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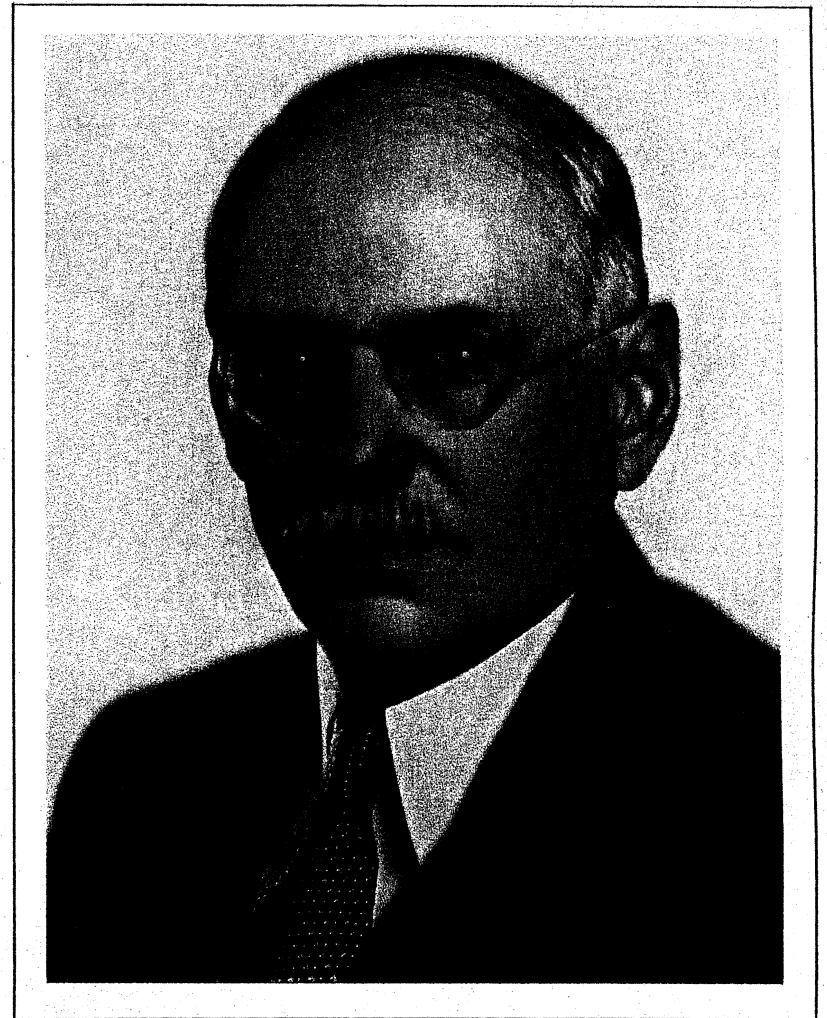
# *Freedom and Reform*

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*Essays in Economics and  
Social Philosophy*

FRANK H. KNIGHT



*Frank H. Knight*

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**LibertyPress**

*Indianapolis*

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## Contents

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LibertyPress is a publishing imprint of Liberty Fund, Inc., a foundation established to encourage study of the ideal of a society of free and responsible individuals.



The cuneiform inscription that serves as the design motif for our endpapers is the earliest known written appearance of the word "freedom" (*ama-gi*), or liberty. It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.

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Photo courtesy of Mrs. Ethel V. Knight.

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## *Foreword*

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**T**o those who may not know Frank H. Knight or his works, I can commence by making a “contribution to your education,” one of his own most familiar phrases. Frank Knight was born in 1885 on a farm in Illinois, and was variously educated in schools, colleges, and universities in Illinois and Tennessee (in chemistry, German drama, and philosophy) before settling down for a doctorate in Economics at Cornell (1916). His dissertation, *Risk, Uncertainty, and Profit*, published in 1921, quickly became and remains a classic in economy theory. His broader ranging interests were reflected early in essays written over the period 1921–1935 and published in *The Ethics of Competition* (1935), the first of his three volumes of collected papers.

