

# K. William Kapp's *Social Theory of Social Costs*

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This article deals with the theory of social costs by K. William Kapp, namely, the origin, gestation, and further development of *The Social Costs of Private Enterprise* (1950). This article analyzes archival material to show that Kapp viewed *Social Costs* as a continuation of his contribution to the socialist calculation debate (Kapp 1936), in which he defended the socialist position on the possibility of rational planning, including the need to prevent social costs *ex ante*. In this defense he proposed a “countervailing impossibility thesis,” according to which social costs are proof that the market calculus disregards social needs, which cannot be rational from the perspective of society. Kapp understood his position in the debate as defending Max Weber’s notion of the substantive rationality of planning against Ludwig von Mises’s “impossibility thesis.” During his career Kapp refined his defense of the substantive rationality of planning. The result of this refinement is a foundation for social economics, which Kapp viewed as synonymous with the intellectual project of American institutional economics. This foundation consists of a framework for social-democratic planning based on theories of social costs and benefits, social needs, social value, social minima, socio-ecological indicators, and social

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knowledge. While the socialist calculation debate is the origin of Kapp's defense of planning, he continuously developed it to take account of instances where public administration in Soviet Russia and India fell short of being substantively rational. Kapp never adopted the polarization of capitalism versus socialism. Instead he envisioned a social-democratic framework that effectively ties market, state, and civil society actors to a substantive rationality, that is, social minima. This approach is also dubbed "new rational humanism" because it aims to guarantee social minima that are rooted in existential human needs. The latter are analyzed in a new science of integrated social knowledge on the existential biological and cultural structure of the human being in society. Thus, Kapp's social economics provides a crucial link to ecological economics, environmental sociology, and philosophical anthropology. Hence, Kapp developed a genuinely *social* theory of social costs, which originated as an explicit defense of the substantive rationality of planning to prevent social costs and guarantee social minima, which became the foundation of a comprehensive theoretical framework of social economics.

### **The Birth of "Social Costs" out of the Spirit of the Socialist Calculation Debate**

The trajectory of the social costs discourse in the twentieth century is crucially shaped by the reaction of the Chicago school to American institutionalism, including Kapp's institutional theory of social costs (Berger 2012, 2013; Franzini 2006). What has not been sufficiently registered is that this ideological conflict is an extension of the socialist calculation debate of the 1920s and 1930s, which was the cradle of Kapp's theory of social costs. In this debate, his dissertational treatise "Planwirtschaft und Aussenhandel" ("The Planned Economy and International Trade") (Kapp 1936) sided with the socialists. This work has never been translated into English, and thus the present analysis sheds new light on the genesis of Kapp's theory of social costs.

The thesis of the present article, namely, that Kapp's dissertation contains the nucleus of the theory of social costs, is confirmed by the introduction to *The Social Costs of Private Enterprise* (Kapp 1950b, xxvii–xxviii):

The basic idea of the present study was first advanced in a highly tentative manner in the author's attempt to deal with the problem of economic calculation in connection with his analysis of the economic relations between a foreign trade monopoly and private exporters and importers.

Kapp argued in his dissertation that Mises's (1920) thesis about the impossibility of a rational economy under socialism needs to be countered with an impossibility thesis regarding the market economy. This thesis should be that the economic calculus based on market prices does not meet the requirement of the economic principle from the perspective of society. Kapp sought to defend the possibility and necessity of rational planning by pointing out the one-sidedness and the resulting blind-spots in the Mises argument about the superior rationality of markets. In an unpublished interview (Kapp n.d.a), Kapp explained that he understood the emergence of his argument on social costs to be the result of various factors, including the "great debate initiated by Ludwig v. Mises and Max Weber," the economic calculation controversy, his background of dealing with problems of economic planning, and his critical attitude toward a "free enterprise economy." Kapp's own explicit understanding of the nucleus of his argument as a case of "Weber vs. Mises" on the rationality of the price system is also confirmed in "Social Costs and Social Benefits: A Contribution to Normative Economics" (Kapp 1963b). Arguing that markets are only formally rational but not from the perspective of society, Kapp adopted Weber's analytical framework of the conflictual relationship between formal and substantive rationality. In Kapp's "countervailing thesis," social damages serve as proof of the impossibility of markets to rationally allocate goods and services from the perspective of society. Thus, in this light they reflect the market's purely *formal* rationality, which from the perspective of society appears limited, biased, and even arbitrary.

### **The Fatal Flaws in the Market's Calculus**

The dissertation presents three distinct arguments why a calculus based on market prices only formally meets the requirements of the economic principle while failing to do so from a societal perspective. First, it attends to the issue that insolvent needs are disregarded in a "free exchange-economy" by quoting the second edition of Carl Menger's (1923, 49) *Grundsätze der Volkswirtschaftslehre (Principles of Economics)*. Menger maintains that in business, even the most compelling and urgent needs of the destitute have no weight at all, even among financially comfortable people who are the most sympathetic. The business world disregards the genuine human needs of the population while eagerly pursuing the needs of those who are able and willing to pay. Second, Kapp notes that the market calculus is a source of error and irrationality in the formation of individual valuation, quoting again Menger (1923, 3) on illusionary, undeveloped,

and pathological needs. Psychological manipulation of consumers through advertisement means, according to Kapp, that the economic principle is only fulfilled *formally* because less important needs are satisfied at the cost of more important ones.

