

# BOOKS

## Theoretical Visions and Economic Prophecies

by B. R. Shenoy, edited by  
R. K. Amin and Parth J. Shah

Centre for Civil Society (New Delhi) • 2004  
• 200 pages each • \$3.25 each

*Reviewed by Richard M. Ebeling*

**B**. R. Shenoy (1905–1978) was the most important free-market economist in India during the twentieth century. Throughout the long period when socialism and economic nationalism dominated public policy in India, Shenoy was a lone voice for individual freedom, limited government, and the market economy.

From 1929 to 1932 he studied at the London School of Economics and had the good fortune to hear F. A. Hayek deliver the lectures on the Austrian theory of money, capital, and the business cycle that were published later as *Prices and Production*. Those lectures greatly influenced Shenoy's thinking on economics for the rest of his professional life.

He also became a devoted advocate of liberty during those years at the London School. As one his biographers pointed out, "During this period he acquired considerable interest in the wider issues of social philosophy and methodology. In this connection, his ideas came to be strongly influenced by Hayekian liberalism and throughout the rest of his life, as an economist as well as a social philosopher and critic, he remained a fiercely uncompromising [classical] liberal."

After leaving England in 1932, he held a number of university teaching positions in Ceylon and India. From 1945 to 1953 Shenoy was employed as a senior economic analyst with the Indian central bank, but returned to academic life in 1954 because he desired greater intellectual freedom. He showed why he wanted such freedom when he became the leading opponent of India's

second central plan in 1955–1956, offering a scathing critique of planning in general and in particular the dangers to any chance for Indian economic development from government's intrusive hand. From the 1950s to the end of his life, a time when the Indian government presumed that wealth could be created by simply creating money, Shenoy was an unbending critic of monetary manipulation and inflation.

In 1968 he resigned from his university position and founded the Independent Economic Research Centre in New Delhi, serving as director until his death in 1978. The late Peter Bauer, one of the world's leading free-market experts on development economics, praised Shenoy's "moral courage in dissenting from the Second Five Year Plan and the orthodoxy surrounding it." Bauer said Shenoy "united moral courage, intellectual integrity and technical competence to an exceptional degree."

Shenoy was a prolific writer, and was the author of such works as *Problems of Indian Economic Development* (1958), *Indian Planning and Economic Development* (1963), *Fifteen Years of Indian Planning* (1966), *Indian Economic Policy* (1968), *Indian Economic Crisis: A Program for Reform* (1968), *PL480 Aid and India's Food Problem* (1974), *Food Crisis in India: Causes and Cure* (1974), and *Economic Growth and Social Justice* (1977). A collection of some of his essays was published in 1996 as *Planned Progress or Planned Chaos?*

The Centre for Civil Society in New Delhi has recently published a wide selection of Shenoy's essays in two companion volumes, *Theoretical Visions and Economic Prophecies*. The first contains a series of excellent essays in which he explains the essential political and economic institutions for freedom and prosperity. This is followed by five articles on the meaning and nature of savings and capital accumulation, in which he presents an outstanding summary of the ideas of classical economists on the role of savings in economic development, as well as the Austrian theory of savings and capital formation as found in the writings of Eugen von Böhm-Bawerk.

The remaining pieces in this volume detail the causes and harmful consequences of inflation, and the importance of maintaining a sound currency based on a gold standard. Also included are Shenoy's earlier essays from the 1930s, in which he insightfully demonstrated a number of inherent weaknesses and fallacies in the writings of John Maynard Keynes.

The second volume contains 36 essays in which Shenoy defends free enterprise and the entrepreneur, demonstrating how essential they are if India is to have a prosperous future. In meticulous detail he shows the theoretical and institutional disasters caused by central planning in India. In four of the essays he outlines the harmful effects from foreign aid and how it undermined Indian agricultural development.

He also forcefully speaks out against foreign-exchange and export controls, explaining the economic distortions and political corruption they created. In this vein, he discusses the negative effects on incentives and production from government income and wage regulation, especially in the urban and industrial sectors of the Indian economy. This includes the labyrinth of licensing and other controls on private enterprise. Shenoy also demonstrates how private Indian farming is undermined by government planning, state trading in agricultural output, and price controls on farm products.