Knight’s active teaching career included Cornell and the University of Iowa before the University of Chicago, which he joined in 1928 and where he became the primary intellectual source for the original, or pre-Friedman, “Chicago school”

of economics. At Chicago, Knight put his stamp on several generations of students who learned economics with philosophical overtones. After visiting stints at several universities in his post-retirement years, he died in Chicago in 1972 at the age of eighty-seven.

Do other students of Frank H. Knight experience reactions similar to mine when I reread one of his essays? Having struggled to develop a plausibly coherent intellectual position, and in one sense, feeling a bit of pride in my achievement, I find myself confronted time and again with Knight's much earlier and more sophisticated statement of the same thing. It is as if in rereading Knight I am retracing the sources of my own thoughts, which themselves have somehow emerged without conscious recognition that they are derived from him.

My own relationship to Frank Knight in this respect is, I think, quite different from the more straightforward teacher-disciple connection. When confronted with an intellectual-philosophical "puzzle," I do not go back to search out and see what the master may have written on the subject. For me, Knight's works are not reference materials. In response to a "puzzle," my own proclivities are those of Knight himself (which I surely got from him also), which are those of working out my own preliminary "solution," independent of *any* authority or *any* text.

This characteristic is central to everything Knight approached. The intellectual-moral courage to treat nothing as sacred shines through all his work, perhaps most notably in the philosophical essays of the sort included in *Freedom and Reform*. Honesty, sincerity, integrity—these are the qualities that mark the writings and the man. Frank Knight knew who he was and where he was. He possessed the elementary gumption to stake out his intellectual-moral position unawed by either the "wisdom of the ages" or the potential censure of his peers in the academy. He was willing

to acknowledge his own vulnerability to error, and when he was confused, he was not reluctant to say so.

Frank Knight did not preach a gospel (despite the old University of Chicago saying that "there is no God, but Frank Knight is his prophet"). There was, to him, no gospel to be preached. He made no effort to present the "truth according to Frank Knight." He taught that "truth" was whatever emerged from the free discussion of reasonable men who approached the dialogue without prejudice and as good sports. The question as to the possible existence of something external to such a discussion-agreement process was not within his range of interest for the simple reason that it could never be answered.

Knight's audience was made up of the other potential participants in the discussion process. He did not address his words to the agents who might hold positions of governmental-political power over others. Even in a remote conceptual sense, Knight was not an adviser to governments, a characteristic that, in itself, separates Knight from so many of his fellow economists, in his time and now.

As he himself acknowledged, and as many others have recognized, Frank Knight was essentially a critic. His work, aside from *Risk, Uncertainty, and Profit*, can be interpreted as a series of long book reviews. His "social function" was that of exposing the fallacies, nonsense, and absurdities in what was passed off as sophisticated-scientific discourse. He emphasized repeatedly that the problems we face in modern society are not problems of science and education in the standard meaning of these terms. "The main task of society . . . is *education*, but of the will more than the intellect; it is to develop a more critical attitude."<sup>1</sup> I have personally heard Knight repeat many times the Josh Billings aphorism: "It

<sup>1</sup> *Intelligence and Democratic Action*, Harvard University Press, 1969. Page 14.

ain't what we don't know that hurts us. It's knowing so darned much that ain't so."

Frank Knight was not pleased with developments in modern economics. He shared with the Austrians a highly skeptical attitude toward the value of empirical research. I recall sitting with him at the American Economic Association Presidential Address by Paul Douglas, during which Douglas paraded a panoply of charts and diagrams purporting to demonstrate relationships in aggregate production functions. At the close of the presentation, Knight muttered. "Proving water runs down hill," a comment that he would surely have found applicable to much of the empirical trivia that fills the journals of the 1980s.