Third, Kapp argues—partly with reference to A. C. Pigou (1929, 186, 197)—that the disregard for numerous damages under an economic calculus of market prices means that this calculus is uneconomic from the standpoint of society while being completely consistent with the economic principle that secures the profitability of the private business. The numerous social damages mentioned are the disruption of national health; increases in crime, accidents, and employment-related illnesses and accidents; inadequate protection of motherhood; excessive smoke concentrations; noise pollution; unhealthy construction work; retardation of scientific progress because of patents; advertisement; and premature resource depletion. In a footnote to this closing section on social costs, Kapp (1936, 42) anticipates his future research agenda, which was to materialize in *Social Costs*:

It would be an interesting task for statistics to develop correct methods for the capturing of disadvantages and damages which accrue to society in a free market economy due to the activity of independent entrepreneurs that is solely based on the principle of highest profitability.

The above limitations of an economic calculus based on market prices necessitates, in Kapp's view, economic planning for social benefits. That the valuation of goods according to market prices frequently disregards societal needs and interests reflects a basic incapacity of markets to incorporate these needs in its calculus. In this perspective, economic viability from a societal perspective cannot be achieved by markets alone. As evidence for this conclusion, Kapp refers to social policies in capitalist economies, which compensate retroactively for social damages via laws, and charitable measures. Kapp further concludes that the planned economy can calculate potential damages beforehand and take them into consideration in economic decisions. This conclusion is the origin of Kapp's later fully developed argument about the necessity to prevent social costs *ex ante* and thus to guarantee the fulfillment of social needs. As examples of social needs, Kapp initially considers foremost the defense against dangers that threaten the existence of society, such as epidemics, illnesses, enemy attacks, but also agencies that improve the general welfare, public health, and the cultural level of society. The important task for the planned economy is, according to Kapp, to establish principles for the valuation of

goods based on the needs and goals of society. Just like in the case of social costs above, it is a footnote that indicates the future course of study on social valuation:

Because this question would exceed the frame of this work a systematic treatment of the system of economic calculation on the basis of “social value” should be reserved for a later treatment. (Kapp 1936, 46)

Kapp traces the problem of social valuation to Albert Schäffle's *Bau und Leben des Sozialen Körpers* (*The Structure and Life of the Social Body*) (1881), and Friedrich Wieser's (1924, 116) “*Theorie der Gesellschaftlichen Wirtschaft*” (“*The Theory of the Social Economy*”). In conclusion, Kapp's argument on social costs can be traced back to the socialist calculation debate, in which it was forged as a critique of the formal rationality of the market calculus and a justification for economic planning that guarantees the fulfillment of social needs.

### **The Graduate Institute of International Studies and the Institute for Social Research**

Kapp's early work was supported by the Institut universitaire des hautes études internationales (IUHED, Graduate Institute of International Studies) in Geneva. Archival research indicates that Kapp had attempted to enroll at the University of Frankfurt to work on his doctorate in 1933. The university's enrollment form, however, asked for evidence of Aryan descent, and perhaps the rise of Nazism is the principal reason that Kapp emigrated together with his future wife, Lili Lore Masur, who was Jewish, to pursue doctoral studies at IUHED. The latter also provided a haven for “concerned liberals” in the 1930s, some of whom became leading protagonists in building the neoliberal flagship organization, the Mont Pèlerin Society (Mirowski and Plehwe 2009). The preface to his dissertation expresses Kapp's gratitude to Mises for his continuous suggestions and stimulations, and both Mises and Eugene Stanley of the University of Chicago for the friendly interest they took in his work. The fact that Kapp's argument on social costs emerged at this particular institute buttresses my thesis about its origin. As an economist with socialist leanings,<sup>1</sup> Kapp used the phenomenon of social costs to defend the socialist position on planning against Mises's antisocialist thesis.

1. Kapp's secondary school teacher, the notable German novelist and poet Ernst Wiechert, writes in his post-World War II autobiography that Kapp played a leading role in the school's socialist youth organization.

Kapp also relied for support on the so-called neo-Marxist Frankfurt school, with which he was acquainted in its Geneva exile between 1933 and 1936. Reconstituted as the Institute for Social Research at Columbia University, it supported Kapp's work on social costs financially and was most likely decisive in providing Kapp with a teaching position at Columbia. The principal reason for this affiliation is that Kapp's framing of social costs as a problem of rationality is in line with what Michel Foucault ([1979] 2008, 106) dubbed the "post-Weberian" project of the Frankfurt school, to investigate the irrational rationality of markets. Previous archival research shows that Kapp was a close friend of Friedrich Pollock, the economist of the Frankfurt school (Berger and Forstater 2007), and his dissertation cites the latter's research on the increased capabilities of planning that result from improved statistical methods and technologies (Kapp 1936, 25). Pollock also influenced *Social Costs*:

I also wish to acknowledge gratefully a grant-in-aid which I received from the Institute of Social Research at Columbia University from November 1943 to May 1944. In this connection I wish to record my gratitude to Dr. F. Pollock, Associate Director of the Institute of Social Research, who read the entire manuscript and made many valuable suggestions related to specific phases of the study. (Kapp 1950b, xxx)

It was also Pollock who invited Kapp to participate in a leading role in the formation of the newly founded Institute for Social Research in Frankfurt in the 1950s.<sup>2</sup> Furthermore, *Social Costs* references leading authors of the Frankfurt school, such as Erich Fromm and Max Horkheimer. The position of *Social Costs* within the intellectual project of the Frankfurt school's post-Weberianism turns it into an important link between sociology and economics. In conclusion, the institutional context reflects the origin and core of his argument on social costs. The doctoral candidate Kapp used the latter to launch a post-Weberian attack à la Frankfurt school on Mises's liberalism in order to defend the necessity for economic planning.

