

# **The Meaning of Ludwig von Mises**

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**Contributions in Economics, Sociology,  
Epistemology, and Political Philosophy**

**Edited by Jeffrey M. Herbener**

**Studies in Austrian Economics Series**



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## *Introduction*

Everyone carries a part of society on his shoulders; no one is relieved of his share of responsibility by others. And no one can find a safe way for himself if society is sweeping towards destruction. Therefore everyone, in his own interests, must thrust himself vigorously into the intellectual battle. No one can stand aside with unconcern: the interests of everyone hang on the result. Whether he chooses or not, every man is drawn into the great historical struggle, the decisive battle into which our epoch has plunged us.<sup>1</sup>

**T**his is the message of Ludwig von Mises. In the historical battle of ideologies, Mises is a pivotal figure. With great courage and decisive effect he carried the banner of truth and freedom for others through a time of rising statism. Murray Rothbard is correct when he says, “. . . if the world is ever to get out of its miasma of statism, or, indeed, if the economics profession is ever to return to a sound and correct development of economic analysis, both will have to abandon their contemporary bog and move to that high ground that Mises developed for us.”<sup>2</sup>

This collection of essays is both a restatement and extension of the major contributions of Mises in epistemology, history, economics, and political philosophy.

Mises began constructing the high ground on the foundation provided by Carl Menger and Eugen von Böhm-Bawerk. Menger

<sup>1</sup>Ludwig von Mises quoted by Margit von Mises in her, “A Call to Activism,” in *The Free Market Reader*, Llewellyn H. Rockwell, Jr., ed. (Auburn, Ala.: The Ludwig von Mises Institute, 1988), p. 169.

<sup>2</sup>Murray N. Rothbard, *The Essential Ludwig von Mises* (Auburn, Ala.: The Ludwig von Mises Institute, 1983), p. 5.

rescued economics from the holistic, non-subjectivist dead end arrived at by the British classical economists; and placed it back on the track of truth that runs from Aristotle through various scholastic writers through the great continental economists of the eighteenth and nineteenth centuries. He accomplished this by moving economics toward its correct methodological precepts (a task completed by Mises). Menger understood the broader importance of his work:

Adam Smith and his school have neglected to reduce the complicated phenomena of human economy in general, and in particular of its social form, "national economy," to the efforts of individual economies, as would be in accordance with the real state of affairs. They have neglected to teach us to understand them theoretically as the result of individual efforts. Their endeavors have been aimed, rather, and, to be sure, subconsciously for the most part, at making us understand them theoretically from the point of view of the "national economy" fiction. On the other hand, the historical school of German economists follows this erroneous conception consciously.<sup>3</sup>

Austrian economics was born in Menger's struggle over method with the anti-rationalist German economists. Menger considered methodology the starting point of correct economic theory, placing it first among studies that economists make:

With this, to be sure, the time has come when methodological investigations in the field of political economy necessarily take first place in scientific interest. The progress of our science at present is hindered by the sway of erroneous methodological principles. Methodology thus has the floor and will keep it until, through clarification of the goals of research and subsequent clarification of the ways to attain the goals, those obstacles are removed which arose for the progress of political economy in Germany in virtue of misleading methodological principles.<sup>4</sup>

<sup>3</sup>Carl Menger, *Investigations into the Method of the Social Sciences with Special Reference to Economics* (New York: New York University Press, 1985), p. 196.

<sup>4</sup>*Ibid.*, p. 31.

About the methodological errors of the German historical school, Menger said:

There is scarcely any need to remark that the nature and significance of the exact orientation of research is completely misunderstood in the modern literature of national economy. In German economics, at least in the historical school, the art of abstract thinking, no matter how greatly distinguished by depth and originality and no matter how broadly supported empirically—in brief, everything that in other theoretical sciences establishes the greatest fame of scholars is still considered, along with the products of compilatory diligence, as something secondary, almost as a stigma. The power of truth, however, will finally also be tested for those who, sensing their inability to solve the highest problems of the social sciences, would like to raise their own inadequacy as a standard for the value of scientific work in general.<sup>5</sup>

Menger argued that the economists of the German historical school were wrong for investigating economic theory from the “full empirical reality” of historical events. The correct method reduces human action to its essential components and then applies abstract thinking, i.e., deduction, to reason out the more complex economic laws. In this method, Menger established the Austrian tradition and defined what distinguishes an economist as Austrian. Mises called this method praxeology—the logic of human action. Clearly, Menger was a precursor of praxeology:

This is the ground on which I stand. In what follows I have endeavored to reduce the complex phenomena of human economic activity to the simplest elements that can still be subjected to accurate observation, to apply to these elements the measure corresponding to their nature, and constantly adhering to this measure, to investigate the manner in which the more complex economic phenomena evolve from their elements according to definite principles.<sup>6</sup>

Like Mises, Menger claimed that economic theory, so developed, is a set of absolute laws of economic phenomena:

<sup>5</sup>Ibid., p. 65.

<sup>6</sup>Carl Menger, *Principles of Economics*, James Dingwall and Bert F. Hoselitz, trans. (New York: New York University Press, 1976), pp. 46–47. Also, see pp. 60–62.

It is now the task of the reader to judge to what results the method of investigation I have adopted has led, and whether I have been able to demonstrate successfully that the phenomena of economic life, like those of nature, are orderly strictly in accordance with definite laws.<sup>7</sup>

Like Mises, Menger had only scorn for economists who attempted to construct economic theory (exact laws of economics) empirically:

Among economists the opinion often prevails that the empirical laws, "because they are based on experience," offer better guarantees of truth than those results of exact research which are obtained, as is assumed, only deductively from a priori axioms . . .

Testing the exact theory of economy by the full empirical method is simply a methodological absurdity, a failure to recognize the bases and presuppositions of exact research. At the same time it is a failure to recognize the particular aims which the exact sciences serve. To want to test the pure theory of economy by experience in its full reality is a process analogous to that of the mathematician who wants to correct the principles of geometry by measuring real objects . . .

An empirical law lacks the guarantee of absolute validity a priori, i.e., simply according to its methodological presuppositions . . .

To want to transfer [the empirical method] to the results of exact research is, however, an absurdity, a failure to recognize the important difference between exact and realistic research. *To combat this is the chief task of the preceding investigations.*<sup>8</sup>

Menger was a rationalist who showed that economic theory is a set of absolute laws developed by deduction and considered it his chief task to refute attempts to replace this view with empirical methods such as historicism (and, by association, hermeneutics). His analysis provided the foundation for Mises's later refutation of other versions of empirical investigations such as positivism.

<sup>7</sup>Ibid., p. 48.

<sup>8</sup>Carl Menger, *Investigations*, pp. 69–70; emphasis added.

Hans-Hermann Hoppe demonstrates how Mises formalized and purified Menger's methodology. In praxeology Mises provided the rationalist case for the epistemology of economics; that reason can render true knowledge of reality.

Mises's first step was to show that empiricism, which leads to epistemological skepticism, and historicism, which leads to epistemological relativism, are self contradictory. He then reconstructed economics upon a true a priori synthetic proposition—human action exists. That individuals act is an irrefutable fact known, not by observation, but reflectively by each being capable of human action. Thus, the mental categories of action: value, ends, means, choice, preference, cost, profit, loss, etc. are self evidently true and meaningful. And all propositions (e.g., the law of diminishing marginal utility or the law of association) deduced from the action axiom are likewise true and meaningful.

In praxeology, Mises provided the answer to the charge that a priori knowledge cannot be about reality but is only "ideal":

The relation between reason and experience has long been one of the fundamental philosophical problems. Like all other problems of the critique of knowledge, philosophers have approached it only with reference to the natural sciences. They have ignored the sciences of human action . . .

The real thing which is the subject matter of praxeology, human action, stems from the same source as human reasoning. Action and reason are congeneric and homogeneous; they may even be called two different aspects of the same thing. That reason has the power to make clear through pure ratiocination the essential features of action is a consequence of the fact that action is an offshoot of reason. The theorems attained by correct praxeological reasoning are not only perfectly certain and incontestable, like the correct mathematical theorems. They refer, moreover, with the full rigidity of their apodictic certainty and incontestability to the reality of action as it appears in life and history. Praxeology conveys exact and precise knowledge of real things.<sup>9</sup>

<sup>9</sup>Ludwig von Mises, *Human Action: A Treatise on Economics*, 3rd rev. ed. (Chicago: Henry Regnery, 1966), p. 39.



As Hoppe argues, through action our mind, with its praxeological categories, comes in contact, so to speak, with reality outside of itself. Since action exists it follows that the praxeological categories are about reality. No experience of any kind could contradict the praxeological structure of the mind. Mises demonstrated that all experience must be understood in terms of these categories:

Such an experience [that contradicted praxeological categories] would be impossible in the first place for the reason that all experience concerning human action is conditioned by the praxeological categories and becomes possible only through their application. If we had not in our mind the schemes provided by praxeological reasoning, we should never be in a position to discern and to grasp any action. We would perceive motions, but neither buying nor selling . . .<sup>10</sup>

Menger approached this position in recognizing the constraints put on economic theory by the structure of thinking:

The aim of [economics] . . . is the determination of strict laws of phenomena, of regularities in the succession of phenomena which do not present themselves to us as absolute, but which in respect to the approaches to cognition by which we attain to them simply bear within themselves the guarantee of absoluteness.<sup>11</sup>

If, therefore, exact laws are at all attainable, it is clear that these cannot be obtained from the point of view of empirical realism, but only in this way, with theoretical research satisfying the presuppositions of the above rule of cognition.<sup>12</sup>

The axiom of action is a great epistemological leap beyond Menger's original statement of method. Menger argued that deduction must begin with ideal types (what he called empirical forms) created from basic observable facts, otherwise it was just mental exercise.<sup>13</sup> In economics, Menger believed that the ideal type was economic man pursuing the satisfaction of material needs.<sup>14</sup>

<sup>10</sup>Ibid., p. 40.

<sup>11</sup>Menger, *Investigations*, p. 59.

<sup>12</sup>Ibid., p. 60.

<sup>13</sup>Ibid., pp. 60–61.

<sup>14</sup>Ibid., p. 14.

Regarding the basic observable fact, he said, “. . . the *ultimate* goal of all human economy is thus to cover our direct material needs.”<sup>15</sup> But Mises showed that this argument is insufficient because need is not an observable fact; it is a subjective phenomena understood only reflectively:

The starting point of praxeology is not a choice of axioms and a decision about methods of procedure, but reflection about the essence of action. There is no action in which the praxeological categories do not appear fully and perfectly.<sup>16</sup>

This knowledge determines the scope and method of economic theory. Mises wrote:

The scope of praxeology is the explication of the category of human action. All that is needed for the deduction of all praxeological theorems is knowledge of the essence of human action. It is a knowledge that is our own because we are men; no being of human descent that pathological conditions have not reduced to a merely vegetative existence lacks it. No special experience is needed in order to comprehend these theorems, and no experience, however rich, could disclose them to a being who did not know a priori what human action is. The only way to a cognition of these theorems is logical analysis of our inherent knowledge of the category of action. We must bethink ourselves and reflect upon the structure of human action. Like logic and mathematics, praxeological knowledge is in us; it does not come from without.<sup>17</sup>

Hoppe extends Mises’s dramatic breakthrough in epistemology by demonstrating that praxeology is the key to understanding not just economics but epistemology in general. He does this by weaving together two strands of a priori truths: one is Mises’s a priori of action, the other is the a priori of argumentation. The latter states that humans are capable of argumentation (it cannot be argued otherwise) and therefore know the meaning of truth and validity. Like the action axiom this knowledge is reflectively acquired and indisputable.

<sup>15</sup>Ibid., p. 216.

<sup>16</sup>Mises, *Human Action*, pp. 39–40.

<sup>17</sup>Ibid., p. 64.

Hoppe then demonstrates that praxeology is the foundation of epistemology because knowledge itself is a category of action; and thus, it is constrained by its function within the structure of action categories.

This fact is the basis on which to solve some difficult problems in epistemology, e.g., the realism-idealism controversy, the existence of true a priori synthetic knowledge, and the epistemological status of logic, arithmetic, and Euclidean geometry. For the latter, Hoppe shows how knowledge of these three studies is praxeological, i.e., constrained by human action.

He then demonstrates the necessity of epistemological dualism: that there are two realms of intellectual inquiry that can be understood a priori as requiring categorically distinct methods of treatment and analysis. One is the realm of objects, categorized causally; the other is action which is categorized teleologically. Causality—constant, time-invariant operating causes in observational reality—is a necessary presupposition of action. But the reality of action itself must be teleologically categorized, i.e., as purpose-directed, meaningful behavior. Neither causal nor teleological monism can be justified without contradiction.

Finally, Hoppe shows that the role of praxeology in epistemology is analogous to that of geometry in observations. Geometry, as incorporated in our measuring instruments, constrains the spatial structure of observational reality. Praxeology constrains the range of things that can possibly be experienced in the field of action. These praxeological constraints on the structure of knowledge provide the missing link in the rationalist defense against skepticism and relativism. Mises is the crucial figure in the historical return to a rationalist epistemology.

Even without the advancements forged by Mises and Hoppe, Menger's writings on method gave a sufficient foundation for him to revolutionize economic theory. After solving the paradox of value, he developed an integrated theory of price based upon subjective value and began to unify the diverse strands of economic theory.<sup>18</sup>

<sup>18</sup>Menger, *Principles of Economics*, pp. 17, 49.

After Menger, Böhm-Bawerk considered method a settled issue and counseled economists to address the substantive task of deducing economic theory:

Numerous works of the Austrian economists are devoted to this strife over methods; among them the [*Investigations into the Method of the Social Sciences with Special Reference to Economics*], by C. Menger, stands first in deep and exhaustive treatment of the problems involved . . . But although the strife of methods, perhaps more than anything else, has drawn attention to the Austrian economists, I prefer to regard it as an unimportant episode of their activity. The matter of importance to them was, and is, the reform of positive theory.<sup>19</sup>

Following his own advice, Böhm-Bawerk made major contributions to the Austrian tradition, including his theories of social production, capital, and interest; and his demolition of the foundation of Marxian economics.<sup>20</sup> As with Menger's work, these were built by consciously adhering to the Austrian method. Yet, because modern economists reject praxeology, these achievements have been largely ignored or misunderstood by the economics profession.

Israel Kirzner dispels the bewilderment surrounding Böhm-Bawerk's time-preference theory of interest, which claims that interest in no way depends upon the physical productivity of capital. Böhm-Bawerk posed the interest problem that remains unsolved outside the praxeological tradition: why does entrepreneurial bidding not drive the price of a machine high enough to equal its value productivity? Stated in this fashion, no productivity theory of capital can solve the interest problem, it is solely a problem of *value*. Misunderstanding of this fact led some economists, e.g., Paul Samuelson, to respond to Böhm-Bawerk with hypothetical examples "proving" that productivity can create interest. Kirzner demonstrates why such attempts are barren.

<sup>19</sup>Eugen von Böhm-Bawerk, *Shorter Classics*, vol. 1 (Spring Mills, Penn.: Libertarian Press, 1962), p. 6.

<sup>20</sup>Eugen von Böhm-Bawerk, *Capital and Interest* (Spring Mills, Penn.: Libertarian Press, 1959).

Also, Böhm-Bawerk's interest problem bewilders non-Austrian economists because it asks why interest exists. As with all market prices, the existence of the interest rate depends solely on subjective value. Neoclassical economists such as Irving Fisher asked only why the interest rate is at one level instead of another. Fisher's solution was that the rate of interest is mutually determined by time preference and physical productivity.

This answer is an example of the neoclassical solution to the determination of market prices in general. Their claim that prices are determined mutually by subjective value (demand) and costs of production (supply) is a step backwards from the Austrian subjective value theory to the classical cost of production theory. Rejection of costs of production as a factor in determining price requires rejection of productivity as determining interest. Because the acceptance of praxeology leads to a subjective theory of value, an economist's theory of interest provides a litmus test of his "Austrianism."

While neoclassical economists reject the subjective theory of value and thus praxeology, some do employ a deductive method in theory construction—mathematics. Roger Garrison explains Mises's view of mathematics as a useful method in economics. As Garrison shows, mathematics is a system of logic that employs a language appropriate only to the subject matter of mathematics. Two basic characteristics of the latter are the unit and the constant. All mathematics is predicated on being able to meaningfully define these two terms. Mises showed that for the foundation of human action, i.e., subjective value, no unit exists:

A sound economic deliberation must never forget these two fundamental principles of the theory of value: First, valuing that results in action always means preferring and setting aside; it never means equivalence or indifference. Second, there is no means of comparing the valuations of different individuals or the valuations of the same individuals at different instants other than by establishing whether or not they arrange the alternatives in question in the same order of preference.<sup>21</sup>

<sup>21</sup>Mises, *Human Action*, p. 354.

And for the *results* of human action, for which a unit can be defined (e.g., prices and quantities traded), no constants exist. Mises wrote:

Yet, in mechanics the equation can render very important practical services. As there exist constant relations between various mechanical elements . . . it becomes possible to use equations for the solution of definite technological problems. . . . No such constant relations exist, however, between economic elements. The equations formulated by mathematical economics remain a useless piece of mental gymnastics and would remain so even if they were to express much more than they really do.<sup>22</sup>

Garrison demonstrates that mathematics is an inappropriate language in economics for another reason; it cannot express a necessary aspect of action: ultimate cause. About this Mises said:

[In physics] we know nothing about the ultimate forces actuating these changes. They are for the searching mind ultimately given and defy any further analysis. What we know from observation is the regular concatenation of various observable entities and attributes. It is this mutual interdependence of data that the physicist describes in differential equations.

In praxeology the first fact we know is that men are purposively intent upon bringing about some changes. It is this knowledge that integrates the subject matter of praxeology and differentiates it from the subject matter of the natural sciences. We know the forces behind the changes, and this aprioristic knowledge leads us to a cognition of the praxeological processes. The physicist does not know what electricity "is." He knows only phenomena attributed to something called electricity. But the economist knows what actuates the market process.<sup>23</sup>

The difference in subject matter is the basis of Mises's argument for different epistemological treatment of mathematics versus praxeology:

<sup>22</sup>Ibid., p. 354.

<sup>23</sup>Ibid., p. 355.

The relations and implications of [logic and mathematics] are coexistent and interdependent. . . . A perfect mind could grasp them all in one thought. Man's inability to accomplish this makes thinking itself an action . . . The system [of mathematics] implies neither the category of time nor that of causality. There is functional correspondence between elements, but there is neither cause nor effect.

What distinguishes epistemologically the praxeological system from the logical system is precisely that it implies the categories both of time and of causality . . . change is one of its elements. The notions of sooner and later and of cause and effect are among its constituents.<sup>24</sup>

The use of mathematics precludes discussion of time or causality; but these are precisely the areas of economic phenomena that all economists eagerly wish to discuss. As Garrison shows, their *ad hoc* attempts lead them into epistemological nonsense such as Granger causality which defines cause as temporal patterns in time series data. Armed only with the *post hoc ergo propter hoc* fallacy, mathematical economists are left with nothing relevant to say about the important events of history. In fact, Mises demonstrated that mathematics can only be used to describe situations of nonacting, e.g., general equilibrium:

[The praxeologist] shows how the activities of enterprising men, the promoters and speculators, eager to profit from discrepancies in the price structure, tend toward eradicating such discrepancies and thereby also toward blotting out the sources of entrepreneurial profit and loss. He shows how this process would finally result in the establishment of the evenly rotating economy [i.e., general equilibrium]. This is the task of economic theory. The mathematical description of various states of equilibrium is mere play. The problem is the analysis of the market process.<sup>25</sup>

Mises concluded that all economists who wish to say something relevant to the real world, construct economic theory in an aprioristic-deductive fashion:

<sup>24</sup>Ibid., p. 99.

<sup>25</sup>Ibid., pp. 355–56.

We do not maintain that the theoretical science of human action should be aprioristic, but that it is and always has been so. Every attempt to reflect upon the problems raised by human action is necessarily bound to aprioristic reasoning.<sup>26</sup>

For example, Milton Friedman argued that economic theory must be constructed by positivism,<sup>27</sup> but he actually built his economic theories deductively. He does not reject the laws of demand and supply because they are routinely falsified in econometric studies, or ignore the concepts of subjective value and opportunity cost because they cannot be put in “testable” form. Because such economists use deduction in theory building, Mises has something in common with them, which raises the question: Are they Austrians (e.g., James Buchanan)?

Roger Arnold turns this question around and asks, “Is Mises a public choice economist?” His answer is no, praxeology precludes it. Arnold demonstrates this by showing that the Buchanan-Tullock theory of the state as a super firm, amenable to demand and supply analysis, cannot be developed praxeologically.

Mises categorized all social interactions as either voluntary or involuntary. The voluntary portion consists primarily of the free market—the sum of all voluntary exchanges of private property. Demand and supply analysis is a mental construct the economist uses to analyze the consequences of these exchanges. Since business firms are part of the market, demand and supply analysis applies to them.

The involuntary sector contains legitimate and illegitimate involuntary exchange. The former is defense of private property and the latter is crime against private property. Mises held that government is the institution of legitimate involuntary activity in society established for the defense of private property:

There is in the operation of the market no compulsion and coercion. The state, the social apparatus of coercion and compulsion, does not interfere with the market and with the citizens' activities

<sup>26</sup>Ibid., p. 40.

<sup>27</sup>Milton Friedman, “The Methodology of Positive Economics,” in *Essays in Positive Economics* (Chicago: University of Chicago Press, 1974).



directed by the market. It employs its power to beat people into submission solely for the prevention of actions destructive to the preservation and the smooth operation of the market economy. It protects the individual's life, health, and property against violent or fraudulent aggression on the part of domestic gangsters and external foes.<sup>28</sup>

Government is categorically different from business firms, and thus, is not amenable to demand and supply analysis. Mises devoted an entire book to the consequences of the different nature of the operation of government vis-à-vis the operation of business firms.<sup>29</sup>

Public choice analysis is actually a retrogression to Menger instead of an advancement from Mises. Menger held presuppositions similar to the public choice economists:

Those presuppositions which automatically result from any orderly presentation of theoretical economics are: (1) that all the economic subjects considered here strive to protect their economic interest fully; (2) that in the price struggle they are not in error about the economic goal to be pursued nor about the pertinent measures for reaching it; (3) that the economic situation, as far as it is of influence on price formation, is not unknown to them; (4) that no external force impairing their economic freedom (the pursuit of their economic interests) is exerted on them.<sup>30</sup>

Arnold shows that Misesian praxeology transcends narrow economic interests to provide a general theory of human action, applicable to the real world of acting individuals, not some never-never land developed from the assumption of economic man. Mises viewed *homo economicus*, not as a necessary devise of theoretical economics, but as a tool for understanding historical events:

Economics deals with the real actions of real men. Its theorems refer neither to ideal nor to perfect men, neither to the phantom of a fabulous economic man (*homo oeconomicus*) nor to the statistical notion of an average man (*homme moyen*). Man with all his weaknesses and limitations, every man as he lives and acts, is the

<sup>28</sup>Mises, *Human Action*, p. 257.

<sup>29</sup>Ludwig von Mises, *Bureaucracy* (New Haven: Yale University Press, 1962).