He would have been particularly disturbed by the image of man that the modern emphasis on empirical testability forces on the economist as practitioner. To make hypotheses operational, arguments in utility functions must be specified. Old-fashioned *homo economicus*, man as net-wealth maximizer, reemerges as the actor on center stage. To Frank Knight this reemergence could only reflect retrogression into a simplistic and wrongheaded usage of the valuable insights that economic theory can offer. *Homo economicus* exists in every man, but one of Knight's most persistent themes through all his works is that there exist all sorts of other men (the romantic fool, the sportsman who enjoys the fray, the prejudiced ignoramus, the man who wants to be a "better" man) alongside the rational maximizer of economic interest.

To Knight the task for economists (and for social philosophers) is not to be located at the extensive margin of "science." The task is to be located squarely at the level of elementary common sense. No sophisticated analysis is required to recognize that legally-enforced wage floors cause unemployment or that inflation cannot increase production in any long-term sense. But many men are prejudiced and romantic fools.

The job is to cut through the cant of the professional and tackle the intellectual prejudice where it exists. In staking his own effort toward some ultimate attainment of common sense by ordinary citizens, Frank Knight categorically rejected the elitism too often met in the academy and at the same time reaffirmed his own faith in a society of free men. While he remained always pessimistic as to its potential realization, such a society was, for Knight, the only one worthy of serious consideration.

I am especially pleased that LibertyPress is republishing *Freedom and Reform*. Over and beyond the desirability of insuring that the essays here will now be available again to potential readers, there are particular reasons that make LibertyPress republication appropriate. Pierre Goodrich, whose works made LibertyPress possible, shared with Frank Knight more than membership in the same age cohort. These men shared a respect for ideas and a love of individual liberty. They were also men of mid-America, and the location of the source of the republication is itself of value. Frank Knight personified the mid-American scholar-skeptic-critic of his age. The man and his mind could never have emerged from the culture of either Europe or the American seaboard. And, sad to say, such a man could probably not emerge anywhere in the culture of the late twentieth century.

In this connection, I shall conclude by recalling a conversation with Professor Ronald H. Coase when he and I were colleagues at the University of Virginia, where Frank Knight had visited for an extended period. Coase and I were walking along Mr. Jefferson's Lawn, and we had been discussing famous economists. Ronald said something like the following to me. "I can think of almost any famous economist, like \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, or \_\_\_\_\_," naming the obvious world-renowned figures in our discipline as evaluated from the perspective of the early 1960s, "and I can sort of imagine

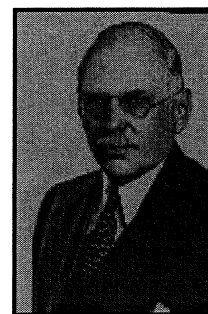
*Foreword*

myself in their position of fame with a bit of luck, persistence, and effort. But I simply cannot imagine myself to be like Frank Knight. I guess that amounts to saying that Knight is a genius." I have always remembered that conversation because Coase put so well what so many of us feel when we think of the professor from whom we learned so much.

*JAMES M. BUCHANAN*

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*James M. Buchanan is the author of many books and articles, including The Calculus of Consent (with Gordon Tullock), The Limits of Liberty: Between Anarchy and Leviathan, and What Should Economists Do?*



Frank Knight

Frank H. Knight

## An Annotated Bibliography

by Ross B. Emmett\*

[Knight's Life](#)
[Knight's Works](#)
[Knight Today](#)
[References and online editions](#)

### Knight's Life

Frank Hyneman Knight (1885-1972) was among the most broad-ranging and influential economists of the twentieth century. As an economic theorist, he laid the foundations for the modern theories of financial markets and entrepreneurship. As a teacher, he helped establish the Chicago school of economics: his students included Nobel Laureates Milton Friedman, George Stigler and James Buchanan. As a classical liberal, he argued against those who wished to use policy for the "betterment" of society. And as a critic, he urged economists not to forget the limits of their knowledge.

"When a man or group asks for power to do good, my impulse is to...cancel out the last three words, leaving simply 'I want power'; that is easy to believe."—Frank H. Knight, Presidential address to the American Economic Association.

