacement of claims of the importance of the transcendent in satisfying basic human longing with their more mundane explanations. Economists ought not to be so taken with their powerful explanations of how the processes of specialization and trade works and how it produces substantial increases in wealth that they move on to claim that these increases in wealth answer the ultimate questions of human dignity and human worth.

Nevertheless, some of the issues that economists deal with do have strong moral content and their work is helpful in understanding these moral issues. If one regards poverty as a moral problem, explanations of how poverty is ameliorated through the wealth creation process are important contributions to a moral discussion. Likewise, there has been much concern about the effects of globalization on poor people in developing economies. This question is largely fueled by ethical concerns on the part of policy-makers. The economists' answer, that globalization has generally contributed to the well-being of the poor in developing economies, is important in dealing with those ethical issues.35

In a similar vein, many government programs are driven by good intentions, namely a desire to help the marginalized, the oppressed, and the poor. The thrust of the Public Choice work has shown that good intentions are not enough and that attention to incentives and information are crucial for effective functioning of government programs.

B. Interaction Between the Personal and Impersonal Realms

Nelson's argument that economists have been responsible for the diminution of traditional norms—norms which may well be crucial for a functioning society of healthy individuals—raises other issues. What is the relationship between virtue and the modern economy, or what is often called modern liberalism?36 And, are there feedback loops between the world of impersonal exchange and world of personal relationships that threaten the stability of the liberal order?


36 Modern liberalism usually refers to the economic and political order, a regime of private property rights and markets, as well as representative democracy.
With respect to the first issue, numerous authors throughout history have argued that the liberal economy requires a set of virtues to function well. According to Jerry Muller:

The notion that sociopolitical orders require dispositions or virtues not cultivated by their dominant institutions is at least as old as Aristotle. In keeping with this tradition of thought, those who were favorably disposed toward the market emphasized the need for counterinstitutions. Time and again, they asserted or implied that the dispositions, character traits, virtues, and experiences promoted by the market were insufficient for human flourishing. Market relations were almost by definition contractual relations, entered into for self-interested motives and capable of being dissolved when self-interest was at an end. But there was more to life—or, more precisely, they believed there should be more to life—than contractual relations. That included relations of friendship and of love, with their accompanying altruism, in which individual interest was subordinated to that of others. The family was the most frequent site of such relations, a point stressed especially by Hegel, but also important for Smith, Burke, and others.37

This raises an important issue that is in the background in Nelson's discussion of the promise of economics to create "a new heaven on earth." What does the expansion of the world of impersonal exchange do to the moral base of society? As economic growth occurs, and as economists explain, and at least implicitly justify it, is there danger that the world of impersonal exchange will destroy the world of personal relationships, the world where much personal fulfillment is found and where certain virtues are nurtured? Recall that Hayek described the danger of the extension of market ethics into inappropriate realms. "Yet if we were always to apply the rules of the extended order to our more intimate groupings, we would crush them."39

37 JERRY Z. MULLER, THE MIND AND THE MARKET: CAPITALISM IN MODERN EUROPEAN THOUGHT 393 (2002) (citation omitted); see also PETER BERGER, THE CAPITALIST REVOLUTION (1986) (arguing that although capitalism is usually seen as a conservative force, it has radically changed social, political, and cultural relations); PETER BERKOWITZ, VIRTUE AND THE MAKING OF MODERN LIBERALISM (1999) (analyzing the views of the major figures of modern liberalism); MICHAEL NOVAK, THE SPIRIT OF DEMOCRATIC CAPITALISM (1982) (exploring the social and moral underpinnings of capitalism); AMARTYA SEN, DEVELOPMENT AS FREEDOM 249-81 (1999) (examining the role of values and reason in furthering freedom and encouraging development).
38 NELSON, supra note 2, at 9.
39 HAYEK, supra note 10, at 17.
This is an important issue, and one of which most economists are, unfortunately, unaware. In their explanation of the world of impersonal exchange and the limited ethics required for that realm, they can be guilty of attempting to extend the world of contract and price to all human relationships. But there is much in the world of personal relationships that does not fit the contractual mold. Jennifer Roback Morse describes some of those relationships:

To describe the relationship between parents and children as a contract, even an implicit contract, is to do violence to the reality of both childhood and parenthood; to describe the relationship between an adult child and an aging parent as a contract, or even a partnership, totally misses the point. 40

Numerous philosophers and ethicists throughout the ages have argued that the family and other close personal affiliations are crucial for the development of the necessary virtues for the functioning of the market order. If this is the case, economists ought to be aware of the possibility that this market order, inappropriately applied, may eat away at the heart of markets. Since economists are not trained to analyze the virtue producing aspects of personal relationships, it is doubtful that they can do much more than acknowledge this possibility. But it is important that there be at least an acknowledgement; otherwise, “economics as religion” can correctly be identified as a false religion.

Thus, economists should be cognizant of the necessity of a functioning moral framework for both the personal and impersonal realms of action and should acknowledge that the work of economics is insufficient to answer all moral questions. More humility on the part of economists in terms of the work that they do and the answers they provide would be helpful in this regard.

IV. CONCLUSION

Nelson’s work is an important contribution to understanding modern economics. He is correct in identifying the normative assumptions behind much economic work, but this does not mean that economics is simply an expression of personal preferences for particular norms. Rather, economists should acknowledge that any discussion of the social coordination process is based upon a particular rights framework, and they should be willing to recognize that there is an ethical foundation for such a rights framework.

40 JENNIFER ROBACK MORSE, LOVE & ECONOMICS 73 (2001).
Economists do, however, have an important contribution to make to the debate about how economies function and what are appropriate policies. They can explicate the different degrees of agreement on the norms that are necessary for the world of personal exchange and the world of impersonal exchange. And they can perform an important social service by helping people understand how the world of impersonal exchange works. This entails explaining the importance of incentives and information that are generated by prices and property rights, and also explaining how this coordination system has increased overall wealth in the last two-hundred years. But they should not claim too much for their analysis and should be aware of the relationship between the world of impersonal exchange that they describe and the rest of human interaction. They should especially avoid claiming that economics offers answers to the ultimate questions of meaning and purpose that people have struggled with throughout history.