### **The Early International and Environmental Focus**

The close affiliation of IUHED with the League of Nations and ILO also proved decisive for the early international and environmental orientation

2. Research in the Kapp Archive has shown no evidence that Kapp accepted the invitation. The present author's inquiries with the institute on this matter have not been answered.

of Kapp's research on social costs. On the one hand, it provided Kapp with an early learning experience on how to insert his economics within the context of international organizations of outstanding importance. See, for example, his membership on the expert committee that prepared the United Nations conference on the human environment in Stockholm, and his membership on the Standing Committee of the Social Science Council of UNESCO. Combined with his dissertation's discussion of pollution and resource depletion, his early international orientation led to Kapp's work on the League of Nations' discussions on natural resources. As a research assistant of John B. Whitton (Princeton University) between January and September 1937, Kapp prepared the "Memorandum on the Efforts Made by the League of Nations towards a Solution of the Problems of Raw Materials" (1937) and submitted it to the 1937 International Studies Conference held in Paris under the auspices of the International Institute for Intellectual Cooperation. Following an invitation from the International Industrial Relations Institute in The Hague, Kapp delivered a report on the work of the League of Nations Committee for the study of the problem of raw materials at the institute's conference in 1937. Later Kapp also published *The League of Nations and Raw Materials, 1919–1939* (1941). His relatively early involvement with issues of environmental disruption and natural resources as economic themes continued after his immigration to the United States, where he initially concentrated on social damages in agriculture, which led him to also see the interrelatedness with water and air pollution (see Kapp n.d.a). This explains *Social Costs'* environmental focus, that is, its five chapters on issues such as air and water pollution, renewable and nonrenewable resources, and resource utilization. This special attentiveness to nature and the environment earned him the recognition as one of the earliest economists to comprehensively analyze environmental problems and even as augur of the environmental crisis.<sup>3</sup>

However, this early interest in the environment may be only partly related to the influence of Pigou's work and the research opportunities at IUHED. Rather, it is documented that Kapp's susceptibility to the theme of industrial society's relationship with nature antedates the 1930s. The profound and lasting ethical influence of his teacher, the famous German novelist Ernst Wiechert, is acknowledged in a series of articles and also documented in their extensive post–World War II correspondence (Berger,

3. See also Marc Tool's and Wilfred Beckerman's special recognition of Kapp as augur of the environmental crisis (Berger 2012).

forthcoming). Kapp highlights Wiechert's lessons on the great importance of nature as refuge, inspiration, and mental and physical restoration, but also the ethics of "love for all suffering creatures."<sup>4</sup> The focus on nature is, thus, deeply rooted in Kapp's biography since his formative years in the 1920s.

**“Social Costs and Social Returns:  
A Critical Analysis of the Social Performance  
of the Unplanned Market Economy”**

Archival material shows that in the 1940s Kapp continued to develop his defense of the socialist position in the socialist calculation debate by elaborating the social cost argument as a critique of the market calculus and a rationale for economic planning. Two unpublished drafts of the introduction to *Social Costs* state that the intention is to provide a critique of the unplanned market economy, equilibrium economics, and capitalism:

As an analysis of the social inefficiency of the unplanned market economy the study was bound to assume the character of a critique not only of capitalism but also of traditional equilibrium economics. (Kapp n.d.b)

The unpublished project outline “Social Costs and Social Returns: A Critical Analysis of the Social Performance of the Unplanned Market Economy” restates this aim with reference to the liberalism of Mises and Friedrich Hayek:

Social Costs and Social Returns: A Critical Analysis of the Social Performance of the Unplanned Market Economy—In harmony with the faith of 19th century liberalism traditional equilibrium economics states that the unregulated forces of supply and demand in an unplanned market economy tend to lead to an optimal allocation of scarce resources among competing ends and objectives. This doctrine continues to be regarded by many as an apparently scientific foundation for all arguments against positive intervention with the economic process in the capitalist economy; its strength is attested by the current success

4. For a brief comparison between Kapp's economics and the early land ethic of Aldo Leopold, see Swaney 2006. For a more detailed account of Leopold's early ecological economics, which exhibit striking similarities to Kapp's approach, see Goodwin 2008.



of the books by Hayek and Mises. . . . This study offers a critique of the basic premises of 19th century economic liberalism by examining the social performance of the unplanned market economy in the light of several facts which are usually omitted and neglected in economic theory. . . . In the first place it attempts to indicate the limitations of all economic calculations in terms of private costs and private returns. To allocate economic resources merely in accordance with private costs and private returns defeats any endeavour to find a rational solution to the economic problem. (Kapp n.d.c)

These materials clearly show that Kapp continued his defense of the socialist position from the socialist calculation debate by developing the argument on social costs as a critique of liberalism while adding the targets “capitalism,” the “unplanned market economy,” and “equilibrium economics.” This is also confirmed in a letter to John M. Clark, which laments the strength of the liberal tradition reflected in the considerable response enjoyed by the recent works—presumably Hayek’s *Road to Serfdom* (1944) and Mises’s *Bureaucracy* (1944)—of these “intransigent economic liberals [Hayek, Mises, and Robbins]” (Kapp to Clark, December 12, 1945, quoted in Berger 2013).