<sup>30</sup>Menger, *Investigations*, p. 71.

subject matter of catallactics. Every human action is a theme of praxeology.<sup>31</sup>

Mises was a rationalist not only in epistemology but in history as well. David Gordon recounts two contributions Mises made to the philosophy of history. The first was Mises's devastating criticism of speculative history—the view that history obeys certain general laws. Praxeology is the center of his argument since it precludes laws of history on two grounds. One is that human action is necessarily an individual phenomena and the other is that logic is a universal characteristic of man. With these principles, Mises refuted the views of history held by Hegel, Marx, Spengler, and Toynbee.

Mises also showed that praxeology is inconsistent with the only possible types of historical laws: a priori or inductive. In the first case he showed that statements about individual events cannot be logically necessary. In the second case, he denied that two particular events can display a necessary connection.

Mises's second contribution to the philosophy of history was his explanation of the relationship between theory and history. He claimed that the "understanding of particular events" (*verstehen*) is not scientific (neither a priori or inductive) but it is rational. It requires judgment as to which laws (of praxeology, natural science, etc.) apply to the explanation of each historical episode. This approach is a continuation of Menger's view on theory and history:

We work at the development of theoretical economics by seeking to determine . . . for example, the general nature of exchange, of price, of ground rent, of supply, of demand, and the typical relations between these phenomena, e.g., the effect on prices of the increasing or decreasing of supply and demand. . . . The historical science of economy, on the contrary, teach us the nature and development of individually definite economic phenomena, thus, e.g., . . . the development of prices, of ground rent in a definite economic district, etc.

The theoretical and historical sciences of economy, accordingly, do exhibit a fundamental difference, and only the complete failure to recognize the true nature of these sciences can produce this confu-

<sup>31</sup>Mises, *Human Action*, p. 651.

sion of these with each other, or occasion the opinion that they can replace each other mutually.<sup>32</sup>

His agreement with Menger on this point, further enhances Mises's stature as the heir of the Austrian tradition. As with method, he improved Menger's work by showing why historical study must be bound by correct praxeological theory. Mises wrote:

[The statements of praxeology] are not subject to verification or falsification on the ground of experience and facts. They are both logically and temporally antecedent to any comprehension of historical facts. They are a necessary requirement of any intellectual grasp of historical events. Without them we should not be able to see in the course of events anything else than kaleidoscopic change and chaotic muddle.<sup>33</sup>

Mark Skousen provides a case study to highlight the importance of using correct theory to explain past events and predict future ones: the great depression. Identifying those who predicted, or failed to predict, the depression indicates the strength of their theories. Skousen illustrates that those who succeeded were mostly "cranks" who advocated sound money—notably, financiers Roger Babson and E. C. Harwood; and economists who held to the Austrian theory of the business cycle. The latter included Benjamin Anderson and H. Parker Willis in the United States and Ludwig von Mises and F. A. Hayek in Europe. The "prudent" apologists of central banking, e.g., Paul Warburg, and the famous orthodox expert on business cycles, economist Wesley Mitchell, failed to anticipate the crash. Other notable economists who did not predict the crash were the "New Era" optimist Irving Fisher and his fellow members of the Stable Money Association—Gustav Cassel, Alvin Hansen, Ralph Hawtrey, John Maynard Keynes, Arthur Pigou, and Knut Wicksell who, Skousen reminds, were not in favor of stable money at all but stable prices, i.e., monetary inflation.

It appears paradoxical that economists who claim prediction is the test of theory, have worse forecasting records than Austrian

<sup>32</sup>Menger, *Investigations*, p. 42.

<sup>33</sup>Mises, *Human Action*, p. 32. Hermeneutic economists should take note.

economists who claim prediction cannot test theory. Yet, Mises's view of theory and history implies this result.

However, as Skousen warns, correct forecasting is not an a priori endeavor; it is the skill of applying the right theories at the right time. The only a priori aspect of forecasting is that accurate forecasting by the vast majority is impossible and self-contradictory; a fact explained by Mises, making him the epistemological father of contrarian investing. Praxeology is necessary for both theory and practical affairs.

Mises was the embodiment of rationalism, founded on praxeology and extending to all sciences of human action. He was the true heir of the great Austrian tradition begun by Menger and furthered by Böhm-Bawerk. Mises, beginning from their foundation, removed the impurities of their work and built a magnificent edifice of economic theory. Using praxeology as his tool, Mises was the architect of the advancement of economic theory in the twentieth century. The importance of praxeology cannot be overstated. Mises wrote:

Praxeology—and consequently economics too—is a deductive system. It draws its strength from the starting point of its deductions, from the category of action. No economic theorem can be considered sound that is not solidly fastened upon this foundation by an irrefutable chain of reasoning. A statement proclaimed without such a connection is arbitrary and floats in midair. It is impossible to deal with a special segment of economics if one does not encase it in a complete system of action.<sup>34</sup>

Murray Rothbard offers Hayek as an instructive example of a great economist who excelled within the Mengerian tradition only to wander down unfruitful paths once loosed from praxeology. Hayek's acceptance of the epistemological views of Karl Popper places him outside the Austrian tradition. Hayek has argued that evolution provides a world view that can explain all phenomena:

I do not wish to dispute that the working out of Darwin's theory of biological evolution, in all of its ramifications, is one of the great

<sup>34</sup>Mises, *Human Action*, p. 68.

intellectual achievements of modern times—one that gives us a completely new view of our world. Its universality as a means of explanation is also expressed in the new work of some distinguished physical scientists, which shows that the idea of evolution is in no way limited to organisms, but rather that it begins in a sense already with atoms, which have developed out of more elementary particles, and that we can thus explain molecules, the most primitive complex organisms, and even the complex modern world through various processes of evolution.<sup>35</sup>

Following Menger, Mises argued that the study of human action is categorically different than the study of biological processes:

However, the sciences of human action differ radically from the natural sciences. All authors eager to construct an epistemological system of the sciences of human action according to the pattern of the natural sciences err lamentably.<sup>36</sup>

Yet, Hayek claimed that his evolution theory of social development was derived from an insight of Menger:

Menger . . . attempted to provide a rational reconstruction, conjectural history, or evolutionary account of the emergence of cultural institutions.<sup>37</sup>

Adequate explanations of [the market, etc.] were disseminated . . . especially by the Austrian school following Menger, into what became known as the “subjective” or “marginal utility” revolution in economic theory. . . . [The most elementary and important one] was the discovery that economic events could not be explained by preceding events acting as determining causes that enabled these revolutionary thinkers to unify economic theory into a coherent system.<sup>38</sup>

What Menger wrote about using organic analogies in the social sciences does not justify Hayek’s claim. Menger viewed analogy as a means of *presenting* theoretical discoveries, while the discoveries themselves are based on exact research:

<sup>35</sup>F. A. Hayek, *The Fatal Conceit: The Errors of Socialism* (Chicago: University of Chicago Press, 1988), pp. 26–27.

<sup>36</sup>Mises, *Human Action*, p. 39.

<sup>37</sup>Hayek, *The Fatal Conceit*, p. 70.

<sup>38</sup>*Ibid.*, p. 97.

Yet I should still not like in any way to deny the value of certain analogies between natural organisms and social phenomena for certain purposes of *presentation*. Analogy in the above sense, as method of *research*, is an unscientific aberration. . . . But [analogies] definitely are to be rejected where what is supposed to be only a means of presentation appears as a means of research and the analogy is drawn not only where it corresponds to real conditions, but really becomes a principle and a universal trend of research.<sup>39</sup>

But universal applicability was Hayek's claim for evolution:

Although also acclaimed as a biologist, Aristotle lacked any perception of two crucial aspects of the formation of any complex structure, namely, evolution and the self-formation of order.<sup>40</sup>

Hayek based his analysis of social development on the biological process of evolution. He approved of Popper's assertion, "Cultural evolution continues genetic evolution by other means."<sup>41</sup> Hayek explained development of the market with "biological" forces:

The answer to this question [how we came to acquire the economic order of the market] is built upon the old insight, well known to economics, that our values and institutions are determined not simply by preceding causes but as part of a process of unconscious self-organization of a structure or pattern. This is true not only of economics, but in a wide area, and is well known today in the biological sciences.<sup>42</sup>

Economics has from its origins been concerned with how an extended order of human interaction comes into existence through a process of variation, winnowing and sifting far surpassing our vision or our capacity to design. . . . We are led—for example by the pricing system in market exchange—to do things by circumstances of which we are largely unaware and which produce results that we do not intend.<sup>43</sup>

Before Hayek made the argument that man is moved about by mysterious forces, Menger refuted it:

<sup>39</sup>Menger, *Investigations*, pp. 137–38.

<sup>40</sup>Hayek, *The Fatal Conceit*, p. 45.

<sup>41</sup>*Ibid.*, p. 16.

<sup>42</sup>*Ibid.*, p. 9.

<sup>43</sup>*Ibid.*, p. 14.

There is hardly need to remark that the [origin and] changes of social phenomena cannot be interpreted in a social-pragmatic way, insofar as they are not the intended result of the agreement of members of society or of positive legislation, but are the unintended product of social development. But it is just as obvious that not even the slightest insight into the nature and the laws of the movement of social phenomena can be gained either by the mere allusion to the “organic” or the “primeval” character of the processes under discussion, nor even by mere analogies between these and the transformations to be observed in natural organisms. The worthlessness of the above orientation of research is so clear that we do not care to add anything to what we have already said.

If this significant problem of the social sciences is truly to be solved, this cannot be done by way of superficial and, for the most part, inadmissible analogies. It can be done, in any case, only by way of direct consideration of social phenomena, not “organically,” “anatomically,” or “physiologically,” but only in a *specifically sociological* way. The road to this, however, is *theoretical* social research, the nature and main orientations of which (the exact and the empirical-realistic) we have characterized above.<sup>44</sup>

Because Hayek was not bound by praxeology, he explained social institutions by evolution:

The idea of biological evolution stems from the study of processes of cultural development which had been recognized earlier: processes that lead to the formulation of institutions like language, law, morals, markets, and money.<sup>45</sup>

Indeed, the basic point of my argument—that morals, including especially, our institutions of property, freedom and justice, are not a creation of man’s reason but a distinct second endowment conferred on him by cultural evolution.<sup>46</sup>

Menger argued that money, markets, prices, division of labor, law, and language develop from individual action:

[These are] the unintended result of innumerable efforts of economic subjects pursuing *individual* interests. The theoretical

<sup>44</sup>Menger, *Investigations*, p. 150.

<sup>45</sup>Hayek, *The Fatal Conceit*, p. 24.

<sup>46</sup>*Ibid.*, p. 52.

understanding of them, the theoretical understanding of their nature and their movement can thus be attained in an exact measure only in the same way as the understanding of the above mentioned social structures. That is, it can be attained by reducing them to their elements, to the *individual* factors of their causation, and by investigating the laws by which the complicated phenomena of human economy under discussion here are built up from these elements. This, however, as scarcely needs saying, is that method which we have characterized above as the one adequate for the exact orientation of theoretical research in the realm of social phenomena in general. The methods for the exact understanding of the origin of the “organically” created social structures and those for the solution of the main problems of exact economics are by nature identical.<sup>47</sup>

Joseph Salerno argues that Mises followed Menger by developing the analysis of the origin and change of social institutions from the “individual factors of their causation.” The most fundamental of these factors for Mises was reason. He wrote, “Reason is man’s particular and characteristic feature. . . . [Praxeology] deals with reason only as far as it enables man to act.”<sup>48</sup> His answer to Hayek’s view of society was:

To those pretending that man would be happier if he were to renounce the use of reason and try to let himself be guided by intuition and instincts only, no other answer can be given than an analysis of the achievements of human society. In describing the genesis and working of social cooperation, economics provides all the information required for an ultimate decision between reason and unreason. If man reconsiders freeing himself from the supremacy of reason, he must know what he will have to forsake.<sup>49</sup>

In contrast to Hayek who saw society as the outcome of evolution, Mises argued that a categorical difference exists between human society (based on reason) and evolutionary processes:

But one must never forget that the characteristic feature of human society is purposeful cooperation; society is an outcome of human

<sup>47</sup>Menger, *Investigations*, pp. 158–59.

<sup>48</sup>Mises, *Human Action*, p. 177.

<sup>49</sup>*Ibid.*, p. 91.



action, i.e., of a conscious aiming at the attainment of ends. No such element is present, as far as we can ascertain, in the processes which have resulted in the emergence of the structure-function systems of plant and animal bodies and in the operation of the societies of ants, bees, and hornets.<sup>50</sup>

Salerno shows that Mises saw society as a strategy of acting individuals in their struggle against scarcity. Purposefulness, not spontaneity, is the essence of every useful social institution: markets, law, language, family, moral conduct, etc. Mises wrote:

Seen from the point of view of the individual, society is the great means for the attainment of all his ends.<sup>51</sup>

Society is concerted action, cooperation. Society is the outcome of conscious and purposeful behavior. This does not mean that individuals have concluded contracts by virtue of which they have founded human society. The actions which have brought about social cooperation and daily bring it about anew do not aim at anything else than cooperation and coadjuvancy with others for the attainment of definite singular ends. The total complex of the mutual relations created by such concerted actions is called society.<sup>52</sup>

For Mises the division of labor (which is predicated on the inherent differences among individuals and natural resources) is the essence of society and the linchpin of all aspects of civilization:

Society is division of labor and combination of labor.<sup>53</sup>

The fundamental social phenomenon is the division of labor and its counterpart human cooperation.<sup>54</sup>

Jeffrey Tucker and Llewellyn Rockwell demonstrate that for Mises the division of labor is the natural outcome of the inherent differences in individuals and natural resources. Mises stated:

<sup>50</sup>Ibid., p. 145.

<sup>51</sup>Ibid., p. 165.

<sup>52</sup>Ibid., p. 143.

<sup>53</sup>Ibid.

<sup>54</sup>Ibid., p. 157.

The natural conditions determining man's life and effort are such that the division of labor increases output per unit of labor expended. These natural facts are:

First: the innate inequality of men with regard to their ability to perform various kinds of labor. Second: the unequal distribution of the nature-given, nonhuman opportunities of production on the surface of the earth. One may as well consider these two facts as one and the same fact, namely, the manifoldness of nature which makes the universe a complex of infinite varieties.<sup>55</sup>

Reason is the tool that allows acting man to employ this fact to establish society. Mises wrote:

The fundamental facts that brought about cooperation, society, and civilization and transformed the animal man into a human being are the facts that work performed under the division of labor is more productive than isolated work and that man's reason is capable of recognizing this truth. But for these facts men would have forever remained deadly foes of one another, irreconcilable rivals in their endeavors to secure a portion of the scarce supply of means of sustenance provided by nature.<sup>56</sup>

Social progress is predicated on extension of the division of labor which requires calculation as a tool of reason. Mises stated:

For monetary economic calculation is the intellectual basis of the market economy. The tasks set to acting within any system of the division of labor cannot be achieved without economic calculation.<sup>57</sup>

This fact explains why Mises placed central importance on the concept of economic calculation:

Our civilization is inseparably linked with our methods of economic calculation. It would perish if we were to abandon this most precious intellectual tool of acting.<sup>58</sup>

Mises argued that economic calculation requires capitalism:

<sup>55</sup>Ibid., pp. 158–58.

<sup>56</sup>Ibid., p. 144.

<sup>57</sup>Ibid., p. 259.

<sup>58</sup>Ibid., p. 230.

The system of economic calculation in monetary terms is conditioned by certain social institutions. It can operate only in an institutional setting of the division of labor and private ownership of the means of production in which goods and services of all orders are bought and sold against a generally used medium of exchange, i.e., money.

Monetary calculation is the main vehicle of planning and acting in the social setting of a society of free enterprise directed and controlled by the market and its prices.<sup>59</sup>

Richard Ebeling deals with the great Misesian challenge to socialism, what Mises considered *the* problem of socialism, economic calculation. While Böhm-Bawerk cut out the heart of socialism—the labor theory of value—Mises cut off its head by showing that the central planners have no rational basis to determine how to use resources in production. By abolishing private property, money, and thus, monetary exchange, socialism destroys the only conceivable procedure for comparing the social value of diverse goods, i.e., market prices. Under such conditions, no common denominator exists for the central planners to compare using different resources across different technological possibilities. Mises argued that capitalism solves this problem via profit and loss calculations formed by entrepreneurs based upon the existence of and expectations concerning market prices.

Because socialism cannot calculate, it is not an *economic* system at all. The attempt to implement socialism must lead to poverty, death, and retrogression of civilization. Mises said:

In abolishing economic calculation the general adoption of socialism would result in complete chaos and the disintegration of social cooperation under the division of labor.<sup>60</sup>

In contrast to this praxeological conclusion, Hayek stated that the major reason to reject socialism is lack of knowledge:

To the naive mind that can conceive of order only as the product of deliberate arrangement, it may seem absurd that in complex

<sup>59</sup>Ibid., pp. 229–30.

<sup>60</sup>Ibid., p. 861.

conditions order, and adaptation to the unknown, can be achieved more effectively by decentralizing decisions, and that a division of authority will actually extend the possibility of overall order. Yet that decentralization actually leads to more information being taken into account. This is the main reason for rejecting the requirements of constructivist rationalism.<sup>61</sup>

But Mises demonstrated that even with *perfect* information, the central planners in socialism cannot rationally calculate how to combine resources to render efficient production. They can only grope in the dark. Mises called socialism “planned chaos,” an irrational endeavor that must leach off and mimic capitalism to provide even a subsistence standard of living to its citizens:

The paradox of “planning” is that it cannot plan, because of the absence of economic calculation. What is called a planned economy is no economy at all. It is just a system of groping about in the dark. There is no question of a rational choice of means for the best possible attainment of the ultimate ends sought. What is called conscious planning is precisely the elimination of conscious purposive action.<sup>62</sup>

Mises’s critique of socialism is devastating; for he showed that the issue of socialism is purely economic and thus, can be answered unequivocally:

If no other objections could be raised to the socialist plans than that socialism will lower the standard of living of all or at least of the immense majority, it would be impossible for praxeology to pronounce a final judgment. Men would have to decide the issue between capitalism and socialism on the ground of judgments of value and of judgments of relevance. . . . However, the true state of affairs is entirely different. Man is not in a position to choose between these two systems. Human cooperation under the system of the social division of labor is possible only in the market economy. Socialism is not a realizable system of society’s economic organization because it lacks any method of economic calculation.<sup>63</sup>

<sup>61</sup>Hayek, *The Fatal Conceit*, pp. 76–77.

<sup>62</sup>Mises, *Human Action*, pp. 700–01.

<sup>63</sup>*Ibid.*, p. 679.

The “fatal conceit” of the socialists is not, as Hayek had it, that evolution is a progressive force in history they cannot control; but that each individual has a separate will, implying that the socialists’ attempt to control others places them above the rest of us as supermen. According to Hayek, the socialists err because they are not super enough—reason is insufficient to plan the spontaneous order. Mises taught us that the socialist can plan but that the outcome is chaos and thus, socialism cannot be a means to achieve the end of industrial production, rising standards of living, and progressing civilization. Socialism is unreasonable.

Ebeling makes an additional contribution to the issue of economic calculation by placing Mises’s criticism in historical context. He chronicles the contributions of Albert Schäffle, Paul Beaulieu, William Graham, Victor Cathrein, and Benedict Elder to the issue of economic calculation in advance of Mises’s argument. Ebeling shows that Mises was aware of their writings and that his argument refines and extends their work. Finally, Ebeling demonstrates how the socialists’ responses to Mises were ineffective. They tried to rebut Mises’s argument by using mathematical economics and econometrics to show that, in theory at least, the problem could be solved by a system of equations if the economy were perfectly competitive. This response, as Mises showed, served only to illustrate their complete failure to grasp the problem of economic calculation. This failure, Mises claimed, could be traced to their rejection of praxeology:

The illusion that a rational order of [socialist] economic management is possible owed . . . its origin to the value theory of the classical economists and its tenacity to the failure of many modern economists to think through consistently to its ultimate conclusions the fundamental theorem of the subjectivist theory.<sup>64</sup>

In contrast to neoclassical economists who claim that the free market requires perfect competition to be justified (i.e., efficient) and Hayek who argued that competition is the necessary mechanism of societal survival of the fittest (and thus, social progress),

<sup>64</sup>*Ibid.*, p. 206.

Mises demonstrated that the social benefit of the market does not depend on *any* type of competition. Hayek disagreed:

Biological and cultural evolution share other features too. For example, they both rely on the same principle of selection: survival or reproductive advantage. Variation, adaptation and competition are essentially the same kind of process, however different their particular mechanisms, particularly those pertaining to propagation. Not only does all evolution rest on competition; continuing competition is necessary even to preserve existing achievements.<sup>65</sup>

Competition is a procedure of discovery, a procedure involved in all evolution, that led man unwittingly to respond to novel situations; and through further competition, not through agreement, we gradually increase our efficiency.

To operate beneficially, competition requires that those involved observe rules rather than resort to physical force. Rules alone can unite an extended order. . . . Neither all ends pursued, nor all means used, are known or need to be known to anybody, in order for them to be taken account of within a spontaneous order. Such an order forms of itself.<sup>66</sup>

Mises showed that the social division of labor is not an arena of competition but cooperation; a complex network of voluntary interaction that is absolutely necessary for the continuing life and prosperity of the world's population. If people fail to understand this and act against their "rightly understood interests," prosperity and civilization will end. Mises wrote:

What makes friendly relations between human beings possible is the higher productivity of the division of labor. It removes the natural conflict of interests. For where there is division of labor, there is no longer question of the distribution of a supply not capable of enlargement. Thanks to the higher productivity of labor performed under the division of tasks, the supply of goods multiplies. A preeminent common interest, the preservation and further intensification of social cooperation, becomes paramount and obliterates all essential

<sup>65</sup>Hayek, *The Fatal Conceit*, p. 26.

<sup>66</sup>*Ibid.*, pp. 19–20.

collisions. Catallactic competition is substituted for biological competition. It makes for harmony of the interests of all members of society. The very condition from which the irreconcilable conflicts of biological competition arise—viz., the fact that all people by and large strive after the same things—is transformed into a factor making for harmony of interests. Because many people or even all people want bread, clothes, shoes, and cars, large-scale production of these goods becomes feasible and reduces the costs of production to such an extent that they are accessible at low prices. The fact that my fellow man wants to acquire shoes as I do, does not make it harder for me to get shoes, but easier. What enhances the price of shoes is the fact that nature does not provide a more ample supply of leather and other raw material required, and that one must submit to the disutility of labor in order to transform these raw materials into shoes. The catallactic competition of those who, like me, are eager to have shoes makes shoes cheaper, not more expensive.

This is the meaning of the theorem of the harmony of the rightly understood interests of all members of the market society.<sup>67</sup>

Mises thus disposed of a common criticism of the market system. The truth is, without capitalism most of the world's population would die and the rest would live in poverty—the fate of citizens in socialist systems.

