

imagination of a number of economists. Unfortunately, few of the results of these studies had reached the author at the time of the completion of the manuscript of the second edition (June 1, 1961). Nobody regrets the neglect of these discussions more than the author. This applies particularly to the papers dealing with social costs, which were presented at the Annual Meeting of the *Gesellschaft für Wirtschafts- und Sozialwissenschaften* in Homburg, Germany, in 1962.

As far as economic theory is concerned there has been a tendency to assimilate social costs (and social benefits) to the earlier concepts of "external diseconomies" (and "external economies") and to the type of welfare economics which makes use of Pareto's concept of indifference and the compensation principle. Another related and perhaps more promising trend of analysis has been to consider social costs (and social benefits) as a form of non-market interdependencies as a result of which negative and positive effects tend to be internalized in the cost and return structure of the various sectors of the economy. This is, of course, correct. The output of a firm is not independent of its ability to shift part of its costs to other sectors of the economy or to the individual. True social costs are then only net and avoidable damages which exceed the benefits accruing either to the sector that can be shown to be responsible for specific damages or to the economy as a whole. Such benefits have been identified as "internalized" economies said to be reflected in a more rapid technological progress or a higher rate of growth than would be possible if social costs could not be shifted. All these attempts may lead to a refinement of the concept of social costs and eliminate fallacious reasoning. However, there are limits beyond which further refinements of concepts do not necessarily improve them as tools of analysis. Indeed, a point may be reached when refined tools of analysis begin to conceal the issues instead of illuminating them. The fact remains that while economic progress may have been more rapid, society as a whole has to pay today in the form of higher taxes the social costs of air and water pollution, of slum clearance and urban redevelopment which an earlier adoption of a rational abatement and location policy could

PREFACE TO THE SECOND EDITION

SINCE the publication of the first edition of *The Social Costs of Private Enterprise* in 1950 considerable progress has been made in the empirical study of social costs. Increasingly national and international agencies have investigated the consequences of such phenomena as air and water pollution, the avoidable exhaustion of renewable resources, the premature destruction of non-renewable resources, the impairment of the human factor by occupational diseases and industrial accidents and the effect of automation and technical change in general. Even the negative effects of the duplication and partial utilization of capital equipment, the "retardation" of sciences and technology and the unplanned concentration of industrial activities in a few already congested areas and the social and economic problems raised by sales promotion and "planned obsolescence" have attracted the attention of economists and social scientists. Research conducted under the auspices of such agencies as the U.S. Department of Health, Education and Welfare and the Air Pollution Control Association in Pittsburgh, USA., the U.S. Department of Agriculture, Resources for the Future, Washington, D.C., has aimed at the elaboration of criteria for the formulation of public policies designed to prevent or at least to remedy some of the most immediate damages arising as a result of private (and public) economic activities. This continued reliance on scientific research and on exact quantitative data as a prerequisite for the formulation of public policies provides the greatest, if not the only, hope that mankind will be able to control rather than succumb to the effects of the most explosive force in recent history: modern technology.

Confronted with the findings of empirical studies economic theory likewise has paid attention to social costs. In Europe in particular, problems of social costs seem to have caught the

have avoided. In other words, we share the uneasiness of those who feel that categories like "external diseconomies" and "external economies" have remained empty boxes. The formal apparatus of modern welfare economics is based upon pre-suppositions which are not free of contradictions—not to mention the fact that the compensation principle, if it could ever be made operational, would be difficult and costly to administer. This impasse of welfare economics is increasingly recognized by the growing number of its critics. In short, the solution of the theoretical and practical issues raised by the phenomena of social costs (and social benefits) seem to call for a new and different approach. The author has always felt that only continuous empirical research and the acceptance of a substantive and objectified concept of social welfare can lead to a better understanding of these economic problems. What we need is not a refinement of formal economic categories which carry over many of the utilitarian and individualistic behavioristic presuppositions of Bentham but the elaboration of tentative and pragmatically tested objective welfare criteria. Recent advances in our scientific knowledge make possible an objectification of economic welfare understood not in terms of positions of general equilibrium but as indispensable minimum requirements of civilized living, at least in a number of specific fields. No doubt, such tentative existential minima may change over time and will differ depending upon the state of economic development of different societies. The second edition has stressed some of these attempts to elaborate such existential minima.