The above unpublished outline also pitches the project against the “prophets of gloom [Hayek and Tocqueville]” who believe that economic planning would imply an inevitable road to serfdom. However, chapter 2 of the final version of *Social Costs* states that the important questions raised by the “current debate on the ‘road to serfdom’” were only indirectly related to the problems under discussion in *Social Costs* and are thus not addressed in more detail in the book (Kapp 1950b, 24). This makes sense when we take into consideration that Kapp separated the initial project, publishing *Social Costs*, while leaving unpublished the sections on social benefits. Only the latter would have been directly related to Hayek’s critique of planning in *The Road to Serfdom*. The unpublished second part was described in the initial project outline as

the re-orientation of economics; . . . [exploration of] the possibilities for the setting up of valid criteria for economic planning and the formulation for economic policy, and perhaps to prepare the way for the elaboration of a positive theory of social value are the chief ultimate purposes of this inquiry. (Kapp n.d.b)

Kapp aimed at developing a theory of social benefits

derived from the gratification of collective needs; from international economic policies designed to achieve a balanced economy . . . and from the improvement of transportation facilities . . . scientific research, multiple purpose projects (such as TVA), and the maintenance of a social minimum with respect to essential foodstuffs, medical care, housing, and education. (Kapp n.d.b)

The decision not to publish the part on planning for social benefits raises questions as to the reasons for excluding this important material. After all, economic planning for social benefits was the larger goal, for which the argument on social costs had merely been intended as a rationale with respect to Mises's thesis. Likewise, in the Kapp-Clark correspondence *Social Costs* was deemed only a first step for the development of a social economics based on theories of social benefits and social valuation (Berger 2013).

What happened to the important social benefits part of the initial project? Previous archival research (Berger 2013) evidences the critical nature of John M. Clark's comments on Kapp's draft manuscript. In a nutshell, Clark considered Kapp to have failed in providing any detailed formulation and evaluation of the potentials and limitations of a "collectivist alternative." Clark urged him to consider that every system, including alternative collectivist ones, would have imperfections and that the desired comprehensive social accountancy might not come about in such a system and that the dispute would be shifted from the "machinery of the markets" to the "political machinery." The unpublished project outline provides further reasons for delaying the work on social benefits. It states that providing solutions via social benefits for each instance of social costs would have unduly enlarged the manuscript, destroyed the continuity of the text, and raised the important issue of liberty, which needs a separate treatment (Kapp n.d.c).

The absence of a discussion of freedom in *Social Costs* was also a point of critique made by Frank Knight, who noted, however, that this issue had been dealt with in a separate article published in the same year, that is, "Economic Planning and Freedom" (Kapp 1950a; Knight 1951). Presumably, the decision to publish *Social Costs* without a discussion of social benefits of planning made a treatment of the issue of freedom in the planned economy unnecessary. This also explains Kapp's above comment that the issues raised by Hayek's *Road to Serfdom* are not directly related to *Social Costs*, which is solely a critique of the unplanned market econ-

omy and capitalism. In a later interview Kapp (n.d.a) mentioned as further reasons for the separation of the initially intertwined projects that completing the entire argument on social benefits would have taken too long at the time and that he had completed only three chapters. He also explained that he viewed his work on development planning in India in the late 1950s and early 1960s as a continuation of this work. This view is confirmed by the chapter "Social Costs and Social Benefits: Their Relevance for Public Policy and Economic Planning" published in his book on economic planning in India (Kapp 1963c).

### **"Private," "Free," or "Business" Enterprise**

*The Social Costs of Private Enterprise* is Kapp's most significant publication in terms of scholarly impact. The work was reviewed widely, most notably by Frank Knight (1951) and John M. Clark (1950), and it attracted responses from economists such as James Buchanan (1962), Guido Calabresi (1961), and Wilfred Beckerman (1972) (for a discourse analysis, see Berger 2012). Google Scholar lists around 630 citations, while the second enlarged and revised edition, which was titled *The Social Costs of Business Enterprise* (Kapp 1963a), shows upward of 220 citations.

*Social Costs* exerted a significant influence on the community of scholars forming under the banner of ecological economics (Ropke 2004), especially those working on the environmentalism of the poor (see, e.g., Martinez-Alier 2002), and the integration of social-ecological economics (Spash 2011), but also environmental sociologists (Foster 2010). Even leading environmental economists like Allen Kneese relied on *Social Costs* in his critique of Pigou's and Coase's theories of externalities: "A perspective more like that of the present paper is found in Kapp" (Ayres and Kneese 1969, 282n1, 295). The group of scholars who awarded most recognition to Kapp's work on social costs is found in the American institutionalist movement, reflected most notably in the works of James Swaney (2006) and Marc Tool (1978, 1):

Dr. K. William Kapp and his forty-year career as a front rank institutional economist . . . [established] the relevance of the holistic, institutional mode of thinking to the complex and urgent problems of environmental deterioration and economic development. Indeed, Kapp was among the first to explore the interdependent significance of these two problems.

This appreciation was also reflected in Kapp's contribution to the formation of the Association for Evolutionary Economics and his collaboration with Gunnar Myrdal on the (unsuccessful) formation of an international association of institutional economists (see Berger and Steppacher 2011 for details). Upon arrival in the United States in 1937, Kapp endeavored to connect his arguments on social costs and benefits with the conceptual frameworks of the American institutionalists. In fact, he even developed the book project *The Foundations of Institutional Economics* with the initial working title "The Foundations of Social Economics." This clearly demonstrates Kapp's recognition of the identity of the American institutional movement and his project of social economics (see Berger and Steppacher 2011). Kapp explicitly placed *Social Costs* in the tradition of social and institutional economics, notably Thorstein Veblen's theory of business enterprise, in the preface to the second enlarged and revised edition, which was titled *The Social Costs of Business Enterprise* (1963a, xxvii):

The change of the title to *Social Costs of Business Enterprise* is intended to express more explicitly the affinity of our analysis to the intellectual tradition of . . . institutional economic theory. . . . [It was] Veblen who, as early as 1921, called for an investigation by economists in consultation with the technical expert, "of the various kinds and lines of waste that are necessarily involved in the present businesslike control of industry."