Knight was born in McLean County, Illinois on November 15, 1885. The eldest child of a farm family, Knight's early education was sacrificed to the demands of farm life (as was that of his brothers Bruce and Melvin, who went on to teach economics at Dartmouth and Berkeley). He did not leave for college until his early twenties. After stints at several small, evangelically oriented colleges, he graduated from the University of Tennessee, with a bachelor's degree in the natural sciences and a master's degree in German. He received his Ph.D. from Cornell University in 1916. Over the next fifty years, he taught at Cornell, the University of Iowa, and the University of Chicago.

Knight arrived at Chicago during a period of transition for the economics department. Along with the theorist Jacob Viner, he quickly established himself as an integral part of the department's future. He was hired to teach history of economic thought, but often taught economic theory as well. He eventually developed a course on economics and social policy, which he co-taught with a philosopher, Charner Perry (on Knight's teaching and role in the department, see Patinkin<sup>1</sup> and Reder<sup>2</sup>). He also wrote a brief introduction to economics—*The Economic Organization*—that was adopted as a text in the general introductory course in the social sciences taught to undergraduates at the University of Chicago during the 1930s. Among the students who were introduced to economics through this book was Paul Samuelson, who used Knight's framework for the opening chapter of his own famous text.

Knight's contributions to the University were not confined to the classroom. In 1928, he and Viner assumed editorship of the *Journal of Political Economy*. During their tenure, the *Journal* became one of the top journals for economists. Along with Robert Hutchins (President of the University, and advocate of liberal education based on reading of the "Great Books"), the economic historian John Nef, and the sociologist Robert Redfield, Knight helped to found the University's interdisciplinary Committee on Social Thought. In recognition of his wider interests, Knight was eventually made Professor of the Social Sciences and Philosophy. Although he retired in 1952, Knight remained active both teaching

"In a democracy, the notion of control is not merely unethical, it is excluded, ipso facto."—*Role of Principles in Economics and Politics*

and writing until the mid-1960s. He was a frequent visitor at universities across North America, speaking on the economics and philosophy of social policy. His lectures on that topic at the University of Virginia in 1958 were published as *Intelligence and Democratic Action*.

Knight's contributions brought him recognition throughout his career. His dissertation, the basis for his widely-read *Risk, Uncertainty, and Profit*, took second prize in a 1917 essay competition sponsored by Hart, Schaffner and Marx. In 1950, he was named President of the American Economic Association, and, in 1957, he was awarded the Association's Francis Walker Medal, which was given every five years "to the living American economist who has made the greatest contribution to economics." Knight was also a Fellow of the American Academy of Arts and Sciences and of the Italian national honorary society Accademia Nazionale Dei Lincei, and was selected by the United States Chamber of Commerce for one of its Great Living American Awards in 1959. (For general overviews of Knight's life and work see, Breit,<sup>3</sup> Buchanan,<sup>4</sup> Emmett,<sup>5</sup> and Stigler.<sup>2</sup>) He died in Chicago on April 15, 1972.

### Knight's Works

Knight's influence on economics began with his doctoral dissertation. Completed at Cornell under the direction of Allyn Young, and revised following advice from J. M. Clark, the thesis was published in 1917 as *Risk, Uncertainty, and Profit*. In it, Knight examined the relation between knowledge and changes in the economy. He argued that it was important to distinguish between two very different types of change, which he called **risk** and **uncertainty**. Risk arose from those repeated changes for which the probabilities can be discovered, such as car accidents or house fires. By joining together with others and pooling their risk, people could insure against these changes. Uncertainty, on the other hand, arose from those unpredictable changes in the "givens" of an economy—its resources, preferences, knowledge and so on—that could not be insured against. For Knight, uncertainty renders impossible the perfect knowledge implicitly assumed by neoclassical economics. However, uncertainty also creates the possibility of profit, which is generated as entrepreneurs try to predict the unpredictable; those who succeed make money from changing conditions.