Via praxeology, Mises demonstrated that capitalism leads to prosperity and socialism to poverty. Yet, because they do not accept praxeology, most economists reject both socialism and capitalism in favor of a mixed system. Mises showed that this view is untenable because property must either be private, and thus controlled by individuals; or public, and thus controlled by central planners:

The market economy must be strictly differentiated from the second thinkable—although not realizable—system of social cooperation under the division of labor: the system of social or governmental ownership of the means of production. . . . There is no mixture of the two systems possible or thinkable; there is no such thing as a mixed economy, a system that would be in

<sup>67</sup>Mises, *Human Action*, pp. 673–74.

part capitalistic and in part socialist. Production is directed by the market or by the decrees of a production tsar or a committee of production tsars.<sup>68</sup>

Economists who advocate a mixed system are actually arguing for a hampered market, or what Mises called interventionism:

The system of interventionism or of the hampered market economy differs from . . . socialism by the very fact that it is still a market economy. . . . [The authority] wants production and consumption to develop along lines different from those prescribed by an unhampered market, and it wants to achieve its aim by injecting into the working of the market orders, commands, and prohibitions for whose enforcement the police power and its apparatus of violent compulsion and coercion stand ready.<sup>69</sup>

The debate between such economists regarding social systems typically centers around the degree to which government is justified in intervening. They construct elaborate arguments for different “optimal” amounts of government activity. But Mises showed long ago that a fixed amount of intervention is a chimera. The interventionist system is unstable, doomed to continue in motion either toward capitalism or socialism. He wrote:

If it is in the jurisdiction of the government to decide whether or not definite conditions of the economy justify its intervention, no sphere of operation is left to the market. Then it is no longer the consumers who ultimately determine what should be produced, in what quantity, of what quality, by whom, where, and how—but it is the government. For as soon as the outcome brought about by the operation of the unhampered market differs from what the authorities consider “socially” desirable, the government interferes. That means the market is free as long as it does precisely what the government wants it to do. . . . Thus the doctrine and the practice of interventionism ultimately tend to abandon what originally distinguished them from outright socialism and to adopt entirely the principles of totalitarian all-round planning.<sup>70</sup>

<sup>68</sup>*Ibid.*, p. 258.

<sup>69</sup>*Ibid.*, p. 718.

<sup>70</sup>*Ibid.*, p. 723–24.



In 1949, Mises recognized that socialism did not exist in pure form, even in the Soviet Union:

Government-operated enterprises and the Russian Soviet economy are, by the mere fact that they buy and sell on markets, connected with the capitalist system. They themselves bear witness to this connection by calculating in terms of money. They thus utilize the intellectual methods of the capitalist system that they fanatically condemn.<sup>71</sup>

Mises recognized the fate of the world-wide adoption of interventionism. He wrote, "The interventionist interlude must come to an end because interventionism cannot lead to a permanent system of social organization."<sup>72</sup> Interventionism must fail because it: restricts the goods available to consumers; cannot bring about its proposed end but leads to a situation worse than the pre-intervention one; has exhausted the "surplus" it seeks to confiscate.<sup>73</sup>

Mises built this theory praxeologically and thus, he knew the outcome in advance of any social experiment. The death and destruction in the twentieth century caused by the global adoption of statism need not have taken place. We have learned nothing from this historical episode that praxeology could not have taught us in advance. This is why Mises placed such great importance on deriving economic theory, educating people in economic truth, and persuading them to act according to it. Mises said, "The characteristic feature of this age of destructive wars and social disintegration is the revolt against economics."<sup>74</sup>

In contrast to Mises's advocacy for capitalism, Hayek gave us the process of evolution as the guide to social development. With Hayek's theory, we would have to wait until a particular society following particular rules either advanced or regressed before we could determine whether to imitate them.<sup>75</sup> We could not reason

<sup>71</sup>Ibid., p. 259.

<sup>72</sup>Ibid., p. 858.

<sup>73</sup>Ibid.

<sup>74</sup>Ibid., p. 9.

<sup>75</sup>Hayek, *The Fatal Conceit*, pp. 16–17.

out in advance whether following certain rules leads to certain outcomes. Hayek stated:

Such new rules would spread not because men understood that they were more effective, or could calculate that they would lead to expansion, but simply because they enabled those groups practicing them to procreate more successfully and to include outsiders.<sup>76</sup>

Despite such differences, all evolution, cultural as well as biological, is a process of continuous adaptation to unforeseeable events, to contingent circumstances which could not have been forecast.<sup>77</sup>

Mises argued, Salerno shows, that society cannot spontaneously develop because social outcomes depend on actions which are based on ideas that must be learned. Society must be thought out in advance. Mises wrote:

Any existing state of social affairs is the product of ideologies previously thought out. Within society new ideologies may emerge and may supersede older ideologies and thus transform the social system. However, society is always the creation of ideologies temporally and logically anterior. Action is always directed by ideas; it realizes what previous thinking has designed.<sup>78</sup>

History reflects a great struggle among different ideologies. Economic theory and education were preeminent for Mises because they are the pathway to correct ideology and thus, social progress:

The main objective of praxeology and economics is to substitute consistent correct ideologies for the contradictory tenets of popular eclecticism. There is no other means of preventing social disintegration and of safeguarding the steady improvement of human conditions than those provided by reason.<sup>79</sup>

<sup>76</sup>Ibid., p. 16.

<sup>77</sup>Ibid., p. 25.

<sup>78</sup>Mises, *Human Action*, p. 188.

<sup>79</sup>Ibid., p. 185.

The result of correct reasoning is the ideology of liberalism. Action based on liberalism is consistent with mans' "rightly understood interests." Mises wrote:

Liberalism is based upon a purely rational and scientific theory of social cooperation. The policies it recommends are the application of a system of knowledge which does not refer in any way to sentiments, intuitive creeds for which no logically sufficient proof can be provided, mystical experiences, and the personal awareness of superhuman phenomena. . . . [Liberalism is] the policy derived from [the] teaching [of the sciences of human action].<sup>80</sup>

Tucker and Rockwell show that Mises understood the indelible bond between the achievements of liberalism and Western culture, it being the one that most fully adopted a rational view of man's nature, and that the fiercest enemy of liberty and prosperity was the irrationality called egalitarianism. Mises wrote:

The liberal champions of equality under the law were fully aware of the fact that men are born unequal and that it is precisely their inequality that generates social cooperation and civilization. Equality under the law was in their opinion not designed to correct the inexorable facts of the universe and to make natural inequality disappear. It was, on the contrary, the device to secure for the whole of mankind the maximum of benefits it can derive from it.<sup>81</sup>

The triumph of this liberal philosophy produced all those phenomena which in their totality are called modern Western civilization.<sup>82</sup>

In describing the civilizations of the Asiatics as inferior civilizations [economists and historians] do not express any value judgments. They merely establish the fact that these peoples did not bring forth those ideological and institutional conditions which in the West produced that capitalist civilization the superiority of which the Asiatics today implicitly accept.<sup>83</sup>

For this reason, Mises was a staunch defender of cultural traditionalism and severely criticized the various modern attacks

<sup>80</sup>Ibid., p. 155.

<sup>81</sup>Ibid., p. 841.

<sup>82</sup>Ibid., p. 842.

<sup>83</sup>Ibid., p. 843.

on it: deviant sexuality, non-traditional families, free love, feminism, and multiculturalism.

Despite this vast array of achievements, Mises left work to be done. He viewed praxeology as a set of sciences of human action, only hinting at where it might apply beyond economics.<sup>84</sup> This task he passed down to the next generation of Misesians.

Rothbard has reasoned out the first integrated, unified theory of liberty. Beginning from the fundamental fact of man's existence, i.e., human action, Rothbard developed both praxeological economic theory and the political philosophy of freedom. The key concept in his argument is property rights—the justifiable ownership of property.

Rothbard began with Mises's initial insight that ownership of property must, praxeologically, mean control of property in action:

In dealing with private property, catallactics deals with control, not with legal terms, concepts and definitions.<sup>85</sup>

Such ownership is a prerequisite of any human action. Because action occurs only individually, praxeological ownership must be an individual phenomenon. Mises said, "Action is always action of individual men."<sup>86</sup>

From Mises's ideas, Rothbard justified "natural" praxeological ownership of labor, land, and capital. He demonstrated that each individual owning his labor, i.e., self-ownership, is the natural condition of man. Mises held the same view:

Human action is purposeful behavior. Or we may say: Action is will put into operation and transformed into an agency . . .<sup>87</sup>

The employment of the physiological functions and manifestations of human life as a means is called labor . . . Man works in using his forces and abilities as a means for the removal of uneasiness and in substituting purposeful exploitation of his vital energy for the

<sup>84</sup>Ibid., pp. 3 and 885.

<sup>85</sup>Ibid., p. 683.

<sup>86</sup>Ibid., p. 143.

<sup>87</sup>Ibid., p. 11.

spontaneous and carefree discharge of his faculties and nerve tensions. Labor is a means, not an end in itself.<sup>88</sup>

Murray Rothbard argued that man's natural condition requires him to appropriate land and transform land into capital with his labor. By establishing control of these means in transforming them, the homesteader establishes praxeological ownership. This ownership by the individual is justified because it is a product of labor which is individually owned. On homesteading, Mises said:

[Private property] came into existence in early ages of history, when people with their own power and by their own authority appropriated to themselves what had previously not been anybody's property.<sup>89</sup>

While Mises asserted that homesteading was arbitrary and historically has been superseded by the market (i.e., contracting), he did not condemn it as antisocial in the way he condemned violent takings of private property.<sup>90</sup> He argued that the government should prevent such violence:

What characterizes [interventionism] as such is the fact that the government does not limit its activities to the preservation of private ownership of the means of production and its protection against violent or fraudulent encroachments.<sup>91</sup>

In addition to self-ownership and homesteading, Rothbard argued for contracting as a way to justifiably obtain ownership over property. Mises clearly agreed that market exchange confers proper ownership:

Private ownership of the means of production is the fundamental institution of the market economy. It is the institution the presence of which characterizes the market economy as such. Where it is absent, there is no question of a market economy.<sup>92</sup>

Self-ownership, homesteading, and contracting Rothbard calls natural rights. Because every action, whether voluntary or violent,

<sup>88</sup>Ibid., p. 131.

<sup>89</sup>Ibid., p. 683.

<sup>90</sup>Ibid.

<sup>91</sup>Ibid., p. 718.

<sup>92</sup>Ibid., p. 682.

presupposes praxeological ownership, natural rights are the foundation of both economic theory and political philosophy. Beginning from this conclusion, Hoppe explicitly extends praxeology into political philosophy, weaving together Rothbard's work with that of Mises. By combining the a priori of action with the a priori of argumentation, he demonstrates that praxeology is sufficient grounds, epistemologically, for both economics and political philosophy. Property rights can be justified with the same rigor as economic propositions.

Hoppe begins by pointing out that justification of ethical principles can only be made in the course of argumentation. Epistemologically, ethics can be viewed as an a priori valid system of norms because argumentation presupposes the validity of certain norms. The act of argumentation implies the recognition of the fact that argumentation requires each person to have exclusive control over the scarce resources of his body. No one could justify anything without presupposing such a property right. Hoppe then demonstrates that not only is self-ownership valid a priori but so is ownership over homesteaded objects as the objective link between self-owned labor and these objects. These norms are precisely the system of private property developed by Rothbard and held by Mises.

While the work of Rothbard and Hoppe is Misesian in approach, Leland Yeager espouses the standard view of Mises as a utilitarian in political philosophy. Mises wrote:

But the teachings of utilitarian philosophy and classical economics have nothing at all to do with the doctrine of natural right. With them the only point that matters is social utility. They recommend popular government, private property, tolerance, and freedom not because they are natural and just, but because they are beneficial . . .<sup>93</sup>

Relying upon his view of "rule" utilitarianism, since Mises did not explicitly elaborate one, Yeager criticizes Rothbard's natural rights position on two counts. One is that Rothbard is really a closet utilitarian, not in procedure, but in his fundamental presupposition—prosperity of man is good. The other is that Rothbard's natural

<sup>93</sup>Ibid., p. 175.

rights lead to unacceptable conclusions. For example, Yeager claims that the distinction Rothbard makes between using government to prevent private (harmful) violent acts and using government to prevent private (harmful) voluntary acts is invalid. In utilitarian fashion, Yeager would allow government to intervene in both cases as long as society benefits.

Mises's view of this debate is unknown but can, perhaps, be implied from his writings. Mises consistently taught that through praxeology we can ascertain the means appropriate to accomplish certain ends. If we seek prosperity and civilization, we must adopt the free market. But the market is predicated on private property and thus, private property must be protected from aggressive violence by defensive violence. Mises defined this as the proper end for government:

In the market economy, the laissez-faire type of social organization, there is a sphere within which the individual is free to choose between various modes of acting without being restrained by the threat of being punished. If, however, the government does more than protect people against violent or fraudulent aggression on the part of antisocial individuals, it reduces the sphere of the individual's freedom to act beyond the degree to which it is restricted by praxeological law. Thus we may define freedom as that state of affairs in which the individual's discretion to choose is not constrained by governmental violence beyond the margin within which the praxeological law restricts it anyway.<sup>94</sup>

Government can be a means to a particular end but not the same end that people pursue via the market. Mises said, "State and government are not ends, but means"<sup>95</sup>; and, "All moral rules and human laws are means for the realization of definite ends."<sup>96</sup> Mises's argument that the state cannot be a direct means to prosperity and civilization has been given above. However, violent means—Mises said, "It is important to remember that government interference always means either violent action or the threat of

<sup>94</sup>Ibid., p. 281.

<sup>95</sup>Ibid., p. 720.

<sup>96</sup>Ibid.

such action"<sup>97</sup>—can be used only in accomplishing the end of stopping those who would disrupt the process of the market by violence, i.e., defense against aggression done to private property. In this argument, Mises limits government by praxeological law—based upon private property.

If voluntary acts are harmful, they cannot, praxeologically, be combated with violent means but only voluntary ones. Mises strictly limited government to the protection of private property, implying that it cannot be effective as an expedient to interfere with voluntary activities.

The difference between Rothbard and Mises on political philosophy is slight. They justified different endpoints of liberalism: Rothbard the praxeological beginning of property ownership and Mises the praxeological ending of the free market. For Mises, justifying the free-market, limited-government society was purely a praxeological matter of deducing the consequences of its adoption:

The problem is whether or not [an unlimited] government is expedient from the point of view of the preservation and functioning of social cooperation. . . . [This problem] must be decided by praxeology, not by a spurious metaphysics of state and right . . .

But the question is whether such a policy can or cannot attain the ends which the government wants to attain by resorting to it. This is a purely praxeological and economic problem.<sup>98</sup>

Convincing the vast majority to accept the teaching of praxeology and act accordingly was, for Mises, an unscientific endeavor in changing their ethical values:

Ethical doctrines are intent upon establishing scales of value according to which man should act but does not necessarily always act . . .

[Praxeology and economics] are fully aware of the fact that the ultimate ends of human action are not open to examination from any absolute standard. Ultimate ends are ultimately given, they

<sup>97</sup>Ibid., p. 719.

<sup>98</sup>Ibid., pp. 721–22.



are purely subjective, they differ with various people and with the same people at various moments in their lives.<sup>99</sup>

The gap between this and reasoning out the consequences of *laissez-faire* is filled by strategy—educating and persuading people in their “rightly understood interests.” Mises considered this a task for reason:

Liberalism is rationalistic. It maintains that it is possible to convince the immense majority that peaceful cooperation within the framework of society better serves their rightly understood interests than mutual battling and social disintegration. It has full confidence in man’s reason. It may be that this optimism is unfounded and that the liberals have erred. But then there is no hope left for mankind’s future.<sup>100</sup>

The preeminent role Mises gave to reason is the key that Rothbard uses, in his essay, to explain why Mises passionately fought against rising statism and widespread acceptance of intellectual error. The apparent paradox in Mises’s adherence to value-free economic theory and his advocacy of *laissez-faire* evaporates in light of the dual importance he placed on reason. Mises was a human actor who, like everyone, acted upon his ideas and his subjective values. He courageously chose truth over error, freedom over slavery, prosperity for mankind over poverty, and a life of advocacy and academic banishment over one of silence (or worse) and academic privilege.

Rothbard also shows that the ivory tower academician spinning out value free theories while remaining unsoiled with the mundane affairs of mankind is a myth. Mises followed a long line of policy advocates, not only within the ranks of the great Austrian economists, but also among neoclassicals and Keynesians.

Gordon provides the solution to another apparent paradox concerning Mises, which sheds additional light on the issue of advocacy. On one hand, Mises showed that only capitalism can lead to rising living standards and civilization. Socialism must lead to poverty and death, and interventionism is an unstable system. On the other hand, Mises assumed, in historical work, that people are

<sup>99</sup>*Ibid.*, p. 95.

<sup>100</sup>*Ibid.*, p. 157.

interested in their material well-being. Why then is there so little capitalism in the world? For Mises, unlike neoclassical and public choice economists, there is no paradox since he does not assume that people act rationally in the neoclassical sense, i.e., with perfect information. In fact, Mises argued that people have been misled by the intellectuals who have taught false doctrine:

Tax-supported universities are under the sway of the party in power. The authorities try to appoint only professors who are ready to advance ideas of which they themselves approve. As all non-socialist governments are today firmly committed to interventionism, they appoint only interventionists. In their opinion, the first duty of the university is to sell the official social philosophy to the rising generation. They have no use for economists.<sup>101</sup>

The masses, the hosts of common men, do not conceive any ideas, sound or unsound. They only choose between the ideologies developed by the intellectual leaders of mankind. But their choice is final and determines the course of events. If they prefer bad doctrines, nothing can prevent disaster.<sup>102</sup>

The existence of erroneous ideology and the destructive consequences of action based on error, help explain Mises's passion for his praxeological conclusions and why he considered the struggle over liberalism a life and death struggle for mankind, civilization, and the human race:

It is vain to speculate about the outcome of the great ideological conflict between the principles of private ownership and public ownership, of individualism and totalitarianism, of freedom and authoritarian regimentation. All that we can know beforehand about the result of this struggle can be condensed in the following three statements:

1. We have no knowledge whatever about the existence and operation of agencies which would bestow final victory in this clash on those ideologies whose application will secure the preservation and further intensification of societal bonds and the improvement

<sup>101</sup>*Ibid.*, p. 872.

<sup>102</sup>*Ibid.*, p. 864.

of mankind's material well-being. Nothing suggests the belief that progress toward more satisfactory conditions is inevitable or a relapse into very unsatisfactory conditions impossible.

2. Men must choose between the market economy and socialism. They cannot evade deciding between these alternatives by adopting a "middle-of-the-road" position, whatever name they may give to it.

3. In abolishing economic calculation the general adoption of socialism would result in complete chaos and the disintegration of social cooperation under the division of labor.<sup>103</sup>

Given these alternatives, Mises ended his *magnum opus* with:

The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race.<sup>104</sup>

Mises was the embodiment of his strategy for advancing truth: the twin concepts of scholarship and popular advocacy. On the first he built the high road of praxeological economics on the second he lived his principles to the benefit of all mankind. Mises has paved the way for a world-wide renaissance of freedom. Those who stand on his shoulders will fight what he called, "the decisive battle into which our epoch has plunged us." Without him the battle would already be lost. This is the meaning of Ludwig von Mises.

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<sup>103</sup>Ibid., p. 861.

<sup>104</sup>Ibid., p. 885.

# 1

## *Praxeology, Positivism, and Public Choice: Was Mises a Public Choicer?*

Roger A. Arnold

### Introduction

**I**n his Nobel lecture, James Buchanan articulated “all three of the constitutive elements that provide the foundation of public choice theory: methodological individualism, *homo economicus*, and politics-as-exchange.”<sup>1</sup> Buchanan, having stated the essence of public choice theory, provides us with the criterion by which to determine whether (or not) economists that work outside the public choice area are “philosophically” public choicers. Loosely stated, are they public choicers in their hearts and minds, if not in what they do in their daily lives as economic theorists and researchers? For example, was Ludwig von Mises a public choicer in this sense?

Mises, the Austrian economist, and Buchanan, the public choice economist, have had much to say about methodological *individualism* and *homo economicus*. Persons familiar with their works know that both are methodological individualists.<sup>2</sup> Also, both Mises and

<sup>1</sup>James M. Buchanan, “The Constitution of Economic Policy,” *American Economic Review* 77 (June 1987): 243.

<sup>2</sup>Ludwig von Mises: “First we must realize that all actions are performed by individuals” (*Human Action*, 3rd rev. ed. [Chicago: Contemporary Books, 1966], p. 42). “Methodological individualism, far from contesting the significance of such collective wholes, considers it as one of its main tasks to describe and to analyze their becoming and

Buchanan have discussed *homo economicus* in much the same way.<sup>3</sup> As to politics-as-exchange, there is a slight but important parting

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their disappearing, their changing structures, and their operation. And it chooses the only method fitted to solve this problem satisfactorily," (ibid.). "Those who want to start the study of human action from the collective units encounter an insurmountable obstacle in the fact that an individual at the same time can belong and—with the exception of the most primitive tribesmen—really belongs to various collective entities. The problems raised by the multiplicity of coexisting social units and their mutual antagonisms can be solved only by methodological individualism" (ibid., p. 43).

James M. Buchanan: "Since our model incorporates individual behavior as its central feature, our 'theory' can perhaps best be classified as being methodologically individualistic" (James Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* [Ann Arbor, Mich.: University of Michigan Press, 1971], p. 3). "My approach is profoundly individualistic, in an ontological—methodological sense . . ." (James Buchanan, *The Limits of Liberty* [Chicago: University of Chicago Press, 1975], p. 1).

<sup>3</sup>Both Mises and public choice economists (of the Buchanan variety) see the uses of *homo economicus*, but are not blind to its limitations.

Mises: "Modern subjective economics starts with the solution of the apparent paradox of value. It neither limits its theorems to the actions of businessmen alone nor deals with a fictitious *homo economicus*" (*Human Action*, p. 64).

Buchanan and Tullock: "The first point to be noted is that economic theory does not depend for its validity or its applicability on the presence of the purely economic man. This man of fiction, who is motivated solely by individual self-interest in all aspects of his behavior, has always represented a caricature designed by those who have sought to criticize rather than to appreciate the genuine contribution that economic analysis can make, and has made, toward a better understanding of organized human activity" (*The Calculus of Consent*, p. 17).

Mises: "Praxeology in general and economics in its special field assume with regard to the springs of human action nothing other than that acting man wants to remove uneasiness. Under the particular conditions of dealing on the market, action means buying and selling" (*Human Action*, p. 240).

Buchanan and Tullock: "The man who enters the market relationship as consumer, laborer, seller of products, or buyer of services may do so for any number of reasons. The theory of markets postulates only that the relationship be *economic*, that the interest of his opposite number in the exchange be excluded from consideration" (*The Calculus of Consent*, pp. 17–18).

Mises: "Everything that economics asserts about demand and supply refers to every instance of demand and supply and not only to demand and supply brought about by some special circumstances requiring a particular description or definition. To assert that a man, faced with the alternative of getting more or less for a commodity he wants to sell, *ceteris paribus* chooses the high price, does not require any further assumption. A higher price means for the seller a better satisfaction of his wants. The same applies *mutatis mutandis* to the buyer. The amount saved in buying the commodity concerned enables him to spend more for the satisfaction of other needs" (*Human Action*, p. 240).

Buchanan and Tullock: "Reduced to its barest essentials, the economic assumption is simply that the representative or the average individual, when confronted with real choice in exchange, will choose 'more' rather than 'less'" (*The Calculus of Consent*, p. 18).

of the ways. This “parting” is explained in terms of the difference in the methodological approach employed by the two economists.

This paper may be seen as answering a question, and making a point. The question: Was Mises a public choicer? The point: that one’s methodological approach sharply influences how one views exchange.