Kapp viewed Veblen's theory of social waste as consistent with his own views since the socialist calculation debate. Namely, social waste and damages are viewed as evidence of a systemic problem that needs to be remedied via systemic social controls. This is consistent with the finding that the theory of social waste is a "source theme" of American institutionalism (Rutherford 2011, 36; this volume), which expresses the view of the Progressive Era's experts that there are inherent market flaws and not just market failures (Leonard, this volume). But also the significant influence of John M. Clark's social economics is acknowledged by Kapp (1950b, xxvii):

His [Kapp's] interest in the problem of social costs was further stimulated by J. M. Clark's contributions to "Social Economics" as well as by the results of the unique and still largely neglected research carried out under the auspices of the National Resources Planning Board. Profes-

sors J. M. Clark and Robert Lynd read an earlier draft of the introductory and concluding chapters and have offered critical comments, which are gratefully acknowledged.

Unfortunately, Kapp decided to publish this second enlarged and revised edition of *Social Costs* in India with Asia Publishing House, which explains the relatively low level of attention it received in the United States, especially when compared with the first edition, which was published by Harvard University Press. This decision must be seen in the light of the Fulbright appointments at the Gokhale Institute of Politics and Economics and the University of Rajasthan during which he conducted research on economic planning for social benefits in India (Kapp 1963c). It may be surmised that he viewed the revised *Social Costs* not only as complementary to the latter but also as important support for the case for economic planning in India.

Further archival evidence suggests that the terms *private enterprise* and *free enterprise* (used in Kapp n.d.d) were eventually discarded because they were perceived to be “too ambiguous” in an economy characterized by large-scale government involvement (Kapp n.d.a). One might wonder why Kapp did not use a more radical title, such as “The Social Costs of Capitalism,” since his initial project outline aimed at a critique of capitalism. The early preference for the Weberian framework since his dissertation and his insistence on the need for detailed institutional analysis are significant here, as they suggest a preference for the approach of the younger German historical school (Weber) and the American institutionalists (Veblen, Clark) over the conceptual framework and terminology of Marxism. However, this distinction may not be that decisive, since even the so-called neo-Marxist Frankfurt school was associated with a post-Weberian intellectual project (see above). Additionally, references to Marx abound in *Social Costs*, and Kapp published three of his major books on economic planning in countries with socialist or communist governments, that is, Soviet Russia (1936), India (1963c), and China (1974). The latter is favorable to Maoist economic planning, especially the recycling and zero-waste schemes, and relies on Marx’s theory of social use value as a theoretical framework. Most likely, the decision to avoid the more radical title “The Social Costs of Capitalism” in the United States of the 1940s was partly related to the “red scare era” characterized by severe repression of economists of socialist or communist orientation (Lee 2009).

### “Shifting,” “Externalizing,” or “Socializing” Costs?

The search for the appropriate terminology in the 1940s also continued with regard to social damages, as Kapp tried to position his work within the US institutionalist movement. While Kapp and Clark agreed on the concept of cost shifting as a rationale for social economics and social controls, they disagreed on what to call the shifted portion of the total costs of production:

[Your definition of] “social” values and costs differs from mine in applying to non-market quantities only, where mine [Clark’s] included also the quantities the market “measures.” (Clark to Kapp, December 4, 1945; quoted in Berger 2013)

In the literature, this important difference between Kapp’s and Clark’s definition of the concept of social costs has unfortunately been conflated by describing Clark’s “shifted costs” as “social costs” (see, e.g., Prasch 2005). Distinguishing, as Kapp did, private costs from social costs (social losses, damages, inefficiencies) emphasizes that the logic of maximizing private returns is a built-in incentive for businesses to *socialize* as many costs as possible. According to Kapp, adding social to private costs results in total costs. This is an important terminology turn from the original notion of “shifted costs”:

The term [*social costs*] covers all direct and indirect losses suffered by third persons or the general public as a result of private economic activities. (Kapp 1950b, 13)

This difference in defining social costs is significant, since Clark’s definition of social costs as nonmarket plus market costs is in the neoclassical tradition of Pigou. This neoclassical conceptualization of social costs is deemed incompatible with the project of social economics by Kapp and the principal reason for its rejection. Commentators noted early on that Kapp’s definition is inconsistent with Pigou’s (Pearce and Sturmeay 1966, 152n1). While Kapp noted that Pigou had radicalized his political-economic conclusions (“bankruptcy of capitalism” and “extending public ownership”) (Pigou, quoted in Kapp 1963a, 38), he viewed Pigou’s conceptual framework as imbued with the limitations of the neoclassical theories of price and value, and closed system and equilibrium preconceptions. The latter preclude an adequate understanding of the circular cumulative causation of social costs, that is, complex causal relationships

that determine the magnitudes and qualities of the damages. The term *external costs* is seen as a consequence of neoclassical preconceptions that suggest that the issue at hand is a relatively minor and temporary aberration from a functioning mechanism, remediable with ad hoc measures within the existing system. Kapp criticized the reform proposals for environmental control that emerge from the “polluter pays principle” that underlies all market-based (taxes, bargaining) and even tort law-based approaches to social costs. The main point of critique was that these solutions address the problem of social costs *ex post* without emphasis on prevention. While he acknowledged that taxation of polluters is better than nothing, he viewed this approach as ineffective, piecemeal, and too conservative (Kapp 1971, n.d.e). Conversely, Kapp’s understanding of social costs was more akin to the American institutionalists’ conception of social costs as large-scale and systemic problems caused by the institution of business enterprise, which require far-reaching changes at the system level. In reassessing twenty years of discussions on *Social Costs*, Kapp maintained the fundamental point of dispute in the preface to the 1971 edition:

*The Social Costs of Private Enterprise* undertakes to diagnose the causes that tend to give rise to the disruption of our physical and social environment. . . . a system of decision-making operating in accordance with the principle of investment for profit cannot be expected to proceed in any way other than by trying to reduce its costs whenever possible and by ignoring those losses that can be shifted to third persons or to society at large. Predictably, this critical view, which runs counter to the presuppositions and biases of conventional economic analysis, has not met with general approval. Thus, various alternative explanations for the occurrence of social costs have been advanced. These have one thing in common: to exonerate the principle of investment for profits from any causal connection with environmental disruption. (xiii–xiv)

Stating the fundamental point of dispute as the principle of investment for profits mirrors Veblen’s terminology and reiterates the view from the socialist calculation debate that social costs are evidence of a systemic flaw in the rationality of markets. This is also interpreted as a fundamental conflict between individual and social interests (Kapp 1963b), which has not only the power to shape history:

The political history of the last 150 years can be fully understood only as a revolt of large masses of people (including business) against the

shifting of part of the social costs of production to third persons or to society. (Kapp 1950b, 16)

It also means that the relative power positions of companies and industries reflect their ability to socialize costs. The extent to which the victims can leverage countervailing power determines the extent of social costs (Kapp 1963b). Thus, Kapp's theory is a social conflict theory of social costs.

### **The Substantive Rationality of Planning: Social Minima, Social Benefits, and Social Knowledge**

His theory of social costs led Kapp to far-reaching conclusions presented in the final chapter of *Social Costs*, "Toward a New Science of Political Economy." Principal among them is the demand to "return to philosophy," referring to the words of Max Horkheimer: "Economic science must overcome 'the horizon of contemporary society'" (Kapp 1950b, 246–47). This demand is specified in the chapter in "The Broadening of the Scope of Economic Investigations," "The Reformulation and Enlargement of Basic Concepts," and "Social Choices, Social Evaluation, Social Value." The task of this new science included the objectification and quantification of social costs. The principal way to achieve this goal was to investigate social costs as deficiencies in the satisfaction of scientifically derived and socially determined minima of adequate living conditions (Kapp 1963b, [1975] 2011). Social minima reflecting social needs can be scientifically derived:

In the field of air and water pollution it is possible to work out minimum standards of public health in the form of maximum permissible levels of concentration of pollutants. Social costs and social objectives can be identified in terms of existing deficiencies by comparing the actual state of pollution with the maximum permissible concentration of pollutants. Similarly, it is possible to work out safe social minima or maximum rates of depletion of renewable resources (e.g. wildlife and fisheries) as well as water and soil by the definition of a *critical zone* beyond which any increase of depletion would give rise to an irreversible process of destruction of the resource. Minimum standards of requirements can be defined also in such fields as public health, medical care, education, housing, civilian defense, transportation and recreation. (Kapp 1963b, 195)



Thus, social minima and indicators are the main policy tools for the planning of social benefits. The initial unfinished manuscript of social benefits from the mid-1940s had already included a chapter on social minima such as the extent of unsatisfied social needs, the obsolescence of residential urban dwellings, inadequate medical care, and deficiencies in the field of public health (Kapp n.d.f). Kapp defined four main characteristics of the social benefits of planning for social minima that result from the existence of social needs and make them a necessary object of government action because private enterprise will not provide them: they are highly defused, cannot be withheld, accrue to all members of society, and are indivisible (Kapp 1963b). This approach to social benefits is explicitly rooted in Weber's concept of substantive rationality:

Substantive rationality . . . measures the extent to which a given group of persons is or could be adequately provided with goods by means of an economically oriented course of social action. (Kapp 1963b, 190)<sup>5</sup>

Thus, substantive rationality meant for Kapp an approach to economic planning that guarantees social minima. In contrast to Weber, Kapp argued that substantive rationality can be objectified via a scientific inquiry into need satisfaction, such that Weber's caveat about the infinite possible value standards under a regime of substantive rationality is unwarranted. Kapp's effort to objectify and quantify social costs and benefits in a substantive and scientific manner was also directed against Mises's argument about the alleged lack of rationality in economic planning. Kapp (1963b) maintained that the price system's quantitative character is only seemingly objective and rational because in actual fact it is highly arbitrary (manipulation of consumers and disregard for the poor, social damages, and needs). In other words, Kapp continued the defense of the socialist position since his dissertation against Mises's impossibility thesis. Yet the quest to scientifically objectify and quantify social costs and benefits also aimed at providing an alternative to the purely monetary appraisal of social costs in neoclassical economics. Social minima, according to Kapp, objectify and quantify social costs and benefits by removing them from the realm of pure ideology into the realm of science and the pragmatic test.

Kapp acknowledged that the problem of social costs and benefits would always remain partly political in nature because of the necessity of social

5. For Kapp's substantive economics, see Berger 2008.

evaluation of essential and less essential human needs. Here, Kapp (1963b) referred to the need for a democratic theory of consumption based on majority votes and referendums.<sup>6</sup> Based on Weber and Otto von Neurath, Kapp adopted the position that substantive rationality can be based on an economic calculation in real terms that compares real physical units of available resources. Yet the potential inefficiencies of substantive rationality are also acknowledged in terms of delays, coercion, and vested interests in the political system. This realistic view of the issues faced by economic planning is characteristic of Kapp's work since the 1960s when he conducted empirical research on economic planning and public administration in India (Kapp 1963c).