"Business life in the strictest sense never conforms closely to the theoretical behavior of an economic man. Always history is being made; opinions, attitudes, and institutions change, and there is evolution in the nature of capitalism...."—*Statics and Dynamics*

Because uncertainty makes the prediction of human action impossible, Knight sees entrepreneurial action as essentially "tragic." Entrepreneurs who succeed try to replicate their success; yet because of uncertainty, their success depends on luck, and so cannot be replicated. Their failures lead them to substitute organization and management for true entrepreneurial action. Since managers are not entrepreneurs, the organizations they run are better at cost control than profit-seeking. In the end, Knight concluded that economic change emerges from the constant tension between new entrepreneurial action and existing businesses hedging against uncertainty by expanding the scope of their internal organization (Emmett<sup>8</sup>).

*Risk, Uncertainty, and Profit* set the tone of much of Knight's work over the next couple of decades. Knight defended traditional neoclassical economic theory as necessary, but not sufficient, to understand modern economic organization. He argued that economics' analytical power arises from its restrictive assumptions about the world. These would have to be relaxed, over perhaps even set aside, to fully explain the economy. Relaxing these assumptions, Knight went on to argue, takes us far beyond the boundaries of economic theory, and hence limits the predictive power of economics. Moreover, the combination of unpredictable human action and uncertainty limits the possibility for *any* predictive science of human conduct, making effective social control impossible.

Knight's contributions to the development of economic theory from the 1920s to the 1940s reflect this framework. In articles like "Cost of Production and Price Over Long and Short Periods", "Bemerkungen über Nutzen und Kosten", "The Ricardian Theory of Production and Distribution", the series articles on capital theory written in his debate with the Austrians (see "The Quantity of Capital and the Rate of Interest" for a summary statement of his view), and "Realism and Relevance in the Theory of Demand," Knight calls attention to the implications of



the restrictive assumptions of neoclassical theory for the possibility of understanding economic change.

Knight's emphasis on the need to appreciate both the power of economic theory and its limitations carried over to his methodological and ethical writings during this period. In the mid-1920s, he extended the argument of *Risk, Uncertainty, and Profit* while defending economic rationality against the Institutionalist economists, who wanted to create a more realistic economic theory. At the same time, he, unlike most economic theorists (including many of his own students) explored the limitations of economic rationality as the basis for a predictive science. "The Limitations of Scientific Method in Economics" is the most famous of these articles, but see also "Ethics and the Economic Interpretation".

The interplay of economic theory and moral philosophy articulated in the latter essay was carried forward in "The Ethics of Competition", in which Knight argued that market organization does not "produce" moral people, at least by any standard account of ethical behavior. Eventually, Knight launched a major evaluation of the relation between ethics and economics, examining utilitarianism, liberalism and Marxism, and Christianity ("Ethics and Economic Reform"; Knight and Merriam, *The Economic Order and Religion*). His scathing attack on the possibility of Christian social ethics—"evil rather than good seems likely to result from any appeal to Christian religious or moral teachings in connection with the problems of social action"—foreshadowed his argument in the 1940s and 1950s against those who sought moral solutions to modern social problems.

By the 1930s, the importance of moral philosophy as a supplement to economic analysis was complemented in Knight's work by a focus on the importance of historical study. In "Statik und Dynamik", published in English in 1935 in *The Ethics of Competition*, he argued that there is an "impassable gulf" between the equilibrium states posited by economic theory and the actual path taken by a real economy, and that the latter require a historical examination which cannot assume movement toward equilibrium. The focus on history grew out of his immersion during the mid-1920s in the German historical school, which sparked a lifelong interest in the work of Max Weber. In 1927, Knight produced the first English translation of Weber's work: *General Economic History*. Knight would have continued to translate Weber's work, if his friend Talcott Parsons had not already arranged for the translation of several key works, including *The Protestant Ethic and the Spirit of Capitalism*.

During this period, Knight also laid the foundations for his own history of modern liberalism. Unlike his contemporaries, Knight did not see the history of liberalism as one of gradual illumination and progress. Rather, his account is tragic: the obstacles that our ancestors faced—arbitrary power and absolutist claims regarding knowledge—continue to rise up before us and threaten to return us to tyranny unless we are constantly vigilant (see, for example, "The Sickness of Liberal Society"). Knight argued that the most important contemporary challenges to liberalism were "scientism" and "moralism"—the substitution of the absolutisms of science or morality for the open-ended discussion of democracy—not socialism.