## Mises on Government

Mises was not an anarchist. He says:

An anarchistic society would be exposed to the mercy of every individual. Society cannot exist if the majority is not ready to hinder, by the application or threat of violent action, minorities from destroying the social order. This power is vested in the state or government. . . . The state is essentially an institution for the preservation of peaceful interhuman relations.<sup>4</sup>

Thus, Mises saw government as necessary to the provision of protection, and indirectly, to the preservation of liberty. On the latter point, Mises says:

As far as the government . . . confines the exercise of its violence and the threat of such violence to the suppression and prevention of antisocial action, there prevails what reasonably and meaningfully can be called liberty. What is restrained is merely conduct that is bound to disintegrate social cooperation and civilization, thus throwing all people back to conditions that existed at the time homo sapiens emerged from the purely animal existence of its nonhuman ancestors.<sup>5</sup>

<sup>4</sup>Mises, *Human Action*, p. 149. Along similar lines, Mises says: “In order to preserve the state of affairs in which there is protection of the individual against the unlimited tyranny of stronger and smarter fellows, an institution is needed that curbs all antisocial elements. Peace—the absence of perpetual fighting by everyone against everyone—can be attained only by the establishment of a system in which the power to resort to violent action is monopolized by a social apparatus of compulsion and coercion and the application of this power in any individual case is regulated by a set of rules—the man-made laws as distinguished both from the laws of nature and those of praxeology. The essential implement of the social system is the operation of such an apparatus commonly called government” (ibid., p. 280).

<sup>5</sup>Ibid., p. 281.

Besides viewing government as necessary to the provision of protection, Mises also saw it as necessary to the provision of some public goods.<sup>6</sup> In particular, protection-oriented public goods, such as national defense. He says:

He who wants to remain free, must fight unto death those who are intent upon depriving him of his freedom. As isolated attempts on the part of each individual to resist are doomed to failure, the only workable way is to organize resistance by the government. The essential task of government is defense of the social system not only against domestic gangsters but also against external foes.<sup>7</sup>

In this statement, Mises implicitly acknowledges market failure. Specifically, when he says that “isolated attempts . . . are doomed to failure, the *only* workable way is to organize resistance by the government.” It comes as no surprise that public choicers, too, see market failure.

It also comes as no surprise that both Mises and public choicers see government failure.<sup>8</sup> Mises puts it straightforwardly and bluntly:

Every step a government takes beyond the fulfillment of its essential functions of protecting the smooth operation of the market economy against aggression, whether on the part of domestic or foreign disturbers, is a step forward on a road that directly leads into the totalitarian system where there is no freedom at all.<sup>9</sup>

Buchanan says, “Markets fail; governments fail.”<sup>10</sup>

Even though Mises and public choicers see both market failure and government failure, this is not enough commonality between the two to label Mises a public chooser.

<sup>6</sup>Public choice economists also see government as necessary for the provision of protection and public goods. This is made manifestly clear in Buchanan’s, *The Limits of Liberty*. Buchanan speaks of both the “protective state” and the “productive state.”

<sup>7</sup>Mises, *Human Action*, p. 282.

<sup>8</sup>On this Buchanan has said, “Public choice is a theory of ‘government failure’ here in the precisely analogous sense that theoretical welfare economics has been a theory of ‘market failure.’” “Notes on the History and Direction of Public Choice,” in *What Should Economists Do?* (Indianapolis, Ind.: Liberty Press, 1979), p. 178.

<sup>9</sup>Mises, *Human Action*, p. 282.

<sup>10</sup>Buchanan, *What Should Economists Do?*, p. 210.

## Politics-As-Exchange

Even though Mises sees a role for government, he did not endorse the view of government put forth by public choicers. That view is best described by Buchanan and Tullock, when they say:

Men co-operate through exchange of goods and services in organized markets, and such co-operation implies mutual gain. The individual enters into an exchange relationship in which he furthers his own interest by providing some product or service that is of direct benefit to the individual on the other side of the transaction. At base, political or collective action under the individualistic view of the State is much the same.<sup>11</sup>

Popularly stated, government is a super-firm, through which complex exchanges are made.

Did Mises accept the “super-firm theory of government”? No. Mises was a praxeologist, and praxeology, as I shall show, does not allow for a super-firm theory of government. The super-firm theory is basically positivist in nature.

For example, in developing public choice theory, both Buchanan, and Buchanan and Tullock, have advocated positivism. In *The Calculus of Consent*, Buchanan and Tullock say:

Assumptions may or may not be “descriptive” or “realistic,” as these words are ordinarily used. In many cases the “unrealism” of the assumptions causes the models to be rejected before the conclusions are examined and tested. Fundamentally, the only test for “realism” of assumptions lies in the applicability of the conclusions.<sup>12</sup>

Similarly, Buchanan has said:

What I am calling for, as the proper function of economists, is institutional theory or institutional analysis, which involves in

<sup>11</sup>Buchanan and Tullock, *The Calculus of Consent*, p.19. Also relevant here are two statement-definitions by Buchanan: “In my vision of social order, individual persons are the basic component units, and ‘government’ is simply that complex of institutions through which individuals make collective decisions, and through which they carry out collective as opposed to private activities. ‘Politics’ is the activity of persons in the context of such institutions” (*What Should Economists Do?*, p. 144).

<sup>12</sup>Buchanan and Tullock, *The Calculus of Consent*, p. 29.



many cases the use of highly rarefied and abstract models, the implications of which can be checked by real-world observations.<sup>13</sup>

Positivism gives way to *as-if explanations*. For example, the theory of perfect competition assumes that all buyers and sellers have complete information as to buying and selling activities. In the real world, positivists argue, buyers and sellers do not (or rarely) have complete information. Still, many positivists contend, the theory of perfect competition predicts well. So, it is *as if* buyers and sellers in the real world that have complete information (even though we know that they do not).

Milton Friedman, the dean of economic positivism, discussing the law of falling bodies, puts it this way: “. . . under a wide range of circumstances, bodies that fall in the actual atmosphere behave *as if* they were falling in a vacuum.”<sup>14</sup>

The super-firm theory of the state employs this *as-if positivism*. Public choice economists are not unlikely to say that people, in their political lives, behave *as if* government were a super-firm in which they “buy” certain goods and services that government “sells.” But what is not clear at this level of discourse, is whether (or not) the super-firm theory actually does predict well. (If not, then employing the *as-if* explanation is not justified. “As-if explanations” should only come *after* the theory has been confirmed. This is implicit in what Milton Friedman says in his famous essay on positivist methodology.)

Specifically, it is not clear that the falsifiability criterion of positivism has been met by the super-firm theory. The empirical evidence is not all on one side. For example, it is true that one observes acceptance of many of government’s rules and regulations: there is no mutiny. But one also observes public discontent over taxes and regulations, and certainly simply because there is no mutiny it does not necessarily follow that everyone (or even a majority) choose to “exchange” with government. It may just be that

<sup>13</sup>Buchanan, *What Should Economists Do?*, p. 147.

<sup>14</sup>Milton Friedman, “The Methodology of Positive Economics,” in *Essays in Positive Economics* (Chicago: University of Chicago Press, 1974), p. 18.

we are witnessing a “forced” exchange (one in which it is too costly to get out of) instead of a “complex” one. In short, there is just not enough evidence to confirm the super-firm theory of the state, such that it would be premature to say, as some public choice economists do, that it is *as if* government is a super-firm in which buyers “buy” certain goods and services which government “sells.”<sup>15</sup>

Mises, the praxeologist, would not have been tempted to use the *as-if* explanation that is inherent in positivism because praxeology does not extend itself to the same degree as positivism does.<sup>16</sup> In praxeology, there is no equivalent to the “*as-if* explanation.” Things are not “*as if*,” they either *are* or *are not*. This can be no other way because of the way praxeology proceeds. Praxeology is no more or less than logic applied to the fundamental axiom that human beings act. The methodology is air-tight: there is no room for *as-if* explanations to sneak in. The process of logical deduction keeps them out. Once again, things are either logically correct or not. That is all.<sup>17</sup>

Knowing this, we can see that “politics-as-exchange” is not logical, nor illogical, it is simply a statement that may or may not be true.<sup>18</sup> To a large degree, it is simply outside the realm of praxeology.<sup>19</sup>

<sup>15</sup>Once again, we are not saying that the super-firm theory is incorrect. Only that the empirical data is not all in one direction. Granted, this may be an easy point to make (in fact, it is), but still it may be correct.

<sup>16</sup>What we say here is not a denunciation of positivism at all levels of analysis. We believe that positivism, although it does extend itself to the sometimes shaky *as-if explanation* for an event or behavior, does have important uses. The problem is that positivism is easier to abuse, and make mistakes with, than praxeology, thus a positivist must be much more careful using positivism than a praxeologist must be using praxeology. In a way, praxeology offers safeguards which positivism does not. We shall discuss this in greater detail later.

<sup>17</sup>Once it is realized that praxeology is air-tight, that it is no more or less than logic applied to the fundamental axiom that human beings act, it is easier (we think) to see why Austrians, who practice praxeology, do not feel it necessary to “test” their theories with real-world data. What, in short, is there to test? If *C* follows logically from *B*, and *B* follows logically from *A*, and *A* has to be (it cannot be not-*A*), then what else is there? One cannot test logic with something other than logic.

<sup>18</sup>Something may be true but impossible to logically deduce.

<sup>19</sup>Another way of putting this is to say that praxeology has no way of determining whether “politics-as-exchange” is correct or not. This is a limitation of praxeology (of course praxeologists don’t assert that they can establish the truth of all by using praxeology; they believe, for example, there are some genuinely empirical

Strict praxeologists are prohibited by their methodology from being public choicers. In short, Mises was not a public choicer.

## Praxeology and Positivism

In a loose way, praxeologists and positivists remind us of the tale of the tortoise and the hare. The positivists, because of the flexibility of their methodology, may get from point A to Z in record time. There is nothing to hold them back: no logic to worry about, no strict need for precise assumptions. Simply think up a theory, and test it. In some cases, the theory is confirmed; in other cases, it is not. Try again.

Praxeologists, on the other hand, have to take it slowly. First they have to make certain that their axioms are correct. Then they have to apply careful logic. They will not take that next step, so-to-speak, unless it makes logical sense. Compared to positivism (where, at the theorizing stage, almost anything goes), praxeology is rigid. In praxeology, some things are off limits because they are a priori ridiculous. In positivism, nothing is a priori ridiculous; prediction is what counts, don't judge a book by its cover, and so on. (In terms of our tale of the tortoise and the hare, positivists are more likely than praxeologists to get off the main road and go down "bunny trails" that lead nowhere.)

Is there a place for both praxeology and positivism? Yes. There are some genuinely empirical issues. When we want to know more about them, positivist methodology (with its emphasis on prediction, the falsifiability criterion, and so on) may be helpful. And when the empirical evidence is definitive, it would seem then (and only then) that it is permissible to use the *as-if explanation* implicit in positivism. In all other cases, it is safer to employ praxeology, which doesn't allow for as-if explanations. The as-if explanations implicit in positivism are just too easy for some people to over- and mis-use.

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issues). Limitations, of course, sometimes help us from making mistakes, and sometimes hinder us from making advances.

## Conclusion

Our conclusions are:

1. Mises was not a public choicer. He did not view “politics-as-exchange”; he did not accept the super-firm theory of the state. The reason he did not, is that Mises was a praxeologist and praxeology does not allow for the as-if explanation (which is only implicit in positivism) or politics-as-exchange. One cannot be a praxeologist (exclusively) and public choicer, too.

2. The as-if explanation in positivism should only be used after empirical evidence has confirmed the theory. Even though the empirical evidence is mixed, and therefore the super-firm theory of the state has not been confirmed, many public choicers speak *as if* people “buy” the goods and services that government “sells.”

3. The super-firm theory of the state may be true. Praxeology, or logic applied to the fundamental axiom that human beings act, cannot establish the truth of the super-firm theory of the state. Positivism perhaps can, but has not.

4. Praxeology is subject to less misuse than positivism. The reason is that it has nothing comparable to the “as-if explanation” implicit in positivism.

## 2

# *Economic Calculation Under Socialism: Ludwig von Mises and His Predecessors*

Richard M. Ebeling

### **The Austrian School of Economics in the Years Between the World Wars**

**T**he era between the world wars was a high watermark in the history of the Austrian school of economics. Politically, World War I had been a catastrophe for Austria. The dual monarchy of Austria-Hungary, that had given the ruling House of Hapsburg reign over a vast central European empire, splintered into seven different pieces: a new Czechoslovakia, a separate Hungary, an enlarged Rumania, a reborn Poland, an expanded Italy, a Serbian-led Yugoslavia and a small, land-locked "Republic of Austria." The new Austria was financially bankrupt and economically ruined. An English journalist described the situation in 1920: "Vienna, instead of being the vital centre of fifty millions of people, finds itself a derelict city with a province of six millions. It is cut off from its coal supplies, from its food supplies, from its factories, from everything that means existence. It is enveloped by tariff walls."<sup>1</sup> And the economic hardships of trade restrictions were soon

I wish to thank Mr. John Battalana of Merrill Lynch in Tokyo, Japan for invaluable suggestions.

<sup>1</sup>Norman Angell, *The Fruits of Victory* (London: The Labour Publishing Co., 1921), p. 27; see also, Elizabeth Wiskerman, *Europe of the Dictators, 1919-1945* (New York: Harper & Row, 1966), pp. 17-19.

joined by a devastating inflation that wrecked even more havoc on the crippled and weak new nation.<sup>2</sup>

But in spite of the political instability and economic hardships that plagued little Austria through most of the inter-war years, in the 1920s and early 1930s Vienna once again became one of Europe's cultural and intellectual centers. Vienna was home to Freud and the psychoanalytic movement, to Carnap and Schlick and the school of logical positivism, to Karl Popper and Ludwig Wittgenstein, to Hans Kelsen and the school of the "pure theory of law," and to the Austrian school of economics.<sup>3</sup>

At the University of Vienna, Hans Mayer held the senior chair vacated by Friedrich von Wieser's retirement in the mid-1920s.<sup>4</sup> Ludwig von Mises was senior economic consultant at the Austrian Chamber of Commerce, taught a seminar at the University, and led a "private seminar" at his Chamber offices twice a month.<sup>5</sup> Around Mayer and Mises there developed an entire new generation of "Austrian economists," many of whom would gain international recognition in the decades to come: Friedrich A. Hayek, Fritz Machlup, Gottfried Haberler, Oskar Morgenstern, Paul Rosenstein-Rodan, Leo Schönfeld, Erich Schiff and Richard Strigl.<sup>6</sup> Indeed, by 1931, Lionel Robbins (a young enthusiast of the "Austrians" at the University of

<sup>2</sup>J. van Walré de Bordes, *The Austrian Crown* (London: P. S. King and Sons, 1924); also, Leland B. Yeager, *Experiences With Stopping Inflation* (Washington, D.C.: American Enterprise Institute, 1981), pp. 45–52.

<sup>3</sup>See, William M. Johnston, *The Austrian Mind: An Intellectual and Social History, 1848-1938* (Berkeley, Calif.: University of California Press, 1972); Allan Jamik and Stephen Toulmin, *Wittgenstein's Vienna* (New York: Simon and Schuster, 1973).

<sup>4</sup>On Hans Mayer and his contribution to the Austrian school, see, Alexander Mahr, "Hans Mayer—Leben und Werk," *Zeitschrift für Nationalökonomie* Bd. 16 (March 1956), pp. 3–16; and Wilhelm Weber, "Hans Mayer," *Handwörterbuch der Sozialwissenschaft*, Bd. 7 (Stuttgart: Gustav Fischer, 1961), pp. 364–65.

<sup>5</sup>Gottfried Haberler, "Mises' Private Seminar," *Wirtschaftspolitische Blätter* 28, no. 4 (1981): 121–26; a slightly shorter version of Haberler's essay may be found as an appendix to Ludwig von Mises, *Planning for Freedom* (Spring Mills, Penn.: Libertarian Press, 1980), pp. 276–78; also, a wide variety of reminiscences of Mises's *privatseminar* have been collected and added as an appendix to Margit von Mises, *My Years with Ludwig von Mises*, 2nd rev. ed. (Spring Mills, Penn.: Libertarian Press, 1984), pp. 199–210.

<sup>6</sup>See, Richard M. Ebeling, "Austrian Economics—An Annotated Bibliography: Part 1, The Austrian Economists," *The Humane Studies Review* 2, no. 1 (1983); and "Part 2, Methodology of the Austrian Economists," *The Humane Studies Review* 3, no. 2 (Fall 1985).

London) could write: "The School of Vienna, which in recent years, under the leadership of Professor Mayer and Professor Mises, has experienced such a marvelous renaissance, has laid the scientific world under yet another last obligation."<sup>7</sup>

The "lasting obligation" to which Robbins referred was the Austrian theory of the trade cycle, as first developed in the 1920s by Ludwig von Mises and then elaborated upon by Friedrich A. Hayek. Beginning with the choice processes underlying the individual demands for money, the Austrians explained the emergence of the value of money in the general market; how changes in the value of money originated either in the demand for or supply of money; how the structure of relative prices was distorted during the sequence of events culminating in a change in the value of money; and how such a process could have the characteristics of the "business cycle" when changes in the supply of money originated in the loan market and distorted market rates of interest.<sup>8</sup>

In the 1920s, the Austrians had also formalized the concept of choice. Two variations on the choice-theme were developed. One, found in the works of Hans Mayer and Rosenstein-Rodan, had emphasized the "economizing" quality of choice; that choice was the relationship between a set of given ends ranked in terms of importance and a set of given means usable for alternative purposes which were to be allocated in the service of those ends. The other variation on the choice-theme was developed by Ludwig von Mises, in which choice, and the resulting logic of the ends-means relationship, was an outgrowth of the wider concept of "meaningful action"; action was "meaningful" when the behavior in question was guided by a purpose in mind, with the purpose defining the action in question as one of a certain kind.<sup>9</sup>

<sup>7</sup>Lionel Robbins, "Foreword" to *Prices and Production* by Friedrich A. Hayek (New York: Macmillan, 1930), p. ix.

<sup>8</sup>See, Richard M. Ebeling, "Ludwig von Mises and the Gold Standard," in *The Gold Standard: An Austrian Perspective*, Llewellyn H. Rockwell, Jr., ed. (Lexington, Mass.: Lexington Books, 1985), pp. 35–59, for a summary and explanation of the Austrian approach to monetary theory and policy.

<sup>9</sup>See, Richard M. Ebeling, "Two Variations on the Austrian Theme: Hans Mayer and Ludwig Mises on Price Formation in the Market Process," *Wirtschaft und Gesellschaft*

Another set of themes characteristic of practically all the Austrian economists of the period was that of change, time and uncertainty. Since Menger the analytical “twist” unique to the Austrians, in comparison to other schools of economic thought, has been an interest in problems of “process” and adjustment to change in markets, rather than only a description and analysis of “equilibrium states” that were the hallmark of the mathematical economists. In the 1920s and 1930s, the Austrians focused on an array of problems: How were prices dynamically formed on markets? What were the relationships between market changes in time and market adjustment for coordination through time? What did “equilibrium” mean and how did it relate to different assumptions about the knowledge possessed by market actors? How did market participants form expectations for mutual coordination of plans in the social division of labor?<sup>10</sup>

The growing output of these Austrians soon began to have an expanding influence on economists far beyond the frontiers of the new Austrian Republic. Its impact was particularly felt in England, with the London School of Economics the center of this interest. Arnold Plant relates that when visiting an economics institute in Kiel, Germany, in early 1933, a German economist looking for a teaching position outside the domain of the new Nazi Reich, despondently commented, “I suppose that LSE will have no vacancy for me, now that you have become ‘ein Vorort von Wien’—a suburb of Vienna.”<sup>11</sup>

### **Ludwig von Mises and the Debate over Socialist Economic Calculation in the History of Economic Thought**

The leading figure in the post-World War I “renaissance” of the Austrian school was Ludwig von Mises. It is hardly an exaggeration

(forthcoming) for an explanation of the difference between these two variations in the Austrian approach and the resulting theories of price formation for each.

<sup>10</sup>Richard M. Ebeling, “Expectations and Expectations-Formation in Mises’ Theory of the Market Process,” *Market Process* (Spring 1988).

<sup>11</sup>Sir Arnold Plant, “Homage to Hayek,” *Selected Economic Essays and Addresses* (London: Routledge & Kegan Paul, 1974), p. 170.



to say that almost all of the contributions for which the Austrians are credited in this period either began in one of Mises's works or was given additional insight and impetus to further development in his writings.<sup>12</sup> Already before World War I he had made a major and original contribution with the publication of the first edition of *The Theory of Money and Credit* in 1912.<sup>13</sup> But what drew Mises international attention and an impact that is still felt today (not only in the realm of "pure theory," but also in the course of economic policy around the world) was his 1920 essay, "Economic Calculation in the Socialist Commonwealth,"<sup>14</sup> which became the centerpiece of his 1922 treatise, *Socialism: An Economic and Sociological Analysis*.<sup>15</sup> Hayek has told that, "To none of us . . . who read the book [*Socialism*] when it appeared was the world ever the same again . . . [Wilhelm] Röpke . . . [Lionel] Robbins or [Bertil] Ohlin . . . would tell the same story."<sup>16</sup>

First in his essay and then in his book, Mises challenged the socialists to explain how they would solve the fundamental problem that would confront them if they were to gain power and follow through with their stated program of nationalization of all the society's means of production. The problem being how would the socialist central planners rationally allocate the scarce means of

<sup>12</sup>See, Richard M. Ebeling, "Mises' Influences on Modern Economic Thought," *Wirtschaftspolitische Blätter* 28, no. 4 (1981): 15–24, for a general appreciation and interpretation of the impact of Mises's writings on twentieth-century economic theory in a number of different areas. For a brief discussion by Mises of how he saw his own work in the history of economic ideas, see, "My Contributions to Economy Theory," in *Planning for Freedom*, pp. 224–33, which was a lecture delivered at the Faculty Club of New York University in 1940. The evolution of his ideas are discussed in all too brief detail by Mises in his *Notes and Recollections* (Spring Mills, Penn.: Libertarian Press, 1978).

<sup>13</sup>Ludwig von Mises, *The Theory of Money and Credit*, 3rd rev. ed. (1912; 2nd rev. ed., 1924; Indianapolis, Ind.: Liberty Fund, 1981).

<sup>14</sup>Ludwig von Mises, "Economic Calculation in the Socialist Commonwealth," in *Collectivist Economic Planning*, F. A. von Hayek, ed. (London: George Routledge & Sons, 1935), pp. 87–130. The essay originally appeared under the title, "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen," in the *Archiv für Sozialwissenschaften* 47 (1920). Reprinted in 1990 as a monograph by the Ludwig von Mises Institute.

<sup>15</sup>Ludwig von Mises, *Socialism: An Economic and Sociological Analysis*, 3rd rev. ed. (1922; 2nd rev. ed., 1932; Indianapolis, Ind.: Liberty Fund, 1981). The book originally appeared under the title, *Die Gemeinwirtschaft: Untersuchungen über den Sozialismus* (Jena: Gustav Fischer, 1922).

<sup>16</sup>F. A. Hayek's, "Tribute to Ludwig von Mises," appendix three in Margit von Mises, *My Years with Ludwig von Mises*, p. 220.

production among all their alternative uses, so as to efficiently provide a more plentiful supply of goods and services than under the “anarchy” of capitalist, competitive production?