Thus, in conclusion, the argument on social costs maintained the central target of the dissertation. Relying on Weber's critique of formal rationality and Veblen's critique of pecuniary principles, Kapp (1963b) continued to attack Mises's purely formal defense of the rationality of the price system. Adopting Neurath's proposal for planning in real terms, Kapp solidly tied himself to the very socialist position that had been the reason for Mises's initiation of the socialist calculation debate. Kapp epitomized in important respects the Progressive Era expert who has a "faith in the scientific state," sees himself as a "forward-looking modernist," and believes himself to be an "ethical economist," a "guide to the social good" with the "public interest at heart" (Leonard, this volume).

Kapp's ([1975] 2011) plea for a "new science of political economy" and "return to philosophy" materialized in the above-mentioned unfinished book project "Foundations of a Social Economics" but also *Towards a Science of Man in Society: A Positive Approach to the Integration of Social Knowledge* (1961). In fact, this concern was so important to Kapp that it later became the main mission statement of the Kapp Foundation for the Integration and Humanization of the Social Sciences. Joining the issues of economic planning and a positivist approach to a unified social science had previously been a project associated with Neurath, but Kapp did not acknowledge this source of inspiration in *Science of Man* (for a discussion of this link, see Spash 2012). Instead, the final chapter closes with references to "realtypical" and Gestalt analysis (Weber, Spiethoff) and substantive economics (Polanyi 1957). Thus, Kapp's approach to social knowledge is best understood as part of a means-ends instrumentalism (Kapp 1963b, [1975] 2011; Berger and Forstater 2007). His own

6. Kapp's social minima approach can also be viewed as a science-based social-democratic alternative to Hayek's nondiscretionary rules argument (Burczak 2011).

recognition of the kinship with instrumental analysis, that is, the theory of economic knowledge for controlled economic systems, is decisive here (Kapp 1976; Lowe 1965). In this, social knowledge about the dynamic structure of human needs in society is part of the process of scientifically deriving means, while social minima are part of the process of socially determining normative ends. Kapp's democratic approach to social control is strongly influenced by John Dewey and thus differs from the notion of politically unaccountable expert control enacted by many Progressive Era economists (Leonard, this volume). Throughout his works Kapp (2011, 88n9) explicitly targeted Mises's instrumentalism, that is, his "purely positivist [read: value-free], formal and subjectivist procedure [i.e., praxeology]," revealing once more the continuity of his main intellectual thrust since the socialist calculation debate but also *Social Costs*. The latter doubts that Mises would be prepared to apply his definition of economics as a science of human action (means-ends) to social choices and evaluations, that is, "decisions of government in matters of economic policy" (see Kapp 1950b, 252). Kapp's integrated and social conceptualization of knowledge is a contribution to the "economics of scientific knowledge" (Mirowski and Sent 2002) that provides an alternative to purely individualist conceptualizations of knowledge, such as personal knowledge (Polanyi 1958) and commodified knowledge (Hayek 1945).

### **The Life of Kapp's Ideas in the Material World: Environment and Development, Science and Technology, Law and Economics**

The major impact of Kapp's ideas emerged during the 1970s and 1980s, which is mainly attributable to their ability to attract organizational and financial support.<sup>7</sup> Most notable are Kapp's influential membership on the expert panel for environment and development, which helped prepare the 1972 UN conference on the human environment, and his chairmanship of the German ministerial commission on green technologies. His vision is credited as inspiring the conception of at least four major organizations still operating today, that is, the Socialist Environment and Resource Association (SERA), the Centre for Environment and Development in Paris, the European Association for Evolutionary and Political Economy (EAEPE), and the German Association for Ecological Economics (VÖÖ).

7. For the social epistemology adopted here, see Mirowski and Nik-Khah 2008 and Mirowski 2013.

Significant also was the fact that Kapp's work on social costs attracted financial support from the Institute for Social Research and the Fulbright Foundation. Additionally, since the early 1980s the K. William and Lore L. Kapp Foundation for the Humanization and Integration of the Social Sciences continued to support research and to be involved in the awarding of the Kapp Prizes of EAEPE and VÖÖ. Additionally, collected volumes on Kapp's economics flourish in the heterodox economics community (Gerber and Steppacher 2012; Ramazzotti, Frigato, and Elsner 2012).

Richard Gaskins (2010) has recently pointed out that a major source of support for Kapp's "whole-society" perspective of social costs and precautionary *ex ante* approach of social controls of technologies exists within public health studies of injury and disease. This seems correct, as Kapp explicitly referred to the kinds of technological controls effective in the industries of food, pharmaceuticals, and nuclear power as ways to reduce social costs and guarantee social minima:

In this context the burden of proof that a new technology, a new product, a new process, and a particular input (and output) pattern are safe would have to rest in principle upon the producer and not upon the damaged person or society. Institutionalized agencies would have the function and responsibility to anticipate, appraise, and judge beforehand the hazards and benefits of alternative technologies, techniques, and locations. On the basis of such an assessment it would be possible to direct investments with respect to both permissible choice of factor inputs and the location of specific industries, in accordance with criteria that take account of the full range of the costs and consequences of new techniques for the individual and society as well as the world community. (Kapp 1971, xxi)