In one of his last writings in the year before his death, Shenoy explained what is necessary for prosperity in India: "The economic affairs of a free society are controlled, directed and governed by truly sovereign consumers. . . . Consumer control and direction of the economy is effected through a price-regulated market mechanism. . . . Traders interpret these price and turnover signals, and direct producers to adjust their production programs to match the consumer needs thus recorded. . . Available investment resources, i.e. domestic savings and inflows of foreign savings get shifted, through such activity of traders and producers, and via capital markets—which is an integral part of the overall price-regulated market. . . . The full and efficient functioning of a free society

demands recognition of the institution of private property, not only in respect of a family house, durable consumer goods in it and a car, but also in respect of capital assets, the means of production."

All this may sound mundane and almost trivial to many readers who appreciate the nature and workings of a free economy. But in 1977 and earlier, when only socialist voices were heard in India and most other parts of the third world, these were radical and dangerous ideas. To speak them was to go against the tide and risk being viewed as an "enemy of the people." B. R. Shenoy would not be silent, and if India has been moving in more free-market directions over the last two decades, it is to a great extent because of the intellectual legacy left by this man of moral courage. □

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## Hayek's Challenge: An Intellectual Biography of F. A. Hayek

by Bruce Caldwell

University of Chicago Press • 2003 • 489 pages  
• \$55.00

*Reviewed by Gene Callahan*

**B**ruce Caldwell notes that "challenge" describes the career of Austrian economist F. A. Hayek in several senses. Hayek frequently challenged prevailing ideas. He opposed economic planning when its popularity was at its zenith. He rejected the theories of John Maynard Keynes even as the vast majority of economists and policy makers enthusiastically embraced them. He asserted that the social sciences need not ape the methods of the physical sciences, at a time when any other approach was considered "unscientific."

Furthermore, Hayek delved into economics, history, psychology, law, politics, and philosophy, leaving those less intellectually nimble breathless. Since he was always willing to re-consider his earlier ideas, it is often hard to pin down just what he thought on some topic. And the many thinkers offering

diverse explanations of what Hayek was *really* getting at do not make matters easier. In fact, Caldwell says the “secret title” of his book is *Caldwell’s Challenge*. Nevertheless, he has created a masterful work: thorough, engaging, and itself challenging.

The first section of the book examines Hayek’s intellectual forebears, beginning with Austrian school founder Carl Menger. Caldwell’s concise, informative historical survey is a wonderful bonus in a book focused on Hayek.

In the next section, “Hayek’s Journey,” we find our protagonist in Vienna, in the 1920s. Hayek, just out of graduate school, was under the tutelage of Ludwig von Mises, whose writings had converted Hayek from socialism. Hayek worked on elaborating Mises’s theory of the business cycle, as well as other aspects of monetary and capital theory.

In the 1930s Hayek moved to the London School of Economics, where he had a profound influence on noted economist Lionel Robbins. He and Mises were at the forefront of what became known as “the socialist calculation debate.” While developing their arguments against socialism, they became aware of fundamental differences between their Austrian approach and the emerging neoclassical mainstream.

That dawning awareness opened new vistas to Hayek. Beginning with his 1937 paper, “Economics and Knowledge,” he began to explore the themes typically characterized as “Hayekian”: the dispersion of knowledge, the evolution of spontaneous social orders, and the limits of human reason.

Caldwell consistently succeeds in highlighting one or two key ideas essential to a particular stage in Hayek’s journey. During “The Abuse of Reason Project,” Hayek focused on how ignoring the limits of human reason results in “rationally planned” disasters. “Individualism and the Sensory Order” characterizes a period when Hayek revisited his early interest in psychology and sought to differentiate true individualism from its caricatures. “Rules, Orders, and Evolution” refers to the maturation of his ideas on law, morality, institutions, and social order.

The final section of the book surveys the journey from an aerial perspective, both summarizing Hayek’s achievements and examining what basis they might offer for further research. Already, others have built on his legacy. Contemporary theorists in cognitive science often have proceeded along Hayekian lines. Hayek’s work on complexity and spontaneous order anticipated the contemporary surge of interest in such topics by decades. He is cited as a forerunner of agent-based computational economics, an emerging field studying how complex macroeconomic phenomena can arise from agents following simple rules.

In a few places I disagree with Caldwell’s interpretations. For instance, he disputes the common notion that Hayek’s paper “Scientism and the Study of Society” marked a “hermeneutic turn” in his theorizing. (The hermeneutic approach to social science focuses on people’s own interpretation of their circumstances as an explanation for their actions.) Instead, Caldwell writes, Hayek wanted to refute materialist reductionists and behaviorists on scientific grounds. Therefore, he came to emphasize the distinction between simple and complex phenomena, rather than that between human actions and mechanical occurrences.