Mises had argued that the market economy was able to place calculable relative valuations on the means of production through the competitive pricing of those who wished to use them in alternative lines of production. But under socialism with the elimination of private property and market transactions through a monetary medium of exchange, the socialist planners would have no rational method for assigning scarce resources among competing tasks for which they could be applied. As Mises curtly summarized the problem: “Where there is no market, there is no price system, and where there is no price system there can be no economic calculation.”<sup>17</sup>

In the history of economic thought this has come to be seen as the great opening challenge to a debate that has now raged for almost seven decades. Both socialists and anti-socialists have bestowed homage on Mises for having raised the veil from an earlier reluctance on the part of socialist critics of capitalism to explain how a centrally directed economy would function once property, prices, and markets had been abolished.<sup>18</sup>

The answer that the socialists developed in the 1930s was that socialism did not have to mean the abolition of either markets or prices. In the most popular of these “market socialist” formulations, that of the Polish economist Oskar Lange, it was proposed that the central planning agency would be assigned the task of setting “parametric prices.” Socialist managers of nationalized firms would use this centrally set structure of resource prices for planning their production activities; if, at these prices, shortages or surpluses

<sup>17</sup>Mises, *Socialism*, p. 131; “Economic Calculation in the Socialist Commonwealth,” p. 111.

<sup>18</sup>Examples of crediting Mises for being the first (or primary influence) to raise the question as to whether economic calculation would be possible under socialism, can be found in Hayek’s introduction to *Collectivist Economic Planning*, p. 32; Trygve J. B. Hoff, *Economic Calculation in the Socialist Society* (1938; 1949; Indianapolis, Ind.: Liberty Press, 1981), p. 2, and Karen I. Vaughn’s introduction to this edition, p. x; Dominick Armentano, “Resource Allocation Problems Under Socialism,” in *Theory of Economic Systems* by William P. Snavelly, with contributions by Morris Singer and Dominick Armentano (Columbus, Ohio: Charles E. Merrill, 1969), pp. 127–28.

materialized this would “signal” the central planners that relative resource prices were “wrong,” and through a process of trial and error the planners would move those prices until they were “correct” and supplies and demands were matched. Lange was obviously so pleased that he was able to show that socialism could work, in spite of Mises’s charge, that he flippantly suggested that, “Both as an expression of recognition for the great service rendered by him and as a memento of the prime importance of sound economic accounting, a statue of Professor Mises ought to occupy an honorable place in the great hall of the Ministry of Socialization or the Central Planning Board of the socialist state.”<sup>19</sup>

But even as the socialists were hailing their “solution” to the problem of economic calculation under socialism, it was pointed out that, in fact, the entire exercise had been a tempest in a teapot, because Mises had been proven wrong even before he wrote it. It appeared that before World War I two Italian economists, Enrico Barone and Vilfredo Pareto, had demonstrated that the system of mathematical equations that would be necessary to solve the problem of competitive general equilibrium under private ownership of the means of production were the same equations that would be necessary for equilibrium under socialism. As Schumpeter expressed it, “The essential result of Barone’s or any similar investigation is that there exists for any centrally controlled socialism a system of equations that possess a uniquely determined set of solutions, in the same sense and with the same qualifications as does perfectly competitive capitalism.” And as a consequence, “this means that so far as its pure logic is concerned the socialist plan makes sense and cannot be disposed of on the ground that it would necessarily spell chaos, waste, or irrationality.”<sup>20</sup>

Mises, therefore, seemed to be sandwiched between two sets of mathematical solutions (Barone’s and Pareto’s before him and

<sup>19</sup>Oskar Lange, “On the Economic Theory of Socialism,” in *On the Economic Theory of Socialism* by Oskar Lange and Fred M. Taylor (1936; New York: McGraw-Hill, 1964), p. 57; Lange, too, said that, “. . . it was chiefly due to Professor Mises’ challenge that many socialists became aware of the very existence of such a problem.”

<sup>20</sup>Joseph A. Schumpeter, *History of Economic Analysis* (New York: Oxford University Press, 1954), p. 989.

Lange's after him) that appeared to make his entire argument redundant. Mises had failed to see, it was claimed, that "the economic problem" was ultimately a mathematical one: what was required was the specifying of the shapes and positions of the respective supply and demand functions to find that solution that assured a simultaneous clearing of all markets, both for factors of production and finished products. It appeared that Mises, who in a sense was accusing the socialists of not understanding economics, wasn't himself as good an economist as he thought. Mises's problem seemed to be the old one that Austrians have been accused of for almost a hundred years: he just didn't understand mathematics or its applications to economics.<sup>21</sup>

The most recent contributions to the debate have put the issues involved on a different plane. Professor Donald C. Lavoie, in his exhaustive study, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered*, cogently argues that for all intents and purposes, the debate has been misunderstood. The historians of economic thought have failed to appreciate the tacitly different assumptions that Mises (and Hayek) were basing their argument upon, in contrast to those who saw a socialist solution to the calculation problem. As Lavoie expresses it: "At the heart of the debate is a confusion between two fundamentally divergent views of 'competition': (1) the rivalrous competitive process of the Austrians (similar to the classical notion), and (2) the neo-classical notion of a nonrivalrous, static, competitive equilibrium."<sup>22</sup>

Mises and the Austrians, Lavoie explains, conceived of the market economy as a dynamic competitive process in which a complex system of division of labor was matched by an equally complex system of division of knowledge. Rivalry in the market was

<sup>21</sup>That this charge of mathematical ignorance is least of all applicable to Ludwig von Mises has been assured by no less an authority than the noted mathematician Karl Menger, Jr., who referred to Mises's knowledge of mathematics and probability theory; see Karl Menger, *Selected Papers in Logic and Foundations, Didactics, Economics* (Dordrecht, Holland: D. Reidel, 1979), p. 259.

<sup>22</sup>Don Lavoie, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (New York: Cambridge University Press, 1985), p. 259.

the means through which decentralized knowledge was conveyed to every corner of the economy via the price system to assist mutual coordination of production and consumption plans. At the same time, market rivalry was the means through which knowledge in the market was discovered and brought to bare for the satisfaction of consumer demands.

This "Austrian" conception of the market process is in contrast to the neoclassical view of perfect competition, in which all the "knowledge problems" of market coordination are assumed away; either by postulating the presence of "perfect knowledge" on the part of all market participants; or through the assumption that all relevant knowledge can be translated into quantitative and objective forms that are easily conveyable to planners for their use and application to the problem of resource allocation in a centrally organized economy.

This new interpretation of the calculation debate is reinforced when we take into consideration the brief overview of the Austrian school during the inter-war years that was given at the beginning of this paper. The entire orientation of the Austrian "approach" was precisely in terms of how markets worked under conditions of imperfect knowledge, constant change and the passage of time. Mises and the Austrians, therefore, were not defeated. Rather, the illusion of victory belongs to the "anti-Misesians" because their conception of the market and the problem requiring a solution was different from Mises's conception of the market and the "economic problem." And since it is the neoclassical theory of perfect competition that is slowly falling further into disuse by economists, because of its unrealism, the economists' view of the market and economic processes is slowly coming around to Mises's, as well.<sup>23</sup>

<sup>23</sup>It is worth pointing out that while Hayek is usually credited with having drawn attention to the problem of market coordination under conditions of a division of knowledge, Mises had already referred to this circumstance and how the competitive market was the only method for utilizing that divided knowledge; see, Mises, *Socialism*, p. 101; and Mises, "Economic Calculation in the Socialist Commonwealth," p. 102.

## Mises's Forgotten Predecessors on the Problems of Central Planning Under Socialism

The magnitude of the change [arising from the implementation of socialism] is perhaps best seen from the usual proposal to abolish the use of money. Let anyone try to imagine how the business of a great country is to be carried on without money and prices, how the value to society of various species of labor is to be estimated, and how the relative utilities of consumable commodities and transient services are to be calculated, and he will soon discover that the abolition of money would logically end in the abolition of the division of labor.

J. Shield Nicholson  
*Principles of Political Economy* (1893)<sup>24</sup>

But before the book can be closed on the history of the socialist calculation debate there is at least one more chapter that needs to be added. The “standard” interpretation, as we saw, points out that Mises may have initiated the debate, but he was preceded by two economists—Barone and Pareto—who had tried to offer a solution through the avenue of mathematical general equilibrium analysis.

Earlier than that, it is said, neither socialists nor non-socialists confronted the issue. Socialists spoke either in generalizations about the coming paradise of an exploitation-free society, or condemned speculation on the socialist society of the future as “unscientific.” Anti-socialists devoted their energies either to condemning a socialist society as the ultimate tyranny in which all would be slaves to a super-collectivist state that would own, produce and distribute everything; or warned that the elimination of private property would be a threat to both production and progress because of the demise of the direct link between work and reward. The question of how the socialist planners would go about the mundane business of deciding what to produce or how to allocate scarce resources among industries in the economy was left untouched.

<sup>24</sup>J. Shield Nicholson, *Principles of Political Economy*, vol. 1 (New York: Macmillan, 1893), pp. 432–33.

While generally true of most economists and popular writers on socialism before World War I, this is not the whole truth. There was a small minority of economists who attempted to deal precisely with this question. Yet, they seem to have been completely forgotten with two exceptions, one of which was the “forgotten” Herman Gossen who has over the years been given belated recognition on this point. But while Gossen’s were passing comments in a book on marginal utility theory, these other writers devoted *entire chapters* to the subject in larger studies on various aspects of socialism.<sup>25</sup>

There are five books in particular which deserve recognition for their work on this topic, and with which we shall be concerned in this section: Albert Schäffle’s *The Quintessence of Socialism* (1874)<sup>26</sup>; Paul Leroy Beaulieu’s *Collectivism* (1885)<sup>27</sup>; William Graham’s *Socialism: New and Old* (1891)<sup>28</sup>; Victor Cathrein’s *Socialism: Its Theoretical Basis and Practical Application* (1890)<sup>29</sup>; Benedict Elder’s *A Study of Socialism* (1915).<sup>30</sup>

What is noteworthy about their contributions is the manner in which they anticipated some of the ideas later developed by Mises, Hayek and other Austrians about the essential insurmountable difficulties precluding the effective functioning of a centrally directed socialist economy. As we will see, their view of competition, their conception of the role of markets and prices and their view of

<sup>25</sup>I have made a search through all the major (and many of the minor) works on the socialist calculation debate. With one exception, none of these nineteenth-century and early-twentieth-century critics of socialist central planning are even mentioned in any of this literature. It is particularly strange that no Austrian economist has ever drawn attention to their works, because as we shall see they anticipated many of the salient points of the Austrian critique of both socialism and neoclassical competition theory.

<sup>26</sup>Albert Schäffle, *The Quintessence of Socialism*, English trans. (1874; London: Swan Sonnenschein, 1892).

<sup>27</sup>Paul Leroy Beaulieu, *Collectivism*, English trans. (1885; London: John Murray, 1908); Beaulieu was professor at the College of France.

<sup>28</sup>William Graham, *Socialism: New and Old* (New York: A. Appleton, 1891); Graham was professor of political economy and jurisprudence at Queen’s College, Belfast, Ireland.

<sup>29</sup>Victor Cathrein, *Socialism: Its Theoretical Basis and Practical Application*, English trans., rev. and enl. by Victor F. Gellelmann (1890; New York: Benziger Brothers, 1904); Father Cathrein was a Jesuit priest in Germany.

<sup>30</sup>Benedict Elder, *A Study of Socialism* (St. Louis, Mo.: B. Herder, 1915).

the particular "knowledge problems" confronting any attempt at central direction of economic affairs were similar to the arguments that the Austrians presented in the 1920s, 1930s, and 1940s.

That their view of competition was similar to the Austrians' is not very surprising. As has been pointed out by previous writers, the "Classical" conception of competition was exactly opposite that of modern microeconomic textbook theory.<sup>31</sup> Lionel Robbins has clearly described the Classical notion:

. . . it is clear that the claims of the Classical Economists for competition and the market do not rest upon any very precise mathematical or semi-mathematical conception of static equilibrium. Indeed, I cannot help suspecting that if they had been confronted with the systems of this sort which have been developed since their day, they would have had some hesitation in acknowledging a near family relationship. Their conception of the mechanism of the System of Economic Freedom was surely a conception of something more rough and ready, something much more dynamic and real than these exquisite laboratory models.<sup>32</sup>

And the economists we are to discuss were indeed "Classical" in this sense.

### *Albert Schäffle*

Albert Schäffle seems to have been the first to have systematically tried to conceive of what a centralized economy would look like by asking what the socialists said they wished to eliminate in the present (capitalist) economic system. This then led him to tease-out the nature of the alternative socialist economy. Since Schäffle's contribution has been discussed already in some detail by T. W. Hutchison,<sup>33</sup> we need only emphasize the essential points. In *The Quintessence of Socialism*

<sup>31</sup>Paul J. McNulty, "A Note on the History of Perfect Competition," *Journal of Political Economy* (August 1969): 395-99.

<sup>32</sup>Lionel Robbins, *The Theory of Economic Policy in English Classical Political Economy* (London: Macmillan, 1952), p. 16.

<sup>33</sup>T. W. Hutchison, *A Review of Economic Doctrines, 1870-1929* (Oxford: Clarendon Press, 1953), pp. 294-96; Hutchison also points out some interesting remarks made about a socialist economy by Lejo Brentano and Erwin Nasse, pp. 296-97; also, Hutchison, *The Politics and Philosophy of Economics* (Oxford: Basil Blackwell, 1981), pp. 171-72.



Schäffle explains that, “Critically, dogmatically, and practically, the cardinal [socialist] thesis stands out—collective instead of private ownership of all instruments of production (land, factories, machines, tools, etc.); ‘organization’ of labor by society, instead of distracting competition of private capitalists . . . public organization of the labor of all on the basis of collective ownership of all the working materials of social labor; and, finally, distribution of the collective output of all kinds of manufacture in proportion to the value and amount of the work done by each worker.”<sup>34</sup> Over a series of brief chapters Schäffle explains the socialist criticisms of the existing capitalist system and why the establishment of socialism logically requires the end to private ownership of the means of production, the elimination of the “wage-system,” the abolition of interest and rent, the prohibition of commodity trading and speculative markets, and the demise of a money-system of exchange. “[I]f we suppose the production of private capitalists to be removed,” says Schäffle, “and a unified, organized common-production in its place, buying, selling, competition and markets, prices and payment by money are at once superfluous. Within the socialist economic organization they are even impossible.”<sup>35</sup> And he asks us to visualize the resulting economic order:

Imagine the control of all production vested in a single office of public economy, in a single central office, representing the bureaus of production and sale, it being insignificant whether this control was arranged in the spirit of federal or of centralistic socialism. In such a case no doubt an actual transport of products from one factory to the other, and a delivery to the consumers, would have to be organized from the central and intermediate stations in the economic organization; transportation, housing, and storage, in order to secure the distribution of each article of production over all the necessary districts in the right proportion and at the right time, and in proportion to the public returns stating the demand of each district, become unavoidable. Therefore, transport and storage, which accompany the trade of today, would be the necessary concomitants of the barter of the socialistic state, and would

<sup>34</sup>Schäffle, *The Quintessence of Socialism*, pp. 7–8.

<sup>35</sup>*Ibid.*, p. 70.

be conducted in accordance with the centralized filing of accounts, bookkeeping, and settlement between all the branches of business. But this barter could no longer be a private transaction or exchange, therefore no longer trade, nor purchase and sale in a continuous chain of private transactions. Trade would disappear, would really have become superfluous.<sup>36</sup>

Schäffle explains that under divided decisionmaking in a private property order, the coordination of the processes of production and the satisfaction of consumer demands are established through trading on markets, in which prices act as both checks and incentives on economic planning in various directions. But under socialism, "The bureaus of disposal ascertain the demand, distribute accordingly the national labor among the different classes of trade, and among the departments of production, transport, and storage, and their bureaus, and fix the value of the produce in proportion to the labor-time socially necessary to be spent upon it [Karl Marx]. The produce would be distributed in accordance with the thus regulated value, by way of liquidation of the labour-accounts of the entire body of producers."<sup>37</sup>

In the market economy, Schäffle reminds the reader, money performs two functions, as a "general standard of value," for the comparison of the relative value of things entering into exchange, and as a "vehicle of value," i.e., as a general medium of exchange through which all exchanges are facilitated.<sup>38</sup> Under socialism, the unit of account would be labor-time invested in the production of commodities; and labor-certificates representing the quantities of "socially necessary" labor contributed by each member of the production process would serve as the medium by which laborers would present claims against various quantities of finished goods in the State's storehouses.<sup>39</sup>

<sup>36</sup>Ibid., pp. 71-72

<sup>37</sup>Ibid., p. 74.

<sup>38</sup>Ibid., pp. 78-79.

<sup>39</sup>Ibid., pp. 80-81; Schäffle explains that "socially necessary labor" is "labor of such a kind as must be *on the average* expended, according to the existing national standard of technique, for a unit of supply, in order to produce the commodity to the whole extent of the demand for it" (p. 82).

Schäffle has two basic questions about the workability of a socialist economy along the lines presented: (1) is the premise correct that “the social cost of labor is the standard of the value of commodities?” and (2) whether the socialist society, on the basis of its labor theory of value could successfully have a principle for the allocation of labor among alternative uses in the economy?

On the first point, Schäffle declares that “the ‘value’ of commodities clearly does not depend solely on the cost, but also on the value in use, i.e., the urgency of demand. Without considering the varying use-value of different labor and different products, it is impossible to conceive a socialistic estimate of value, which could take the place of the present market value as contemplated by normal political economy.” If “use-value” was disregarded “socialistic demand and supply would fall into a hopeless quantitative and qualitative discrepancy, which would be beyond control.”<sup>40</sup>

But quite separate from the necessity of the pricing of final goods at prices that equalize demand with existing supply (and, therefore, the avoidance of potential shortages and surpluses at “wrong” labor-time determined prices), did the socialist society have a pricing method for the distribution of labor among employments? Since the direction of labor must reflect the uses for labor in different sectors of the economy, Schäffle saw the same problem as in the pricing of final output. Unless labor could be priced at rates that deviated from the value as measured in terms of labor-time no rational mechanism would exist for guiding labor into appropriate channels. “Unless this use-value is comprised in the social estimate [i.e., in the pricing of goods and labor services],” concluded Schäffle, “that is, without a *corresponding imitation of all incidents which affect value in the present market*, it is not conceivable that any authoritative direction of the consolidated productive system could keep the demand for labor and for goods, as to quantity or kind, in harmony with the supply of labor and of goods—that is, could preserve that economical balance of work

<sup>40</sup>Ibid., pp. 86–87.

and consumption which is daily reestablished, though only by jerks, under the influence of market prices."<sup>41</sup>

For our other authors Schäffle's analysis often served as a signpost for their own criticisms of socialist central planning. But Schäffle's conclusions were seen by them as more of a rationale of how socialism could be made to work through the imitation of market-type pricing, rather than as a refutation of the socialist ideal. Hence, they saw their task as demonstrating how there was no substitute for actual private, competitive markets.

### *Paul Leroy Beaulieu*

Paul Leroy Beaulieu's *Collectivism* is a detailed critique of the socialist indictment of the private property order. After challenging the socialist arguments against private property and an analysis of Marx's labor theory of value, he turns to an analysis of the socialist alternative.

A leading error in the socialist argument, insists Beaulieu, is the inability to appreciate the workings of the spontaneous order that emerges from the voluntary interactions of a multitude of men following their respective interests. "A force is not necessarily unregulated because it acts automatically," argues Beaulieu, "on the contrary, it is most probably more regular, more uniform and more purposeful in its action, than a force which is entirely directed by volition—a fundamental truth which is quite disregarded by collectivists." He reminds the reader that without state intervention or the assistance of regulation great cities like Paris and London are daily provisioned with all the necessities and conveniences of life. And all of this is brought about "unconsciously." "Persons who are absolutely ignorant to the general welfare, are nevertheless completely successful in supplying these great cities with the required quantities of all the innumerable commodities demanded by their inhabitants." "This wonderful automatic adjustment of supply and demand is far from being an incoherent and anarchic force, as asserted by collectivists."<sup>42</sup> What guides actors in the market are

<sup>41</sup>Ibid., p. 93; my emphasis.

<sup>42</sup>Paul Leroy Beaulieu, *Collectivism*, pp. 157–58.

prices, "the automatic regulators." Yet, it is prices that would disappear in a regime of State ownership; instead of the information presently supplied by prices for assisting production decisions, the planners will have to rely upon the collection of statistics about supply and demand conditions prepared by "committees of inquiry." Yet, statistics, Beaulieu says, can never serve as an effective substitute for the fluctuations in prices that always are "a more rapid and certain indication of the required amount of production than statistical abstracts." Not only would the centralized statistical bookkeeping be a colossal task, it had to be remembered that,

. . . they are defective in many respects, and when the subject to which they relate is complex, they are always liable to be affected by the idiosyncrasy of the compiler. Another cause which makes this source of information deceptive and not to be relied on, is the delay, often considerable between the occurrence of the events and the completion of the statistics relating to them.<sup>43</sup>

Furthermore, "*even the most perfect statistics can do no more than supply information, which has then to be interpreted, and interpretations are certain to vary widely.*" Only "'Price' is the sure guarantee of an adequate supply," declared Beaulieu, "and is thus the guardian of the subsistence of humanity."<sup>44</sup>

Deprived of this guidance, and without the incentive of personal interest, accounts and statistics, however complete, would be of very little use, and unless they were the mundane representatives of an omniscient providence, the directors of production would be quite unable to avoid occasional excess or deficiency of supply, which would cause terrible disorder and confusion, with effects infinitely more serious than mistakes made by private enterprise, which, as a whole, is never actuated by precisely similar motives; thus its errors correct each other, and being uninfluenced by prejudice, or *amour propre*, it shows a marvellous quickness of adoption; mistakes committed by the state would be not only far more serious, but far more difficult to remedy.<sup>45</sup>

<sup>43</sup>Ibid., pp. 161-63.

<sup>44</sup>Ibid., p. 169. My emphasis.

<sup>45</sup>Ibid., p. 164.

Under the market system individuals possess free rein within the constraints of their income to choose and demand whichever products they desire. Since, it was the provision of desired commodities that was the source of the seller's own income, self-interest was harnessed to the satisfaction of consumer demand. "Today," said Beaulieu, "it is demand that determines supply, and private enterprise is always on the alert to meet it." The producer is incessantly required to search out new and improved methods of production and capture profits by creating discrepancies between selling prices and the prices of factors of production by lowering costs. And this alertness to such profit opportunities is incessant because all profits are temporary in a competitive environment; as soon as one rival succeeds in such endeavors, the attention of his competitors is aroused and they soon attempt to match and exceed his accomplishments.<sup>46</sup>

Both incentive and price systems would be gone with the arrival of the socialist alternative, and with dire consequences.