When Knight considered the threat of socialism to liberty, he did not focus on its economic shortcomings. In "The Place of Marginal Economics in a Collectivist System", Knight, like his socialist colleague at Chicago, Oskar Lange, argued that even socialist planners would have to obey the underlying principles articulated in neoclassical theory. Thus, what was needed was not an economic critique of socialism, but an ethical and political one. For Knight, socialism was just another of the diversions from the road to liberty for which modern liberals must constantly watch. But in principle socialism posed no greater threat to the open discussion of democratic society than scientism and moralism ("Socialism: The Nature of the Problem" and "Laissez-Faire: Pro and Con").

#### Knight Today

In an age which often featured new deals and great programs, and which usually

"But the realism of such theorizing [about economic fluctuations] would be severely limited because the heart of the phenomena in the human case is uncertainty, error, and speculation...."—"Realism and Relevance in the Theory of Demand"

"The latest 'new economics' and in my opinion rather the worst, for fallacious doctrine and pernicious consequences, is that launched by the late John Maynard (Lord) Keynes, who for a decade succeeded in carrying economic thinking well back to the dark age, but of late this wave of the future has happily been passing."—*Role of Principles in Economics and Politics*

cast the social debate in terms of the ideals of free enterprise versus those of socialism, Knight pointed to a less ambitious, more practical social philosophy. He reminded us of the common sense embedded in economic theory, a common sense that we ignore at our peril. He argued that economics should lead us to question the goals of those who would seek to "better" society by enforcing changes through government action. For Knight, the exercise of social control too often led to a state of affairs that was worse than the original situation.

Yet Knight was never unqualified in his acceptance of free enterprise. He argued that liberalism's greatest achievement—freeing individuals from the shackles of arbitrary power—could be abused if free individuals do not seek to become better persons. Thus, his reading of the history of liberalism offers only a qualified sense of hope for its future; unless we continue to strive and remain open to discussion about what we could (and should) become, tyranny awaits. Fortunately, for Knight and for us, the conversation remains open.

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A complete bibliography of Knight's work is available<sup>9</sup>. The recent publication of *Selected Essays by Frank H. Knight*<sup>6</sup> provides the first collection of Knight's essays spanning the entirety of his career and the breadth of his interests. Earlier collections of his work focused on economic and philosophical material from specific decades: *The Ethics of Competition and Other Essays*; *Freedom and Reform: Essays in Economics and Social Philosophy*; and *On the History and Method of Economics: Selected Essays*. Knight's papers are held in the University of Chicago Archives.<sup>10</sup>

"A humorist [Will Rogers] once popular in this country stated my favorite "principle" in education: 'It ain't ignorance that does the most damage, it's knowin' so derved much that ain't so.'"—*Role of Principles in Economics and Politics*

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<sup>1</sup> Patinkin, Don. 1981 [1973]. "Frank Knight as Teacher." In *Essays On and In the Chicago Tradition*, 23-51. Durham: Duke University Press.

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<sup>7</sup> Stigler, George J. 1987. "Frank H. Knight." In *The New Palgrave: A Dictionary of Economics*, ed. John Eatwell, Murray Milgate and Peter Newman, vol. 3, 55-59. New York: Stockton Press.

Additional Websites:

[The New School: Knight](#)

"The first question in regard to scientific economics is this question of how far life is rational, how far its problems reduce to the form of using given means to achieve given ends. Now this, we shall contend, is not very far; the scientific view of life is a limited and partial view; life is at bottom an exploration in the field of values, an attempt to discover values, rather than on the basis of knowledge of them to produce and enjoy them to the greatest possible extent."—*Ethics of Competition*

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The cuneiform inscription in the logo is the earliest-known written appearance of the word "freedom" (amagi), or "liberty." It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.

Picture of Frank Knight: ©: Ethel V. Knight.

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