It is true that Hayek shifted his emphasis. But I dispute two aspects of Caldwell’s account. First, while I agree that the paper “Scientism” did not represent a hermeneutic turn for Hayek, that is because Austrian thought generally has followed a broadly hermeneutic approach, so that we find Hayek emphasizing meaning well before “Scientism.” Second, if it is true that meaning is essential to comprehending human action, then there is nothing “scientific” about discounting its importance.

Caldwell also disapproves of Mises’s contention that economics is, at its core, an *a priori* discipline, based on insight into universal principles that underlie all action. However, in several other passages Caldwell asserts the primacy of “basic economic reasoning” in the subject. But it was never clear to me how Caldwell’s notion differs significantly from Mises’s. Is it just that it doesn’t

contain the offensive term *a priori*?

Despite such quibbles, I highly recommend Caldwell's book. Indeed, I believe it is mandatory reading for anyone attempting to seriously engage Hayek's work. □

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## The Future of Freedom: Illiberal Democracy at Home and Abroad

by Fareed Zakaria

W.W. Norton & Company • 2003/2004

• 286 pp. • \$24.95 hardcover; \$14.95 paperback

*Reviewed by Gene Healy*

**M**odern political discourse often treats democracy as if it were synonymous with liberty. In *The Future of Freedom*, Fareed Zakaria aims to refute that facile notion and reinvigorate the distinction between the two. As Zakaria puts it, pithily: "The execution of Socrates was democratic but not liberal."

Zakaria's book is an extended brief against the fetishization of democracy, and it's exceptionally well-argued. The author echoes the great classical liberals in arguing that democracy is a means to an end, not an end in itself. *Liberty*, as Lord Acton said, is our highest political end. What we're after—in developing countries and in our own country—isn't a system where anything goes, so long as the majority decides. On the contrary, what we want is, first, liberty and law, and then and only then, majority rule. After the rule of law is established, the political process will, and should, open up. But to imagine that "all we need is free elections" is to fundamentally misconceive the problem of democratic development.

One of the more interesting sections of the book discusses the relationship of economic growth to participatory institutions. As a country gets richer and develops a middle class independent of the state, the prospects that its political process will open up are enhanced. Zakaria cites social-science data showing that, historically, when a country

has passed \$6,000 in per-capita income (in today's dollars), its chances of successfully maintaining democratic institutions are virtually certain.

Wealth matters—but not just any kind of wealth. In fact, as Zakaria shows, wealth derived from natural resources can impede liberalization and the transition to democracy. Such unearned riches can be a curse, he explains. In autocracies without an independent source of wealth in the form of natural resources, the government has an incentive to provide a framework of neutrally administered laws that facilitate wealth generation, which can in turn provide revenue for the state. The independent middle class that emerges, in turn, has an incentive to hold the state accountable. But in "trust fund states" like Nigeria or Saudi Arabia, the governments have a ready source of revenue, and less incentive to liberalize.

With all that in mind, Zakaria proposes several countries as "the most likely prospects where democracy, if tried, could over time become genuine and liberal": Romania, Belarus, Bulgaria, Croatia, Malaysia, Turkey, Morocco, Tunisia, and Iran. (Although Iran is an oil state, Zakaria includes it because "it has always had a strong non-resource-based economy as well.")

You'll notice a conspicuous omission from that list—Iraq, which Zakaria in a recent speech half-jokingly called "our 51st state." What's surprising, then, is how sanguine Zakaria is about our current quest to transform Iraq from a bureaucratic despotism into a commercial republic. In a passage drafted before the invasion of Iraq in March 2003, Zakaria writes, "Were the United States to dislodge Saddam and—far more important—engage in a serious, long-term project of nation-building, Iraq could well become the first major Arab country to combine Arab culture with economic dynamism, religious tolerance, liberal politics, and a modern outlook on the world."

Yet Iraq fails most of the preconditions Zakaria outlines for successful transition to a liberal, democratic regime. It's a trust-fund state, lacking an independent middle class. It

has a level of literacy (58 percent) that's low even for the Arab world. Unlike postwar Japan and Germany, it's really three countries rather than one—fragmented among Sunnis, Shiites, and Kurds. And even within subnational groups Iraqi society is unusually tribal. As John Tierney has reported in the *New York Times*, half of all marriages in Iraq are between first or second cousins, and nepotism is seen “not as a civic problem but as a moral duty.”