We see then, that the momentous problem of the adjustment of supply and demand under a collectivist *regime*, in all localities and in all industries, remains unsolved. The play of prices would vanish with the disappearance of private trade, as also would that variation in profit which, although apparently unjust, is in reality the instrument by means of which harmonious interaction between production and requirements is maintained. In place of these potent and benign forces, the only safeguard against disaster would be infallibility on the part of the economic administration of the socialist state; but history and experience show that state administration, so far from being infallible, is, on the contrary, far inferior to private administration in respect of certainty and promptitude of conception and execution. On the one side is private interest, always alert and active; and on the other, officials hampered by rigid regulations imposed by a bureaucracy, slaves of red tape, capable of dealing with normal conditions only, and impotent when confronted with the exceptional difficulties and unexpected vicissitudes to which the economic world is always liable. Again, on the one side we have the energies of millions of men freely and

<sup>46</sup>Ibid., pp. 133 and 165.

actively engaged in work which they understand, on which their living depends, and which, therefore, they perform with the greatest keenness; and on the other, the cool indifference of administrators, who would be quite as much benumbed as stimulated by the responsibilities thrown upon them.<sup>47</sup>

Nor, Beaulieu points out, is it explained what procedure will be used to select the planners—the “committees of control,” as he calls them.<sup>48</sup> Beaulieu also considers it illegitimate for the collectivists to point to industries presently administered by the State as examples of how an extended system of socialism would work. He reminds the socialists that these public sectors copy similar private administrations in organizing their affairs. And, “the present faults of public administration would increase because the privately managed industries which now serve more or less as models, and which maintain the spirit of emulation, would have disappeared.” Furthermore, the complexity of task and administration would multiply significantly under complete socialism, in comparison to isolated industries in a sea of private enterprise.<sup>49</sup>

Finally, in a separate chapter Beaulieu challenges the validity and practicability of the labor theory of value as a standard of remuneration or technique for directing labor into alternative lines of production. He points to three problems in this context: First that the simple conception of “socially necessary labor” as the basis for measured labor-time falls into a quagmire once we take under consideration the differing physical conditions that will require differing amounts of labor to produce the same quality and quantity of output; and the insolubles of varying qualities and types of labor and the establishment of calculations of what multiples are high quality labor of “simple labor.” Second, the pricing of labor in terms of some form of labor-time standard of work performed would leave unanswered the question of what *non-compulsive* method would be available to attract labor into alternative occupations or industries, if wages could not fluctuate as remunerative price signals to guide

<sup>47</sup>Ibid., p. 174.

<sup>48</sup>Ibid., p. 160.

<sup>49</sup>Ibid., pp. 175–77.

the required changing distributions of labor among sectors in the economy over time. And, third, if commodities were priced at State retail shops on the basis of labor-time invested in their production, this would result in the lack of a "price mechanism" to limit demand to existing supply, and would lead to only slowly corrected surpluses and shortages.<sup>50</sup>

This latter difficulty, Beaulieu points out, would soon result in the re-emergence of private speculation and trading, i.e., the black market.

Although all purchases would legally have to be made in the national shops, and no person would be permitted to buy goods from his neighbor, it is certain that the more energetic members of society, with the connivance of the more inert, would in the long-run establish a complete system of illicit trade. How would it be possible to prevent an economical person who saved some labor-cheques [i.e., the medium in which he was paid by the State for labor services rendered] and who foresaw that certain goods were likely to rise in price, from buying and storing them, and selling them when the expected rise occurred at a price somewhat lower than that charged in the national shops? . . . However, severe the regulations might be, it would be impossible to suppress this private commerce.

Beaulieu also anticipated the re-emergence of an illegal loan market, on which labor cheques (representing claims on goods at State stores) could be lent out at interest.<sup>51</sup>

### *William Graham*

William Graham begins his analysis of socialism by explaining that a socialist system requires collective ownership of the means of production and distribution of collectively produced output on the basis of some measure of labor time performed. Products will be distributed at public warehouses and all industries will be directed by managers who would now be employees of the State. Like Beaulieu, he critically evaluates the meaning and complexities of devising a labor-standard of value.<sup>52</sup> Graham explains

<sup>50</sup>Ibid., pp. 186–201.

<sup>51</sup>Ibid., pp. 205–06.

<sup>52</sup>William Graham, *Socialism New and Old*, pp. 152–59.



that, "There will be no market in the socialist kingdom and no money. Markets and market prices are now useful to adjust supply and demand; this will be unnecessary under Collectivism, because the State will do it through labor bureaus and statistics." Whereas in the market economy, "Money is now chiefly needed as a general medium of exchange; something with which you can buy anything, something for which you can sell anything. . . . In the Socialist State you will get for your work or your special services the desired things . . . simply by presenting your labor cheques at the State stores."<sup>53</sup>

Production decisions will reside ultimately in the hands of the State managers who would decide what was to be produced, in what quantities and of what qualities. An essential flexibility in the competitive market would be lacking in the socialist state: the capacity for innovation and improvement. In the market an individual needs to only convince a few to back his idea financially; but in the socialist state, it will be required to gain the approval of the entire planning agency to direct a portion of "the society's" resources in a new manner.<sup>54</sup> This same reluctance to change and innovate would result in the demise of the market principle that it is demand that determines the allocation of resources.<sup>55</sup>

But the main thrust of Graham's argument is the dilemma of attempting to use the labor standard of value for purposes of economic calculation. With the elimination of markets and prices, asks Graham,

How are we to know how much a worker produces in a cotton or linen factory where machines are working as well as he, and where the work of twenty different kinds of laborers is necessary as well as his to the final product? Where this is a common result from different kinds of human labor, from machine labor, and even from the gratuitous labor of natural forces, how are we to

<sup>53</sup>Ibid., pp. 160-61.

<sup>54</sup>Ibid., pp. 165-66.

<sup>55</sup>Ibid., p. 176.

measure the amount of the product, thus due to such a different cooperant agents, with which an individual is to be credited.<sup>56</sup>

The Marxian answer, says Graham, sounds easy enough: "Labor-force is converted into labor-time, of which products are only a 'congelation.' Products are 'congealed labor-time.' Laborers in the factory who have worked the same number of hours are to get the same wages, the more skilled being reduced to the average by some, we know not what, rule of conversion."<sup>57</sup> But assuming that a conversion rule was available, the computational trail would be immense that would have to follow each and every product from its beginnings in its most unfinished state, through stages of production, through the various types of labor the product would have to pass through, including all the intermediate transporters: "We must then add the number of hours' labor of unloading, the hours of the dockhands and wharfingers, the hours of the draymen who convey it to the railway station, of the railway porters, of the guards and engine-drivers. All these mere carriers have a claim on the ultimate product, or on products in general, measured by their number of hours or work, or labor-time—a very unequal measure indeed for the railway porter, and the railway guard or engine-drivers, the former of whom only bestowed a few minutes' hard work, and the latter not definitely measurable work on the goods at all, their time being spent in the general transport and care of both passengers and goods." The intricacies of the computational detail would grow more and more complex as the production path of each and every product was followed through literally every physical step of its respective production processes. And, finally, Graham says, "As to the bookkeepers own labor I will only say that, however difficult it would be to measure it on the theory under consideration, it would be very real and responsible."<sup>58</sup>

But the capacity for the entire computational process and the apportionment of "labor-cheques" as payment for work performed requires a rule for converting skilled into unskilled labor.

<sup>56</sup>Ibid., p. 187.

<sup>57</sup>Ibid., p. 188.

<sup>58</sup>Ibid., pp. 189–92.

And Graham explains that no such conversion table is objectively capable of being constructed; the types, qualities, and characteristics of the multitude of laborers being too great and heterogeneous for the discovery of a physical common denominator.<sup>59</sup> And, hence, there collapses any hope for an objective law of distribution.

Graham, like Schäffle and Beaulieu, emphasizes the dilemma of labor-time priced commodities when the demand for the goods is greater or less than the supply at the labor-cheque redemption rate. The State manager must either raise or lower the labor-cheque redemption rate to bring supply into balance with demand, or see the accumulation of surpluses or frustrated consumers because of shortages. In the next planning period, output can be modified, but what would be the mechanism and incentives through which labor would be redirected, if wages could not fluctuate to reflect changing patterns of demand?<sup>60</sup>

The artificial labor "prices" for commodities in the economy would merely lead to the re-emergence of markets and prices for the facilitating of illegal and speculative transactions. Yet, Graham emphasizes that these illegal market transactions will be a distorted reflection of an open market and narrowly confined to those areas in which traders could evade and avoid the restrictions on private ownership of factors of production. The end result would be a set of perverse unintended consequences:

On the whole we may say that the well-intentioned but ambitious attempt of the Socialists to suppress Money, the Investment list and the Stock Exchange, would lead to much greater visible evils than exist at present, not to speak of other evils certain from analogy, though, without trying the hazardous experience, we cannot describe them precisely. . . . To dispense with money . . . In a great modern complicated society, especially on having a great foreign trade, would be fraught with disaster and chaos.<sup>61</sup>

<sup>59</sup>Ibid., pp. 193-98.

<sup>60</sup>Ibid., pp. 205-06.

<sup>61</sup>Ibid., pp. 224-25.

*Victor Cathrein*

For Victor Cathrein, the inferiority of a socialist system of planning in comparison to the market economy is the latter's ability to take advantage of an intellectual division of knowledge in a manner that is not possible in the socialist society.

The central task of the Socialist state is to "regulate the national production." But regulation of production requires estimation of "social demand" on a daily, weekly, monthly and yearly basis. Nor could one begin socialist planning from the existing pattern of demand, because the redistribution of property and wealth with the implementation of socialism would significantly modify those demand patterns. The Socialist state would, therefore, have to acquire detailed and personal information from individuals and households about the demands of all the members of the society, to assure that the right things are produced in the correct quantities at the desired times. Only by this procedure could the planners avoid the risk and waste of over or under production,

But a census is mere child's play compared with a determination of social demand . . . it would be necessary to inquire into the daily need of every man and every family in the most varied circumstances. Even the smallest details in the matter of clothing, underwear, toilet articles, traveling outfits, writing materials, amusements, and luxuries would have to be ascertained and tabulated.

Add to all this the numerous articles of food which are required even in the humblest family, the supplying of the kitchen with fuel and cooking utensils, the fitting up of the drawing rooms and bedrooms with furniture and ornamentation, the lighting and heating, the stocking of the pantry. . . . The authorities will have to supply needle and thread to replace the missing shirt-button. All these items must be tabulated for the determination of the demand upon which the great system of production is to be based. And all of this would have to be done not for one family, but for the millions of families which constitute a modern state and for every one of their members.<sup>62</sup>

<sup>62</sup>Cathrein, *Socialism: Its Theoretical Basis and Practical Application*, pp. 269–70.

And Cathrein emphasizes that this is only a fraction of all the various private and public demands for which the central planners would be required to form detailed estimates.<sup>63</sup> The information required by the “central bureau” concerning demand would have to be matched with equivalent information about the supplies of various types and quantities of factors of production, including the talents, inclinations, strengths and abilities of all the members of the potential labor force.<sup>64</sup>

Cathrein’s question, after this enumeration of responsibilities to be assigned to the State, is “Can any human wisdom be equal to this stupendous task?” The advantage of the market is precisely the decentralization of responsibilities, which includes the “knowledge” responsibilities expected from any one participant in the market.

First, Cathrein argues, under the market individuals are required neither to anticipate each and every one of their wants in advance nor to commit themselves to advance purchases. “At present everyone is at liberty to supply all his own wants at pleasure, either by his own labor or by purchase, when and where and from whomsoever he pleases, whether at home or abroad. Thus he is enabled to conceal the secrets of his household from the public gaze.”

Second, in the division of labor each commercial establishment is only required to concern itself with a comparatively small section of the overall market. “[T]he immense difference between a single comparatively small company, established for a limited purpose, and an entire commonwealth made up of several millions of human beings” makes it significantly easier for the former to successfully manage the collection and use of relevant knowledge.<sup>65</sup> At present, Cathrein said,

Countless commercial travelers study the condition of the market; the most advantageous chances of buying and selling are ascertained. The transportation and distribution of commodities throughout the country is taken charge of by numerous business concerns. All this work and care, which at present is divided among

<sup>63</sup>Ibid., pp. 271–72.

<sup>64</sup>Ibid., pp. 274–75.

<sup>65</sup>Ibid., p. 169.

thousands of different firms, would fall to the share of the socialist central government. In its hands would converge the millions of intricate threads of international relations. Can any human wisdom be equal to this stupendous task?<sup>66</sup>

The knowledge requirements for central direction of economic production and distribution make the market the only alternative: for in the market the division of tasks limit the amount of information each unit is to be responsible for and, thus, manageable in a complex economy.

### *Benedict Elder*

For Benedict Elder, the greatest weakness of the socialist economy is that it lacks a competitive process for market discovery of entrepreneurial talent. "Direction is necessary to the simplest motion," Elder states, and "There is no human action that is not directed by the human brain." This is no less true in the realm of the organization and direction of production. If the market doesn't select the entrepreneurs—the "brains" behind the production process—how shall leadership in the socialist economy be selected.<sup>67</sup> Elder sees no reason to believe that the laborers in the firm would have the ability to pick from among themselves, or from outside, the decisionmaker for the organization.

If the managers for the firms are to be selected by "the central authority in Socialisdom," what criteria shall they use? They might look for honesty and "good intentions"; but what is really wanted is "ability." Ability cannot be bestowed and the "known limitations of human capacity" forbid any likelihood that the central authorities would have the ability to discern ability in others; particularly since each individual finds it difficult to even correctly interpret his own abilities.<sup>68</sup>

There is no test of the "fit" or "unfit" for the directing of enterprise other than the market test itself:

<sup>66</sup>Ibid., p. 273.

<sup>67</sup>Elder, *A Study in Socialism*, pp. 263–64.

<sup>68</sup>Ibid., p. 267.

Capitalists, both large and small, fail; they fail singly and in groups; they fail not for lack of capital or of co-operation, but for lack of competent and reliable management in the business. . . . Competition unfailingly registers, in all their bearings, the mistakes and the shortcomings of each person within its domain, and with stern precision it assesses the penalty of financial loss for each delinquency suffered to exist . . . the invariable law of competition is to eliminate the unfit from the industrial field and to yield to the fit exactly that measure of control they are fitted to sustain.<sup>69</sup>

Since under socialism there would be no market competition to test ability in satisfying consumer demand there would be no method to sort out the competent from the incompetent entrepreneurs. Indeed, there would exist no method to even discover who they were. "Directive ability must be determined automatically [i.e., through market competition], or it must be left to the erring, weak, not always unbiased and sometimes vicious judgment of men to determine."<sup>70</sup>

In an interesting way Elder comes close to Hayek's argument that the market rewards "service" and not "merit."<sup>71</sup> Just as there is no method to determine the sustained assignment of this entrepreneurial function independently of success in market competition, Elder argues that there is no objective standard for the implementation of the socialist slogan "From each according to his ability" independently of the market process that "rewards" individuals for services rendered and therefore demonstrates each individual's comparative ability and place in the social division of labor. "By its proposal to do away with competition and with profits, the reward flowing from, and, therefore, the incentive to, competition, the Socialist economic aim is reduced to an impossible and ridiculous economic absurdity."<sup>72</sup> Also for Elder, there is no valuation standard for the economic calculation of the relative value of labor and other resources, other than the prices on the market.

<sup>69</sup>Ibid., p. 268.

<sup>70</sup>Ibid., p. 270.

<sup>71</sup>Friedrich A. Hayek, "The Mirage of Social Justice," in *Law, Legislation and Liberty*, vol. 2 (Chicago: University of Chicago Press, 1976).

<sup>72</sup>Elder, *A Study of Socialism*, p. 276.

He justifies his rejection of any notion of a labor standard of value in an extremely "Austrian" fashion. "The Socialist conception of value is comprehended in the single idea that it is an exchange characteristic. It is peculiar to commodities," says Elder. "It is determined by labor, the only measurable thing that is common alike in all commodities." But, continues Elder, "The root fallacy of the teaching thus outlined is found in the assumption that equal values are received and demanded in the course of exchange. . . . But in truth, exchange takes place only when values are unequal. Both parties to every exchange demand and believe they receive a greater value than they relinquish by the exchange."<sup>73</sup> There is no standard of remuneration, therefore, other than the market's. And it is the market rates of remuneration that permit the calculation of profit so competition can function.

### *Their Contribution*

When looked at as a group, these "forgotten" contributors to the debate over socialist planning present a set of criticisms of socialism and defenses of the market that distinguish them from other anti-socialists of their period who emphasized the negative political or incentive consequences that would follow from the establishment of the Socialist State. At the same time they stand extremely close to the Austrian side of the debate.

Each of them clearly sees competition as a process rather than a state of affairs. Competition acts as an impetus to economic improvement, but it is also the mechanism through which markets are coordinated by actors discovering discrepancies in supply and demand and undertaking positive actions to correct for the discrepancies. Competition is also a discovery method for the disposition of talents into their comparative advantages. Indeed, for Elder there is no method of discovering who are the competent entrepreneurs independent of the competitive process that tests, selects and sorts out the "abilities" of each in the division of labor.

<sup>73</sup>Ibid., pp. 291, 294.



The discovery procedures would all be absent under socialism because the elimination of private ownership prohibits the rivalrous bidding and use of resources that is the testing ground. The banishing of trading logically disposes of market prices. And we saw with each of them, particularly Beaulieu, it is the price system that weaves together a spontaneous social order and gives direction to everything that occurs in the market. Prices are the binding threads of social coordination that socialism throws away, with nothing put in its place except intricate and incomprehensible statistical information that arrives late, is subject to poor organization and is subject to divergent interpretations that cloud the capacity for successful central planning.

Once the extent of the information and knowledge burdens that now fall on the shoulders of the central planners is appreciated, Cathrein asks us to appreciate even more the effective solution that the market provides through decentralized responsibility and decisionmaking. Each participant in the productive division of labor is given a manageable task, with responsibility for only a portion of the entire knowledge required for general economic coordination.

And all of these men grasped the impossibility of the labor theory of value, either for assigning "redemption" prices on final goods and services available in State warehouses, or "labor-value" for time rendered in participation in the production process. Both involved the assignment of arbitrary values to inputs and outputs in a way that logically had no relationship to the underlying supply of and demand for either factors of production or final goods and services. Only the competitive market process has the capacity for discovering in an environment of change what relative prices should be assigned to both commodities and resources.

We find the essence of their message conveyed in the following passage from the 1908 volume by Robert Flint on *Socialism*:

... no council of the wisest men in London, although invested with absolute powers, could feed, clothe, lodge and employ the population of that city, were no man allowed to act without having their authority, were no competition permitted in buying and selling,

and were wages and prices prohibited, and some supposedly strictly rational determination of what labor was to receive and what commodities were to be exchanged for, adopted instead. The problem involved is of a kind which cannot be solved by the reasoning and calculation, the legislation and administration, even of the wisest and most uncontrolled rulers: it can only be solved, as it is actually solved, by leaving men free, each to seek his own interest and to attend to his own business, to carry his services or his goods where the rise of wages or of prices shows that they are most wanted, and to withhold them where the fall of wages or of prices warns him that the market is overstocked. Even when this method of freedom and of nature is followed numerous mistakes will occur, but they will be comparatively slight, and those of one man will counteract those of another. . . . But let the collectivist method be tried, and the risks of mistakes will be immensely increased, the provisions which nature has made for their correction will be prevented from operating, the amount of mischief produced by each error will be vastly multiplied, and the faculties and activities of the individuals composing society will be but feebly brought into exercise. . . . May we not safely conclude that what they [the Collectivists] dream of as organization would be ruinous disorganization?<sup>74</sup>

### **Ludwig von Mises on Economic Calculation Under Socialism in the 1920s**

This is the decisive objection that economics raises against the possibility of a socialist society. It must forgo the intellectual division of labor that consists in the cooperation of all entrepreneurs, landowners, and workers as producers and consumers in the formation of market prices. But without it, rationality, i.e., the possibility of economic calculation, is unthinkable.

Ludwig von Mises  
*Liberalism* (1927)<sup>75</sup>

<sup>74</sup>Robert Flint, *Socialism*, 2nd ed. (London: Sir Isaac Pitman & Sons, 1908), p. 164.

<sup>75</sup>Ludwig von Mises, *Liberalism* (1927; Kansas City, Kans.: Sheed Andrews and McMeel, 1978), p. 75.

It is very likely that Mises was familiar with most or all of the critics of socialism discussed in the previous section. In *Human Action*, Mises refers to Gossen, Schäßle, Pareto, N. G. Pierson and Barone as earlier economists who had addressed the problem of socialist planning before 1920.<sup>76</sup> In *Socialism*, Mises refers to Victor Cathrein's book on socialism, but in the context of Cathrein's discussion of the relationships between Christianity and private property.<sup>77</sup> And Paul Leroy Beaulieu is quoted, but from another of his books on the collectivist conception of the State.<sup>78</sup>

When we turn to Mises's *Notes and Recollections* to discover possible influences on him in the evolution of his thinking on socialist planning and calculation, Mises offers few details. His earlier work on monetary theory had pressed home to him the importance of money prices for market calculation and how changes in the value of money can distort such calculations.<sup>79</sup> "When I set out to work further on the ideas in my book, *Socialism*, I felt compelled to develop especially the fundamentals of catallactics," Mises explains. "Any theory of socialism that does not have at its very foundation a consideration of the problem of economic calculation, is simply absurd." In 1919, he presented his paper on "Economic Calculation in the Socialist Commonwealth" at the *Nationalökonomische Gesellschaft* (the Austrian Economic Society), and it appeared the following year in *Archiv für Sozialwissenschaft*

<sup>76</sup>Ludwig von Mises, *Human Action: A Treatise on Economics*, 3d rev. ed. (Chicago: Henry Regnery, 1966), p. 701.

<sup>77</sup>Mises, *Socialism*, p. 459.

<sup>78</sup>*Ibid.*, p. 53.

<sup>79</sup>In his 1919 volume (*Nation, State, and Economy* [New York: New York University Press, 1983], pp. 160–65) Mises had emphasized the falsification of capital accounting that an inflation can cause with a resulting consumption of capital under the illusion that capital is being maintained. In his article, Fritz Machlup pointed out that, "Professor Ludwig v. Mises was the first, so far as I know, to point to the phenomenon of the consumption of capital" due to inflation. ("The Consumption of Capital in Austria," *The Review of Economics Statistics* 27, no. 1 [January 15, 1935]: 13.) "As a member of a committee appointed by the Austrian Government (including two other committeemen, Dr. Dollfuss and Dr. Pella) Mises also emphasized comprehensive factual information," in a report entitled *Bericht über die Ursachen der wirtschaftlichen Schwierigkeiten in Österreich* (Vienna, 1931). Cf., also, Nicholas Kaldor, "The Economic Situation of Austria," *Harvard Business Review* 10, no. 1 (October 1932): 23–34.

*und Sozialpolitik*.<sup>80</sup> This is all the information that Mises was willing to provide.

A starting point for an analysis of Mises's contribution is to ask in what ways his 1920 article and 1922 book were improvements upon the arguments that the earlier critics of socialist planning had developed. These earlier writers, as we saw, focused on two pricing problems: first, how would final goods offered for distribution by the State be priced to assure balances between supplies and demands of each and every commodity offered for redemption? And second, how would labor of various types and qualities be priced so their distribution among alternative lines of production would assure balances between their supplies and demands in various sectors of the economy? Having seen the inapplicability of a labor theory of value, they showed that only prices competitively formed on markets could fulfill the task.

Mises, too, critically evaluated the labor theory of value as a standard for economic calculation and also emphasized its inherent unworkability.<sup>81</sup> He also pointed out the potential for a discrepancy between the supply and demand for finished commodities at the centrally administered "price" for those commodities.<sup>82</sup>

But what clearly distinguishes Mises's analysis from the earlier commentators is his clarity of exposition of what the problem of economic calculation under socialism is really about, and the particular use he makes of it to demonstrate the "impossibility" of socialism.