Kapp concluded that this approach would imply radically new forms of decision making and planning by institutions responsible to society and more responsive to human needs. The individual allocation and investment decision, the private choice of technology, and the selection of the site of production would be replaced. A detailed framework for technological controls was elaborated during Kapp's chairmanship of the German ministerial commission Governmental Furtherance of Environmentally Friendly Technologies (Kapp [1975] 2011): (1) goal formulation, which involved (a) dealing with goal conflicts, (b) societal assessment of alternative technologies as a prerequisite of selecting an objective, and (c) choice of goal and participation in research policy decisions; (2) prob-

lems in coordinating research, which involved (a) coordination of research on the national level and (b) international cooperation; (3) financing the research and promoting the diffusion of environmentally sound technologies, entailing (a) possibilities of financing research, (b) state profit sharing, (c) state support of research projects with great risk and relatively small prospects of commercial utilization, (d) state research institutes, (e) measures of promoting the dissemination of environmentally sound technologies, methods, and products, (e1) legal and institutional bases, (e2) dissemination of information about environmentally sound technologies, (e3) new patent and license regulation, and (e4) financial aids to promote the dissemination of environmentally sound technologies; and (4) from the causation principle to the objective principle: technology as a dependent variable.

Another application of Kapp's theory pointed out by Richard Gaskins (2007) occurred within the field of law and economics (for references to Kapp in legal scholarship, see Kimball 1959, 934; Koplín 1955, 840). Kapp (1950b, 63) had clearly exposed the problems with legal solutions to social costs in the case of work injuries, such as the inability of victims to receive their rewards because of insolvent employers or private insurance companies. Citing the 1939 report of the National Resource Committee, Kapp also noted that court action failed to resolve problems such as water and air pollution because of the problems of large numbers of affected parties, prohibitively expensive legal fees, and the burdensome if not impossible proof of specific damages, their amounts, and the possibility of abatement (80–81). The “liability law solution,” Mises's preferred solution (Dawson 2013; Cordato 2004), is criticized just like the “bilateral market approach,” which is the preferred solution of Coase and Stigler (Coase 1960; Medema 2011) as an instance of the ideology of individual decision making underlying the “polluter pays principle” (see above for Kapp's rejection of this principle) (Kapp n.d.e).

Partly because of the influence of J. M. Clark, legal realists adopted a perspective on social costs akin to that of Kapp (Gaskins 2007). They recognized the complexity of social cost cases and supported the idea of a “community responsibility” for social costs in the form of a social insurance scheme. The latter was viewed a public law alternative to tort law, which would introduce the responsibility to prevent social costs *ex ante*, resorting to, for example, “criminal penalties, industrial health and safety laws, and a comprehensive prevention strategy aimed at reducing injuries and environmentally caused diseases” (Gaskins 2007, 4). This kind of

community responsibility proposed by legal realists for the account of social costs of a community is today recognized by New Zealand's Accident Compensation Corporation (ACC), based on three remediation strategies, that is, "prevention, rehabilitation and compensation, stressing that order of priority" (Gaskins 2010, 39). Trying to prove the defendants' fault or negligence, or even establishing causality according to tort law in complex economy-environment interactions with time lags and cumulative circular interactions, is viewed as erratic, inconsistent, time consuming, and administratively expensive. The chances of becoming a victim is viewed as a statistical inevitability because of the injury-generating practices of complex industrial societies and a risk of social progress, and is not due to individual fault. The simplistic, individualistic, and linear view of causation and compensation of the nineteenth-century fault principle is deemed inappropriate to deal with the complexity underlying social costs because the attempt to disentangle the multiplicity of causations behind individual social cost cases is either very inefficient or even ineffective because of being impossible or too time consuming. Additionally, the unnecessarily expensive administration of legal solutions to cases of social cost makes it cost inefficient. An inconsistency of legal rulings across similar cases is likewise problematic. That is, tort law is perceived as unsuitable for dealing with social costs because it leaves a large part of the social costs unpaid for, that is, a social costs deficit. ACC aims to make it impossible that social costs stay with the victim and are not compensated for unless the victim's claim can pass the court's fault test. Insidious avoidance strategies of defendants with deep pockets are likewise unnecessary. While the ACC's prevention strategy remains underdeveloped because of conflicts over the distribution of costs of preventing social costs, it maintains Kapp's idea that the most efficient and just solution to social costs is prevention via effective health and safety regulation (Gaskins 2010, 39–45).

## Conclusion

The article has demonstrated that K. William Kapp provided a genuinely *social* theory of social costs. This genuinely social character is the result of a consistent effort to defend the socialist position from the socialist calculation debate, that is, the possibility of substantively rational planning to prevent social costs. The core argument is that social costs reflect the violation of social needs by the market's calculus. Substantive rationality in planning is needed to guarantee the fulfillment of social needs.

Social needs are scientifically objectified and quantified via the elaboration of social minima, that is, minimum adequate living conditions. The latter are rooted in the structure of existential human needs, which are investigated in a science of integrated social knowledge. Social costs, according to Kapp's view, are a genuinely social, that is, complex macro-phenomenon, resulting from circular cumulative causation between the open economic system and its social and natural environment. Consequently, Kapp's theory of social costs is not based on the "polluter pays principle" underlying individualist and *ex post* solutions to social costs, such as neoclassical taxation or bargaining, or Mises's tort law solution. Instead, Kapp proposed and developed a framework for systemic social legislation that prevents social costs *ex ante* via safety limits, social minima, and technological controls. Today, the continued presence of his approach in economic discourse and its application to policymaking are a testament to the power of Kapp's ideas.

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