Needless to add that the analysis of social costs (and social benefits) as, indeed, the economics of objective social welfare minima are concerned with the study and measurement of the substantive social efficiency of the system of production and distribution. Such an analysis of social efficiency is not confined to the system of business enterprise as it is known in the West. There is every reason to believe that a study of the social costs connected with different forms of economic planning would yield significant results which could provide the basis for far-reaching improvements of the planning procedures in less developed as well as advanced economies.

The change of title to *Social Costs of Business Enterprise* is intended to express more explicitly the affinity of our analysis to the intellectual tradition of that branch of institutional economic theory which has stressed not only the cumulative character of social causation and the need for objective criteria of social welfare for the appraisal of the social efficiency of economic systems, but also the importance of raising the question of the quality of human life and behavior under different institutional arrangements. 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."¹

In the course of the revision several chapters had to be rewritten almost completely, particularly where new findings and new data were available. In other instances a reorganization of the materials was found advisable. As far as possible problems of developing economies have been considered although not to the extent that would have been desirable. A systematic inquiry into the implications of social costs for the elaboration of investment criteria in developing countries is still to be made. Similarly, a study of the social costs of underdevelopment on the one hand and of the development process on the other seems to be a worthwhile subject of investigation. If the present study encourages economists to undertake such an analysis the author would welcome it as a further sign of the fruitfulness of the concept.

I am grateful to Professor P. C. Mahalanobis and the Indian Statistical Institute for their encouragement in connection with the decision to publish in India the second edition of my study. If this edition contains fewer statistical tables and estimates of social costs than the first edition this is due to my growing conviction that the available data are incomplete and inadequate. However, the quantitative measurement of specific types of social costs arising in the process of production is long

¹ Thorstein Veblen, *The Engineers and the Price System*, New York, The Viking Press, 1933, p. 152

overdue. In so far as the present study makes use of estimates and data collected by other authors full acknowledgement has been made in the text.

I want to thank my friend, Mr. Mulford Martin for his help in editing the manuscript. He has contributed greatly to the improvement of the form and substance of the text. As on previous occasions Lore L. Kapp has cooperated in every phase of the preparation of the second edition.

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PREFACE

THE MAIN purpose of this book is to present a detailed study of the manner in which private enterprise under conditions of unregulated competition tends to give rise to social costs which are not accounted for in entrepreneurial outlays but instead are shifted to and borne by third persons and the community as a whole. Thus, the present study deals at the same time with a specific technical economic question and with broad issues of social philosophy and economic knowledge. The technical question involved is whether our concept of costs is not incomplete and apparently in need of correction. The broader issues of social philosophy and economic knowledge which the analysis of the social costs of production raise become clear only if we view the phenomenon of social costs within the framework of the basic premises of classical political economy and of the proposition still found in neoclassical economic thought that perfect competition tends to maximize output and the want-satisfying power of available scarce resources. To present a brief outline of this framework is the purpose of the first chapter. The second and third chapters are designed to provide a general introduction to the detailed analysis of social costs by describing the general meaning of social costs and examining the contributions of those economists who have questioned the validity of the main trend of neoclassical economic thought, and in this context have dealt with the phenomena of social losses and social waste. The threads of these theoretical arguments are then brought together in the concluding chapters, which are designed to summarize the results of the detailed analysis of social costs contained in the main part of the book and to draw a number of theoretical and methodological inferences from them.

The basic idea of the present study was first advanced in a highly tentative manner in the author's attempt to deal with