All human action involves acts of exchange, Mises argued. In evaluating finished goods "calculation" is fairly easy in that the individual decides whether he prefers one alternative to the other. And having made that choice, he may be able to evaluate the relative value to him of simple methods of production and the relative value of the resources which may be applied to them for the production of the finished goods in question. But once the

<sup>80</sup>Ludwig von Mises, *Notes and Recollections* (1940; Spring Mills, Penn.: Libertarian Press, 1978), p. 111.

<sup>81</sup>Mises, *Socialism*, pp. 113-16.

<sup>82</sup>*Ibid.*, pp. 138-39.

alternative production methods develop degrees of complexity, both in terms of the types of different resources that could be utilized by those methods and the temporal stages through which the resources would have to pass, direct and simple comparisons of the relative merits of the alternative production methods available are no longer possible. The variety of *technical* alternatives through which a finished product may be produced increase in number and the physical substitutions between various resources become so varied that the human mind, with its finite powers, becomes unable to make rational comparisons among them to make sure that the "least cost" method has been chosen.<sup>83</sup>

The happy circumstance, Mises argued, was that in the market the plethora of heterogeneous physical commodities are reduced to a common denominator, i.e., they all possess ratios of exchange with each other, expressed in terms of one commodity, the one that serves as the generally used medium of exchange—the money good. And this fortuitous circumstance contained a three-fold advantage: "In the first place we are able to take as the basis of calculation the valuation of all the individuals participating in trade. . . . Secondly, calculations of this sort provide a control upon the appropriate use of the means of production. . . . Finally, calculations based upon exchange values enable us to reduce values to a common unit."<sup>84</sup> However, two things were required for such calculation to be feasible: "First, not only goods ready for consumption but also goods of higher orders [i.e., the factors of production] must be exchangeable. . . . In the second place, there must be a general medium of exchange, a money, in use."<sup>85</sup>

Without a general medium of exchange through which all commodity prices are expressed, the goods on the market would not all share a common denominator for comparison and evaluation of the relative value of those goods in terms of each other. Without the

<sup>83</sup>Mises, "Economic Calculation in the Socialist Commonwealth," pp. 95–97, 102–03; *Socialism*, pp. 97–99, 101–02.

<sup>84</sup>Mises, *Socialism*, p. 99; "Economic Calculation in the Socialist Commonwealth," pp. 97–98.

<sup>85</sup>Mises, *Socialism*, p. 101; "Economic Calculation in the Socialist Commonwealth," pp. 101–02.

inclusion of factors of production among the goods traded on the market there would not exist an array of money prices for them that could serve as the common denominator for evaluating the relative costs of using those resources in alternative combinations and the selection of the "least cost" methods. And, finally, the inclusion of practically all members of the society in the exchange process, means the resulting market prices incorporate the valuations and preferences of the community as a whole, and therefore, include the widest range of information about alternative uses for goods and resources, and their registered "weight" as captured in those prices.

All these tools for economic calculation, Mises explained, would be lacking in the socialist society. Having nationalized the means of production, the State would have abolished any opportunity for individuals to either bid for or offer those resources for alternative uses, for there would be nothing to buy or sell; with nothing to buy or sell no prices for factors of production would come into existence; and without prices for factors of production (prices incorporating the judgments and valuations of a multitude of people having uses for those resources) the socialist planners would lack a rational method for assigning relative valuations to those goods. And as a result the Socialist State would have deprived itself of the only avenue for efficient allocation of the resources now at its disposal. As Mises expressed it years later in his volume, *Bureaucracy*, "A socialist manager would be like a man forced to spend his life blindfolded."<sup>86</sup>

Mises's particular improvement *and originality* over the earlier critics of socialist planning was his attention to the special problems that arise in "roundabout" capitalistic methods of production. The dilemma facing the decisionmaker in the planned economy refers not merely to the allocation of labor among alternative employments. Rather, the problem refers to the task of selecting among all of the alternative combinations of many types of physical and human resources that are all technically capable of producing

<sup>86</sup>Ludwig von Mises, *Bureaucracy* (1944; Spring Mills, Penn.: Libertarian Press, 1983), p. 30.

a particular product or set of products, and which involve different investment period time horizons. Which among the technical blueprints would represent the *least-cost* combination of resources (in terms of the relative values of those resources in competing uses) is the question the socialist planner could not answer.<sup>87</sup> Why? Because the planner would lack the price information that converges in the market as a composite statement of all the community members' conceptions, beliefs and valuations concerning the usefulness of those scarce resources for all the competing tasks they could serve. The socialist planner would lack the communications device through which the voice of "the people" could be heard. In his 1927 volume *Liberalism*, Mises concisely summarized this:

This is the decisive objection that economics raises against the possibility of a socialist society. It must forgo the intellectual division of labor that consists in the cooperation of all entrepreneurs, landowners, and workers as producers and consumers in the formation of market prices. But without it, rationality, i.e., the possibility of economic calculation, is unthinkable.<sup>88</sup>

Developing the type of idea that we found in Cathrein, Mises also emphasized that economic calculation in the market not only facilitates an "intellectual division of labor" among industries and firms, but within firms and organizations, as well. Authority and responsibility for tasks and uses of knowledge are divisible within units of firms because the monetary results of each can be compared and judged in terms of success against the calculable monetary alternatives outside the firm or organization. Responsibilities for uses of specialized knowledge can be given wide discretion, while being overseen through monetary accounting methods.<sup>89</sup>

<sup>87</sup>Mises, *Socialism*, pp. 123–24; in the terminology of microeconomic theory, the socialist planner is confronted with an *isoquant* depicting all the alternative physical combinations through which a given goal could be attained (e.g., a desired level of output); but he possesses no *isocost*, i.e., the price ratio at which inputs can be obtained, with the price ratio representing the market-established opportunity costs of those resources in alternative uses.

<sup>88</sup>Mises, *Liberalism*, p. 75.

<sup>89</sup>Mises, *Socialism*, pp. 112–13.

But the real, critical importance that Mises saw in the capacity for economic calculation is that it serves as an evaluation compass in a never-ending sea of economic change. If we lived in a “static” world in which both natural and social changes were absent and the economy had adjusted to the prevailing “data” of the social and economic surroundings economic calculation would be redundant, explains Mises. There would be nothing more to calculate, now that calculation had performed its task and economic relationships were in equilibrium. Repetition requires no compass.

It is change that requires a compass to guide movement through uncertain circumstances. Capital goods are consumed in production, similar ones replace them or new kinds are installed instead. But has the “capital” been maintained? Has the production process that has consumed capital produced profit or loss? This can only be determined through monetary calculation, under which the market values of the physical goods can be added and evaluated to determine whether the “capital” is intact.<sup>90</sup>

Mises’s challenge to socialism is to explain how it will solve the inevitable calculative problems that will surround any planning minister who undertakes “capitalistic” production processes to fulfill the socialist promise of creating a horn-of-plenty. Mises’s challenge is still waiting for an answer.

### **Economic Calculation and “Meaningful Action”: Mises’s Subjectivist Critique of Socialism**

Monetary calculation is entirely inapplicable and useless for any consideration which does not look at things from the point of view of individuals.

Ludwig von Mises  
*Human Action* (1949)<sup>91</sup>

<sup>90</sup>Ibid., pp. 104–05; pp. 124–25; pp. 177–78; pp. 180–83; Mises, “Economic Calculation in the Socialist Commonwealth,” pp. 109–10.

<sup>91</sup>Mises, *Human Action*, p. 229.



A full understanding of Ludwig von Mises's critique of socialism would be incomplete, however, if it concluded with his writings in the 1920s. And in considering Mises's later formulation of his argument, we are only looking at it in the context in which he believed it should be evaluated.<sup>92</sup> Mises presented his restatement, first, in *Nationalökonomie: Theorie des Handelns und Wirtschaftens*<sup>93</sup> (published in 1940 while he was still Professor of International Economic Relations at the Graduate Institute for International Studies in Geneva) and, then, in *Human Action: A Treatise on Economics*<sup>94</sup> (published in 1949 after moving to America and taking up a position as visiting professor in the School of Business Administration at New York University).

The nature and problems of economic calculation are at the heart of Mises's entire conception of the possibilities for and limitations of a functioning economic order. "Economic calculation is the fundamental issue in the comprehension of all problems commonly called economic," in his own words.<sup>95</sup> Indeed, it is clear from a reading of the arguments that run through all of *Human Action* that Mises was firmly convinced that all that is generally referred to as a prosperous civilization rests upon the capacity for market actors to utilize a form of economic calculation in their use of the scarce resources available to them. But Mises was equally insistent on emphasizing that economic calculation has been and is only possible because of the emergence and maintenance of a social order respectful of private property, and containing relatively free competition and a fairly stable medium of exchange.<sup>96</sup>

In this, the argument can be considered as an elaboration and refinement of the one found in his 1920 article and 1922 book on economic calculation. But it is the wider setting in which the

<sup>92</sup>Mises, *Notes and Recollections*, p. 112: "My *Nationalökonomie* finally afforded me the opportunity to present the problems of economic calculation in their full significance."

<sup>93</sup>Ludwig von Mises, *Nationalökonomie: Theorie des Handelns und Wirtschaftens* (1940; Munich: Philosophia Verlag, 1980).

<sup>94</sup>Mises, *Human Action*.

<sup>95</sup>*Ibid.*, p. 199; Mises, *Nationalökonomie*, p. 187.

<sup>96</sup>Mises, *Human Action*, pp. 264–65.

argument is presented that needs to be appreciated. The hallmark of Mises's approach in *Human Action* is the insistence that all social and economic theory must be grounded in *methodological individualism* and *methodological subjectivism*. The first requires economic analysis to explain all the complex phenomena of the market as the result of the actions and interactions of individuals pursuing various purposes in mind with means available to them. The second draws attention to the fact that all human actions are "meaningful," in the sense that the actions are guided by purposes in mind and therefore have a meaning for the actor as defined by him. This latter principle also carries the logical implication that understanding of the actions of men requires an analytical orientation that appreciates the way in which the actors order and interpret the objects and relationships that surround them and to which they assign significance for the achievement of their ends; these are the mental schemas on the basis of which human plans are constructed by actors and which guide their actions. The analyst, therefore, tries to understand the world as seen from the actor's point-of-view.<sup>97</sup>

"The market," Mises said, "is the focal point to which the activities of the individuals converge. It is the center from which the actions of the individuals radiate."<sup>98</sup> The relationships of the market, he argued, were constituted through webs of meaningful actions of mutual orientation. The relationships that emerged, were maintained and which changed over time, always possessed two meanings for each of the actors participating in them: the meaning they see in their own conduct and the meaning they interpret in the actions of the other(s), and which guide their own response to those others.<sup>99</sup> The market is where the plans of a multitude of men meet,

<sup>97</sup>Ibid., pp. 41–43; Mises, *Nationalökonomie*, pp. 31–33.

<sup>98</sup>Mises, *Human Action*, p. 258.

<sup>99</sup>Ibid., p. 26: "The question we have to deal with is whether it is possible to grasp human action intellectually if one refuses to comprehend it as meaningful and purposeful behavior aiming at the attainment of definite ends." In analyzing an exchange, "what is essential in such an offer and distinguishes it from other offers cannot be described without entering into the meaning which the acting parties attribute to the situation"; and p. 194, where Mises refers to the exchange relationship as the "fundamental social relation" involving "intentional mutuality." Also, *Nationalökonomie*, p. 180, where Mises refers to "Wechselwirkung zwischen Menschen"—"reciprocal actions between men." Cf. also, Max Weber, *Critique of Stammler* (1907; New York: The Free Press, 1977), pp. 109, 112.

with those plans either fulfilled or frustrated in the arena of consummated exchanges. And it is in the market that prices arise for both finished goods and factors of production.

Prices can be conceived as a mirror that absorbs images and reflects them. The images absorbed are in the form of bids and offers that compositely form into the prices of commodities and resources; and these composite price images reflect back to each participant in the market as a guide for actions under consideration. Each provides his contribution to the resulting composite price on the basis of his circumstances subjectively conceived, in terms of both the ends they desire and their perception of the world in which their actions are being undertaken. And, in turn, each utilizes and assigns significance to the prices reflecting out of the market in terms of plans in mind and expectations held about the shape of things to come.

The crucial word here is *expectations*. The particular quality of relationships in the market web of mutual orientation is that they require anticipatory judgments on the part of the participants. This arises from the system of division of labor in which specializations in respective lines of production require each to anticipate likely trading opportunities in the future as a basis for various production and exchange decisions in the present. And the essential uncertainty of the future, towards which all human activity is directed, means that all actions are "speculative" in nature.<sup>100</sup>

Mises also emphasized that every decision to buy or sell was based upon one of two purposes in the minds of the market actors: either a *valuation* of the prospective importance of a commodity for satisfaction of some end in mind by the chooser; or an *appraisal* of the significance that a commodity or resource might have for others at a point in the future (and, therefore, the present significance of the commodity or resource as a means for future exchange opportunities for the achievement of desired ends).<sup>101</sup> The reality of price begins in and reflects the mental images of the traders' conceptions of the future and that future's relevancies and opportunities for fulfillment of respective ends in mind.

<sup>100</sup>Mises, *Human Action*, p. 290.

<sup>101</sup>*Ibid.*, pp. 331–32.

The creative quality of pricing judgments and, therefore, price formation in the market process is expressed most clearly in Mises's 1951 essay, "Profit and Loss":

The fact that in the frame of the market economy entrepreneurial profit and loss are determined by arithmetical operations has misled many people. They fail to see that essential items that enter into this calculation are estimates emanating from the entrepreneur's specific understanding of the future state of the market. . . . It is the entrepreneurial decision that creates either profit or loss. It is mental acts, the mind of the entrepreneur, from which profits ultimately originate. Profit is a product of the mind, of success in anticipating the future state of the market.<sup>102</sup>

Thus, the formation of prices and the meaning of prices are always contextual from the respective actors' points-of-view. Prices have no meanings and no significance out of these contexts. The essence of prices, therefore, is not their quantitative ratios, because those ratios are derivatives and not primaries. It is the anticipatory images of future market configurations that determine what valuations and appraisements entrepreneurs place upon factors of production in terms of the prices they might be willing to pay to acquire their use, in relation to expected prices for the goods and services those resources can produce. Profit is the expected discrepancy between those two beliefs. But beliefs only exist in the minds of individuals contemplating alternative courses of action. And, therefore, what is "meaningful" in terms of pricing and production possibilities for one individual may be "meaningless" from the perspective of another. For the same reason, retrospective evaluation of either a "profit" or a "loss" only has full significance for the individual who is judging the outcome of a course of action from the context of his own estimation of "success" or "failure" in the circumstances in which he finds himself.

The subjectivist quality that permeates both the pricing and economic calculation processes is lucidly expressed by Mises in his discussion of cost accounting:

<sup>102</sup>Ludwig von Mises, "Profit and Loss," in *Planning for Freedom* (Spring Mills, Penn.: Libertarian Press), pp. 120, 126.

Cost accounting is therefore not an arithmetical process which can be estimated and examined by an indifferent umpire. It does not operate with uniquely determined magnitudes which can be found out in an objective way. Its essential items are the result of an understanding of future conditions, necessarily always colored by the entrepreneur's opinion about the future state of the market. Calculating costs is a mental tool of action, the purposive design to make the best of the available means for an improvement of future conditions. It is necessarily volitional, not factual. In the hands of an indifferent umpire it changes its character entirely.<sup>103</sup>

This is why Mises said that, "Economics is not about things and tangible material objects; it is about men, their meanings, and actions. Goods, commodities, and wealth and all other notions of conduct are not elements of nature; they are elements of human meaning and conduct. He who wants to deal with them must not look at the external world; he must search for them in the meaning of acting men."<sup>104</sup>

Economic calculation, therefore, only occurs in the context of a personal point-of-view, i.e., the personal points-of-view of each trader entering the nexus of exchange, and is "meaningful" only in that context. And this brings us to Mises's "subjectivist" critique of socialism. In the midst of his discussion of economic calculation and its importance in providing a method for valuational orientation for owners and users of scarce resources, Mises adds a short subsection on "The Theory of Value and Socialism." Towards the end of it, he says that, "the illusion that a rational order of [socialist] economic management is possible owed its origin to the value theory of the classical economists and its tenacity to the failure of many modern economists to think through consistently to its ultimate conclusions the fundamental theorem of the subjectivist theory."<sup>105</sup>

It is easy to read this only as an accusation that twentieth-century economists have erred by forgetting that since value is a "subjective" phenomena of rank ordered preferring there cannot exist an objective standard of value from which to evaluate materials or men in the

<sup>103</sup>Mises, *Human Action*, pp. 349–50.

<sup>104</sup>*Ibid.*, p. 92.

<sup>105</sup>*Ibid.*, p. 206.

market; a reminder that tastes and preferences are “personal” and not open to measurement. Thus, a pillar of socialist theory necessarily falls to the ground.

But I think that a careful reading of Mises’s argument in the context of his general discussion of economic calculation suggests that when he refers to thinking through the subjectivist theory to its “ultimate conclusion,” he is referring to something more than the foundation of utility theory alone. The subjectivist theory emphasizes that “subjective preferences” about goods emerge out of the context of subjective (i.e., personal) perspectives with which each interprets circumstances and opportunities. The “illusion,” therefore, that Mises refers to is really the failure to follow the analytical path back to the “meanings of men” instead of stopping at the measurables of matter.

The wider subjectivist perspective suggests why Mises viewed the proposals of Oskar Lange for a type of market socialism ultimately as unworkable as rigid central planning.<sup>106</sup> First, Mises insists that Lange and others have confused the role and tasks of a manager within a firm with the function of the entrepreneurs and capital owners who guide the direction and allocation of resources into alternative market avenues in the face of changing profit opportunities in the market. The former attends to tasks assigned to him, given a prior capital investment decision that has placed resources at the disposal of the manager. The manager’s horizon is necessarily a different one from that of the entrepreneur or capitalist, both in terms of incentives and ultimate responsibilities.

<sup>106</sup>Mises rejected the possibility for a mathematically-derived general equilibrium “solution” to the problem of socialist central planning because it totally ignored the influence of time and change on the outcome of economic events. An equilibrium state that an economy might hypothetically approach would not be independent of the path by which it was reached. It was impossible to know the actual path leading towards an equilibrium because every step taken along the path would be influenced by and dependent upon the knowledge, preferences and expectations of the economic actors during the on-going process. But, argued Mises, it was impossible from the perspective of “today” for the economic actors to know their future knowledge, preferences and expectations over the sequence of numerous “tomorrows” that would culminate in a hypothetical equilibrium state. Hence, computing a future equilibrium from the standpoint of present information concerning preferences, technological possibilities and resource availabilities could never solve “the economic problem” under socialism; Mises, *Human Action*, pp. 710–15.

Another way of saying this is that the *meaning* of price and profit opportunities are necessarily different, given the subjective perspectives from which the actors evaluate market conditions. Their perspectives guide their actions and their perspectives are determined by how they interpret the circumstances in which they find themselves. The permitted property-rights relationships in an environment of even market-socialism results in different forms of “meaningful actions” than in an institutional setting in which capital may be privately owned and utilized in a corridor of wide discretion in market transactions. A socialist order cannot successfully “play” at market relationships, because the external institutional order has its influence only in terms of how the actors functioning in them interpret the order’s *meanings* as avenues for achieving the individual aims of the participants.<sup>107</sup> And the use and disposal of capital and resources has a different meaning for opportunities for profitable action under market socialism than under competitive, private capitalism.

Secondly, Mises rejected the idea of a central planning agency setting “parametric” prices in the economy and periodically revising them if faced with either surpluses or shortages resulting from the buying and selling of competing socialist firms. “Prices,” Mises says, “are a market phenomena. They are generated by the market process and are the pith of the market economy. There is no such thing as prices outside the market. . . . It is the very essence of prices that they are the offshoot of the actions of individuals and groups of individuals acting on their own behalf.”<sup>108</sup>

If we understand prices to be an absorbing and reflecting mirror constructed out of a multitude of subjective meanings and orientations, then the setting of prices by government, even for the purpose that Lange suggests, is the setting of something that for Mises is not a price at all. Prices emerge out of the interaction of men pursuing purposes within their perspective contexts. Lange’s central planners would be attempting to synthetically make prices on

<sup>107</sup>Ibid., pp. 705–10.

<sup>108</sup>Ibid., pp. 395–97.

the basis of *their* interpretation of what they see as the quantitative, external manifestations (surpluses or shortages) resulting from the meaningful actions of others. It would be an attempt to draw a picture of a mirror image, on the basis of what the artist thinks the mirror image would look like if there was one.

Mises found it amusing enough that after the incessant condemnation of the market economy in all its aspects, socialists were now assuring all concerned that following the revolution there would still be markets and prices, only they would operate under new management.<sup>109</sup> Imitation, after all, is the highest form of flattery, no matter how imperfect it may be.

### The Socialist Calculation Debate in Context

The current mania for comprehensive economic planning by the State may appear, half a century hence, as just another of the red herrings which fate throws across the forward march of free peoples.

John Jewkes  
*Ordeal by Planning* (1948)<sup>110</sup>

In retrospect, the writings of the late-nineteenth-century critics of socialism that were previously discussed now appear extremely insightful and prophetic. In the 1890s and 1900s, socialism was still an ideal, advocated by many but implemented by none. These early critics anticipated many of the essential problems that have eventually brought central planning into disrepute. They were able to discern the weak spots in the socialist program precisely because they were free of the mathematical formalism of twentieth-century economics. They approached the problem common sensically. Competition was what most people think of it as: a rivalrous process. Common sense also showed that knowledge is far from perfect and what the human mind can grasp is limited. Society had developed an institutional order that enabled these problems to be overcome.

<sup>109</sup>Ibid., p. 706.

<sup>110</sup>John Jewkes, *Ordeal by Planning* (London: Macmillan, 1948), pp. 1-2.



Informational responsibilities were decentralized through competition and division of labor. And all the multitude of actions were effectively connected one with the other through the price system that guided supply in the direction of demand and registered all changes in the market with great rapidity.

Mises's writings on socialism were a logical extension of this approach. Being a good Mengerian, it was not surprising that Mises should approach the problem of socialist planning in the context of wondering how the planners would plan in a world of change and uncertainty through time.<sup>111</sup> Socialism's elimination of private ownership of the means of production abolished the arena in which competitive bids could generate the prices that were essential for calculative evaluation of every step and aspect of the production process. And it was Mises's focus on this aspect of the socialist planning problem that made his an original and important contribution to the debate.

What inhibited acceptance of Mises's argument by most economists was their attempt to think about this argument in the emerging context of a formal general equilibrium theory. This new context seemed to make Mises's argument redundant because the assumptions supporting this framework either hid or assumed away the real-world market conditions that Mises believed had to be addressed if the socialists were to successfully make their case for a system of centralized planning.

The failure of central planning socialism during the last 40 years has destroyed its legitimacy as a serious institutional alternative to market-based relationships. Practically all socialists, both inside and outside the socialist countries, now accept and increasingly endorse some form of "planning-through-markets." As a leading advisor to Mikhail Gorbachev recently expressed it, what the Soviet Union needed was "Socialism with cost accounting. . . ."

<sup>111</sup>Cf. Arthur W. Marget, *The Theory of Prices*, vol. 2 (1942; New York: Augustus M. Kelley, 1966), p. 189, where Marget observes that Mises's "discussion of the role of uncertainty and 'estimate' in the calculations underlying the pricing process, like so many other elements in Mises's theoretical position, may be said to follow directly in the path traced out by Menger."