Throughout *The Future of Freedom*, Zakaria treats liberalization and democratization as an incredibly subtle, complex, and contingent evolutionary process. What's surprising, then, is that, when it comes to Iraq, he proceeds as if liberal institutions are the product of conscious design, easily transferable from one country to another by force and fiat. The rest of the book gives readers little reason to be sanguine about the prospects for turning Iraq into a liberal democracy.

Despite Zakaria's unreasonably optimistic take on Iraq (a view from which he seems to have backed off recently), his book is a welcome reminder of what we should really be after when we talk loosely of “democratization.” His aim is not simply a political system in which everyone has a vote and a voice. It's a system in which the most important matters—the security of life, property, and civil rights—are not subject to a vote at all. □

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## World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability

by Amy Chua

Anchor Books/Doubleday • 2002/2004 • 294 pages • \$26.00 hardcover/\$14.00 paperback

*Reviewed by George C. Leef*

**T**he list of complaints against laissez-faire capitalism is long, including such contradictory notions as its guilt in impoverishing the masses and its role in enabling

the poor to escape their “proper” station in life. In *World on Fire*, Amy Chua adds to the list, arguing that capitalism, when combined with democratization in economically developing nations, produces violence. The reason is that “market-dominant” minorities amass far more wealth than the majority population group does, unleashing resentment against their success.

Understand that Chua is not advocating socialist economic controls. She forthrightly states that “Market capitalism is the most efficient economic system the world has ever known.” But her book may be read by opponents of the free market as proving that government policy should be used aggressively to redistribute wealth in order to avoid the kind of violence she describes. For that reason, it is worth examining *World on Fire* to see if Chua makes her case, and if so, what conclusions logically follow.

Chua, a professor at Yale Law School, begins with a painful personal experience. Her aunt was brutally murdered in the Philippines, a victim of anti-Chinese violence. In the Philippines, as in many other nations, ethnic Chinese have been more economically successful than the indigenous population generally. That wealth disparity has been seized on by demagogues eager to exploit the envy of their less successful countrymen. Consequently, many Filipinos have come to believe that violent “retaliation” against Chinese “exploiters” is justified. Chua points to many examples around the world of majority hatred directed against “outsiders” who, by virtue of their superior business acumen, become conspicuously wealthy.

The author's contention is that envy-driven violence against “market-dominant” minorities is apt to occur when a nation moves from political authoritarianism to democracy at the same time it moves from a centrally planned or highly regulated economy to capitalism. That combination, she maintains, leads to rapid accumulation of wealth for a few, but the breaking of the political restraints that had previously held outbreaks of racist envy in check. How to deal with that problem is a question she

leaves unexplored.

I don't find Chua's thesis convincing and certainly do not think that the way to avoid outbreaks of racially driven violence against those who prosper the most under capitalism is to maintain socialism.

First, her examples do not provide much support for her contention that the combination of laissez-faire economic policy and political liberalization is an incendiary mix. That is because the world is virtually bereft of instances of significant reforms in both directions. Chua continually writes about nations that have adopted "free-market democracy," but the cases she cites involve no more than small steps in those directions, especially toward capitalism. For instance, she notes the ethnic violence in Zimbabwe, but that pitiable nation remains a state with little freedom of any kind.

Second, it is easy to find instances of the sort of violence against the economically successful occurring without either of Chua's two conditions being met. She cites anti-Jewish violence in Russia as a case in support of her argument, and while it's true that Russia has moved somewhat in the direction of political and economic freedom over the last decade or so, there was a great deal of violence against Jews by majority Russians for centuries under the autocratic rule of the czars. The fact is that even under highly authoritarian regimes, some people—whether they are from a "market-dominant" minority or not—figure out how to become

wealthier than most of their countrymen and thereby make themselves targets for violence by those who resent their success. Increases in political and economic freedom don't necessarily have anything to do with envy-based violence.

A third difficulty with Chua's thesis is that she attributes ethnic violence to hatred engendered by economic success of a minority group without considering that the violence may have its roots in simple racism. There was, after all, violence against the Chinese in the United States in the late nineteenth century that cannot be said to have been caused by their "market dominance."

Finally, remember that in journalism, bad news sells. Chua is so eager to create an issue with the alleged danger of "free-market democracy" that she says nothing about the upside of freedom. As Samuel Johnson wrote, man is rarely so innocently employed as when he is making money. What capitalism does is liberate all people from state-imposed restraints and eventually spread prosperity to nearly everyone. Nothing does more to reduce violence and many other social ills than the rising standards of living that capitalism alone makes possible.

All that *World on Fire* proves is that governments cannot be depended on to prevent violence against people who have been, for whatever reason, demonized by others. That's nothing new. □

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