Prices must be raised to real cost."<sup>112</sup> Cost prices are taken by the proponents of market socialism to mean something "real," i.e., real expenditure of inputs or monetary outlays. And prices in general are seen as something that balances the scale between quantitative amounts of demand and supply.

The way this is expressed, however, means that Mises's message is still not understood. Yet the arguments for market-formed socialism can only be criticized in terms of Mises's subjectivist approach. As Mises emphasized, "Costs are a phenomenon of value. Costs are the value attached to the most valuable want-satisfaction which remains unsatisfied because the means required for its satisfaction are employed for the want-satisfaction the cost of which we are dealing with."<sup>113</sup> Costs, in other words, are evaluative *states of mind*. And, therefore, can only be understood in terms of "meaningful action," i.e., in terms of the perspective from which and within which the actors undertake various activities. Economic calculation and the offering of a price and the weighing of a set of prices for production plans only occurs, and only has relevancy in, the context of the respective individual points-of-view. What a price means for calculative purposes, therefore, only has meaning in the subjective context of the purposes in mind that define and determine the significance of that price.

An appreciation of the "subjectivist" perspective means that the Misesian message is still as relevant as ever. Unfortunately, it also means that it is a message still waiting to be fully understood.<sup>114</sup>

<sup>112</sup>"Growing Pains of Reform," *Newsweek* (7 September 1987), p. 56. This is an interview with Tatyana Zaslavskaya.

<sup>113</sup>Mises, *Human Action*, p. 396.

<sup>114</sup>See, Ludwig von Mises, "Observations on the Russian Reform Movement," *The Freeman* (May 1966): 23-24, for Mises's critical evaluation of the mid-1960s proposals for reforming central planning in the Soviet Union. This article appears as a chapter in *Money, Method, and the Market Process*, Richard M. Ebeling, ed. (Boston: Kluwer Academic Publishers, 1990), pp. 232-37.

### 3

## *Mises and His Methods*

Roger W. Garrison

Over the past several years, I have participated in a number of short courses on Austrian economics, and for some I was involved in the planning stages. The one aspect of such planning that stands out in my memory has to do with the issue of methodology. How should we present the methodological precepts that underlie Austrian theory? There seemed to be three possibilities: We could deal head-on with the methodological issues in the first lecture, in which case we would spend the remainder of the course trying to put methodology behind us in order to deal with the substantive issues; we could postpone discussion of methodology to the very end, in which case we would spend most of the course anticipating the arguments to be presented in that last lecture; or we could simply exclude methodology from our schedule of lectures, in which case every lecture that we did schedule would quickly transform itself into a discussion of the methodological underpinnings.

I have some concern that my present discussion of Mises and his methods may propel me into the “black hole of methodology.” Economists who allow themselves to become totally immersed in methodological issues rarely escape to do substantive work. In an attempt to keep one foot outside of the black hole, I propose to steer clear of the loftier issues of metaphysics, epistemology, and philosophy of science. I will deal instead with the workaday methods used by Mises and by those who have followed his lead. How did Mises

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go about doing economics? How do his methods compare with those of the modern mainstream?

The issues have become standard: the appropriateness of mathematical formulations, the relationship between theory and statistical data, and the role of assumptions in economic theorizing. Recent developments in econometric methods and in mathematical modeling techniques allow the contrast between Mises and the more modern practitioners to be sharpened.

### **Mathematical Economics and the Eclipse of Causality**

Appearing two years before the initial publication of Mises's *Human Action* (1949)<sup>1</sup> was Paul Samuelson's *Foundations of Economic Analysis* (1947),<sup>2</sup> the title page adorned with a pronouncement by J. Willard Gibbs: "Mathematics is a Language." Samuelson mastered that language in the course of his training at the University of Chicago and then at Harvard. According to Fischer,<sup>3</sup> "Samuelson more than anyone else brought economics from its pre-1930s verbal and diagrammatic mode of analysis to the quantitative mathematical style and methods of reasoning that have dominated for the last three decades." The techniques of the physical sciences are so dominant today that an economist who prefers not to use mathematics in his economic theorizing is held in the same regard as a sculptor who prefers not to use a chisel or a welder who prefers not to use a torch.

Economists who choose to work within the tradition begun by Menger and firmly established by Mises may be tempted to take issue directly with Willard Gibbs. But there is no justification for insisting upon a narrow conception of language. Mathematics *is* a

<sup>1</sup>Ludwig von Mises, *Human Action*, 3rd rev. ed. (1949; Chicago: Henry Regnery, 1966).

<sup>2</sup>Paul A. Samuelson, *Foundations of Economic Analysis* (1947; New York: Atheneum, 1974).

<sup>3</sup>Stanley Fischer, "Paul Anthony Samuelson," in John Eatwell, Murray Milgate and Peter Newman, eds., *The New Palgrave: A Dictionary of Economics*, vol. 4 (London: Macmillan Press, 1987), p. 234.

language. We can respond to Samuelson in a more telling way with the claim that so too is music. There is no reason for economists to observe a categorical prohibition against either mathematical formulation or musical expression. The relevant question is: What sort of language—music, mathematics, or, say, English—allows economists best to communicate their ideas? Which language serves the economist without imposing constraints of its own upon his subject matter?

The answer to the question just posed depends, of course, upon what the economist takes his subject matter to be. And in particular the answer turns—both for Mises and for modern mathematical economists—on whether or not causality in economics is a worthy concern. For Mises causality was the central concern. His methodological individualism has as its goal the establishment of a causal linking of individual actions to observed economic phenomena. The very title of Mises's *magnum opus* identifies his starting point. Human action is the root cause of all economic phenomena. The task of the economist, in Mises's view, is to draw out the historically relevant implications of the fact that individuals act—that they employ means to achieve ends. Alternatively stated, the economist's task is to devise a logic of action—a praxeology, to use the Misesian term.<sup>4</sup>

For Mises and the Austrians, cause and effect in economic theory manifest themselves as human action and its consequences. By human action Mises simply meant purposeful behavior; by consequences he included both the intended consequences and the unintended consequences but maintained a sharp distinction between the two categories. Many of his theories, in fact, involved a contrast between the intentions of market participants or policy makers and actual consequences that flow from the market process.

Systems of equations can be suitably employed to describe the consequences of human action, but such mathematical descriptions

<sup>4</sup>Praxeology can be interpreted as "action logic" in which it is recognized that actions (a) transpire through time and (b) are motivated by perceived cause-and-effect relationships. In Mises's own words "What distinguishes epistemologically the praxeological system from the logical system is precisely that it implies the categories of time and causality," *Human Action*, p. 99.

are inherently blind to notions of intentionality and causality. In the words of Mises,<sup>5</sup> “[The] equations and formulas [of mathematical economics] are limited to the description of states of equilibrium and nonacting.” Until recently, mathematical economists saw the eclipse of causality as one of the virtues of the mathematical method. Four decades ago, for instance, George Stigler<sup>6</sup> wrote approvingly that the profession had abandoned the “older concept of cause and effect” in favor of the “concepts of mutual determination” and accused those still concerned with causality with “fail[ing] to understand some of the most essential elements of modern . . . theory.”<sup>7</sup>

Philosophical insight into the meaning of causality is not at issue here. The point is that some modes of expression make nonsense out of the issue of cause and effect. An orange—or other spheroid—placed in a large rounded bowl will come to rest at the very center of the bowl. Gravity, we might be inclined to say, is the “cause” of this result. But suppose that *two* oranges are placed in the bowl. Which one of the oranges causes the other to be displaced from the center? The question itself is nonsensical. We can describe the loci of possible resting points of the two oranges, however, by manipulating the mathematical expressions representing the sizes and shapes of the oranges and the bowl. The two points of contact would, of course, be mutually determined.

In economics, it is possible to phrase questions about causality which are equally—but maybe not obviously—nonsensical. Under a variety of circumstances, real wage rates and real interest rates are inversely related to one another. But does a low interest rate cause the wage rate to be high, or does a high wage rate cause the interest rate to be low? The question simply makes no sense; the two rates are analogous to the two resting points of the oranges.

<sup>5</sup>Mises, *Human Action*, p. 356.

<sup>6</sup>George J. Stigler, *Production and Distribution Theories* (New York, Macmillan, 1946), p. 181.

<sup>7</sup>For an illuminating contrast between “cause and effect” and “mutual determination” in the context of production theory, see Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles* (Los Angeles: Nash Publishing, 1970), pp. 277–80.

This particular example of the eclipse of causality is not a frivolous one. The inverse relationship between the wage rate and the interest rate forms the bedrock of Ricardian distribution theory.<sup>8</sup> For neo-Ricardians who adopted the mathematical method, the question of which rate was the cause and which the effect gave way to the question of which rate is “exogenous” to the relationship, or predetermined, and which is “endogenous,” or determined by the relationship? Those who believed that the interest rate is predetermined (by social convention) became Cambridge capital theorists; those who believed that the wage rate is predetermined (by the requirements for subsistence) became Marxists. Agnosticism about the true locus of exogeneity was also a respectable position—one that provided a half-way house for neo-Ricardians making a conversion in one direction or the other.

Mathematics can describe the various combinations of wage and interest rates but cannot answer or even make sense of questions about which caused which or about which one is, in reality, determined exogenously. The mathematical economist, however, is content to remain agnostic on the issue of causality; the two rates are mutually determined. The praxeologist, by contrast, seeks to identify the plans and actions of individuals in the marketplace which constitute the ultimate cause of the pattern of wage and interest rates.

While mathematical economists may not deny that the ultimate cause is to be found in the actions of market participants, they proceed untroubled by the fact that mathematics is inherently silent on the issue of cause and effect. This disadvantage of the mathematical method was Mises’s concern<sup>9</sup> when he remarked that “[i]ts syllogisms are not only sterile; they divert the mind from the

<sup>8</sup>Ludwig Lachmann provides an insightful critique of this relationship. His own dissatisfaction with the neo-Ricardian theory derives from the absence of an adequate microeconomic foundation. In particular, the neo-Ricardians are in clear violation of Lachmann’s second rule: “In discussing a system of action . . . , we are not entitled to abstract from the springs of human action, the purposes sought by individuals and the plans in which they find their expression by assuming their *modus operandi* to be known and therefore predictable” (*Macro-economic Thinking*, Studies in Economics No. 6 [Menlo Park, Calif.: Institute for Humane Studies, 1978], p. 6).

<sup>9</sup>Mises, *Human Action*, p. 350.

study of the real problems and distort the relationships between the various phenomena.”

The claim is sometimes made that any relationship, including presumably causal relationships, can be expressed mathematically. John Egger’s attempt to give plausibility to this claim by offering a far-fetched example is noteworthy because the particular example he chose provides—inadvertently—a sound basis for rejecting the claim. Egger<sup>10</sup> translates the old saw “absence makes the heart grow fonder” into  $f'(x) > 0$ . (The first derivative of fondness with respect to absence is greater than zero.) Tellingly, the word “makes,” which indicates the direction of causality, is unavoidably lost in the translation. The exact same mathematical expression would result from a translation of the converse: “growing fonder makes the heart absent.”

At best, Egger’s equation can describe the equilibrium relationship between “absence” and the “growth rate of fondness.” More likely, however, such a wanton use of mathematics would invite attempts to quantify inherently unquantifiable concepts. And worse, the very fact that the expression involves a derivative suggests the appropriateness of the calculus operators. Egger could hardly argue against those who might want to integrate the equation in order to determine the absolute *level* of fondness that corresponds to an absence of a given duration. The real lesson in his curious exercise is not that any idea can be expressed mathematically but rather that mathematical economists have tortured economics in the same way that Egger has tortured a piece of romantic prose.

### **“Causality” in Modern Empirical Economics**

Considerations of technique prevent the modern economist from addressing the full range of economic questions. As mathematician, he can shed no light on issues of causality, but as economist, he is continually confronted with such issues. The melding of classical statistics with formal mathematical modeling, which establishes a link between theoretical abstractions and historical

<sup>10</sup>John B. Egger, “The Austrian Method,” in Louis M. Spadaro, ed., *New Directions in Austrian Economics* (Kansas City, Kans.: Sheed Andrews and McMeel, 1978), p. 29.



experience, does not close the gap between issues and answers. All respectable texts on statistics and econometrics acknowledge that statistical inference can never identify cause and effect; they warn against interpreting correlation as causation.

In recent years it has become acceptable within the economics profession to ignore all such acknowledgments and warnings and to make claims about cause and effect on the basis of empirical tests. For a hypothetical example, the claim that a rising interest rate *causes* the wage rate to fall may be supported by time-series analysis in which an inverse relationship between wage rates and lagged interest rates is demonstrated. The long-respected strictures against reading causality into statistical patterns are flouted. Empirical causality tests are increasingly common in the professional literature.

Only in the early phase of this empirical innovation was it made clear that such tests are based upon a newly stipulated definition of the word "cause." Stripped of all its subtle and difficult philosophical content and of its etymological link with reason, the word "cause" is used to describe observed temporal patterns in time-series data. In the judgment of Clive Granger and Paul Newbold,<sup>11</sup> "A better term might be *temporally related*, but since cause is such a simple term we shall continue to use it." It is interesting to note that, though this usage is defended on the basis of simplicity of expression, economists who employ empirical techniques developed by Granger use the decidedly unsimple and unaesthetic term "Granger-cause," as in: Falling interest rates Granger-cause wage rates to rise.

Christopher Sims, most widely known for his development and use of techniques suggested by Granger, is explicit about the nature of his enterprise. "The method of identifying causal direction employed here does rest on a sophisticated version of the *post hoc ergo propter hoc* principle."<sup>12</sup> "After this, therefore because of this," of

<sup>11</sup>C. W. J. Granger and P. Newbold, *Forecasting Economic Time Series* (New York: Academic Press, 1977), p. 225.

<sup>12</sup>Christopher A. Sims, "Money, Income, and Causality," *American Economic Review* 62, no. 4 (September 1972): 540-52.

course, is not a principal at all, but a fallacy. And sophistication cannot convert fallacy into principle.

The linguistic technique introduced by Granger is nothing short of a scandal. (A better term might be *career-enhancing innovation*, but since scandal is such a simple term I shall continue to use it.) Publishers and editors are not likely to be interested in research that yields limp conclusions about the temporal relationships in the movements of economic variables; they are interested in research that demonstrates that one thing *causes* another.

Granger-inspired research is often reported guardedly in the section on the testing procedure and then unguardedly in the summary section. Gerald P. Dwyer, Jr.,<sup>13</sup> for instance, conducts Granger-causality tests to determine whether or not federal budget deficits Granger-cause inflation. Failing to find any statistically significant *post-hoc* relationship, he tentatively reports in his summary that “. . . there is no reason to predict that a reduction of deficits has a causal role in any policy to reduce inflation.”

The economist's audience is interested in the issue of causality; his mathematical and econometric techniques are not up to the task. The result—for those who confine themselves to mathematical and statistical methods—is a scandalous abuse of the English language. For Mises the notion of cause and effect as used by economists is presupposed by the notion of means and ends, where both cause and means are to be understood in terms of the purposes and plans of acting individuals. None of these notions are adequately illuminated by the methods of mathematical economists or econometricians.

## Mathematical Economics in Perspective

To recognize that the notion of causality cannot be expressed mathematically or tested-for empirically is to suggest that, for the economist, the language of mathematics and econometrics is too confining. Systems of equations can be used to describe abstract

<sup>13</sup>Gerald P. Dwyer, Jr., “Inflation and Government Deficits,” *Economic Inquiry* 20, no. 3 (July 1982): 315–29.

states of general equilibrium, and econometrics can provide some quantification of actual economic magnitudes. There should be no objection to this.<sup>14</sup> In fact, the appropriateness of mathematics for describing an economy in general equilibrium or for describing the evenly rotating economy, to use Mises's own construction, derives precisely from the fact that there is no human action in such states. The Austrian economist, however, is interested primarily in the give and take of market processes. This is where the action is. But his task of making those processes intelligible by identifying the plans and actions that give rise to them is not facilitated by the mathematical method.

There is no justification for insisting that mathematical formulations be expunged from economics in some wholesale fashion. The appropriate imperative is much milder in both substance and tone: Do not allow the applicability of mathematical and statistical methods to define the scope of economics. Most economists if confronted explicitly with this recommendation would, I suspect, accept it, many believing that it simply goes without saying. Implicitly, however, the recommendation is systematically rejected—as judged by the extent to which the applicability of these methods have in fact been allowed to dictate subject matter.

It is convenient to describe the current state of economics with the aid of a simple Venn diagram consisting of two overlapping circles (see figure 1). Let one circle *M* represent mathematics; let the other *E* represent economics. The overlap *ME* represents mathematical economics and includes all those aspects of economics that actually are—even in the Austrian view—susceptible to a mathematical treatment. Descriptions of equilibrium states, for instance, fall in this overlap. Mises's only complaint about such exercises<sup>15</sup> is that they have unduly dominated the attention of economists: "A superficial analogy [i.e. the imaginary construction

<sup>14</sup>The mathematician in his limited role as "pattern maker" and the statistician in his similarly limited role are discussed by F. A. Hayek, "The Theory of Complex Phenomena," in Hayek, *Studies in Philosophy, Politics and Economics* (Chicago: University of Chicago Press, 1967), pp. 22–42.

<sup>15</sup>Mises, *Human Action*, p. 355.

of the final state of rest translated into algebraic symbols] is spun out too long.”

The very construction of the Venn diagram suggests that economists who use the mathematical method should take precautions of two sorts. First, they should guard against allowing mathematical exercises to take them across the border separating *M* from *ME*, where the equations cease to express relationships having any relevance to economics. Second, they should strive continuously to maintain free passage across the other border, which separates *ME* from *E*. They should willingly make excursions into any area of economics—even if they have to abandon the vehicle of mathe-

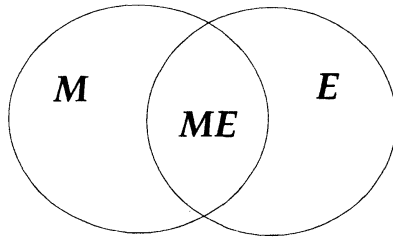


Figure 1.

matics at the border. Anyone familiar with today’s economics profession will quickly realize that the border guards are misdeployed. Dissatisfaction with the state of the profession stems largely, I think, from the work of economists who are oblivious to the border that should not be crossed but who instinctively retreat from the border that should be ignored.

The professional journals are filled with technically sophisticated articles in which mathematical formulations and manipulations have no clear relevance to economic reality. The problem is not abstractness *per se*. The most fundamental and broadly applicable propositions of economics are inherently abstract. Nor

is the realism of assumptions directly at issue here.<sup>16</sup> The problem is the failure to maintain a distinction between mathematical economics and mathematical gymnastics.

Charles L. Schultze<sup>17</sup> recognized the problem of the unguarded border in his assessment of modern technical economics. The profession tends to engage itself in what Schultze calls “finger exercises—you can’t tell where the mathematics ends and the economics begins.” More typically, the crossing of the unguarded border occurs in the opposite direction (i.e., from *ME* into *M*) from that suggested by Schultze’s lament. Mathematical economists begin by associating their symbols with economic magnitudes: *k* is capital; *l* is labor; *q* is output, etc. They proceed, then, to manipulate mathematical equations without concern about the economic meaningfulness—or the possible meaninglessness—of the resulting relationships.

One of the clearest examples of this mathematical procedure is the infamous Cambridge Controversy over capital and the production function. Polynomials which purportedly described multi-period production processes yielded *pro forma* solutions suggesting the possible existence of multiple pure rates of interest, technique reswitching, and capital reversing. Without question these odd-sounding phrases were descriptive of the mathematical results obtained by Cambridge capital theorists; but they are not meaningful in the context of any known economic process. Demonstrations that the results have economic significance are nonexistent, and even the recognition of this lacking is less than sincere. The final sentence of an article on capital reswitching appearing in the profession’s most prestigious journal reads: “What now remains is to establish the economic significance of the constraints imposed to

<sup>16</sup> Assumptions are often made for the sake of conceptual rather than mathematical tractability. Mises, for instance, never hesitated to invoke the *ceteris paribus* assumption—even when it was clearly unrealistic. Debate in recent years about the merits of realism *per se* has been particularly unproductive. For a fruitful recasting of this methodological issue, see Alan Musgrave “‘Unreal Assumptions’ in Economic Theory: the F-Twist Revisted,” *Kyklos* 34, no. 3 (1981): 377–87.

<sup>17</sup> As quoted by Caroline Rand Herron, “Economist to Economist, in English,” *New York Times* (27 September 1987), sec. 3, p. 4.

allow us to get these results.”<sup>18</sup> But more than a decade later, that task, which should have been preliminary to the publication of the mathematical results, still remains. The results themselves have become and continue to be the subject matter of further study.<sup>19</sup>

The problem of the unguarded border is compounded by a problem of the opposite sort on the other side of the overlap. It has become standard practice in the profession today to make assumptions—sometimes bizarre assumptions—in order to render an economic issue mathematically tractable, i.e., to avoid crossing from *ME* into *E*. An analysis of the give and take of the market process is often precluded or trivialized by some assumption that focuses attention on the end result of that process. Examples of assumptions that guard against plunging head-long into non-mathematical economics are easy to find. The Walrasian auctioneer has come to serve as one such border guard. Invoking this piece of fiction allows the mathematical economist to pass over the question of how the economy actually gropes towards an equilibrium and to neglect the consequences of transactions involving disequilibrium prices. A single auctioneer substitutes for competing entrepreneurs, making it unnecessary for market participants to engage in monetary calculation in any nontrivial way or to formulate and implement economic plans. All the issues that captured the attention of Mises and the Austrians are held at bay while the mathematical economists describe the pattern of prices and the allocation of resources associated with a general equilibrium.

The Friedmanian helicopter does for monetary theory what the Walrasian auctioneer does for value theory. Mathematical tractability is preserved if it can be assumed that monetary injections are accomplished by helicopter drops of newly created money. It is often

<sup>18</sup>Lowell Galloway and Vishwa Shukla, “The Neoclassical Production Function,” *American Economic Review* 64, no. 2 (June 1974): 358.

<sup>19</sup>For a critical exposition of the Cambridge controversy and a methodological treatment of the specific issues, see Lachmann, *Macro-economic Thinking*, pp. 15–17; Leland B. Yeager, “Capital Paradoxes and the Concept of Waiting,” in Mario J. Rizzo, *Time Uncertainty and Disequilibrium* (Lexington, Mass.: D.C. Heath, 1979), pp. 187–93; and Roger W. Garrison, “Waiting in Vienna,” in Mario J. Rizzo, *Time Uncertainty and Disequilibrium* (Lexington, Mass.: D.C. Heath, 1979), pp. 221–24.

further assumed in the Monetarist literature that individuals gather up the new money in direct proportion to the amount that they already possess. Propositions about the neutrality of money follow trivially: production functions are homogeneous of degree zero with respect to the medium of exchange. Again, the issues of interest to the Austrians— injection effects, monetary distortions of the production process, monetary calculation during periods of inflation—are all swept aside by assumptions that make the remaining issues mathematically tractable.

In the writings of the New Classicists, the analytical technique introduced by Walras and extended by Friedman has been pushed to the limits. The goal of a “fully articulated artificial economy” and the insistence on the complete absence of so-called “free parameters” is easily interpreted in terms of our Venn diagram: The border separating mathematically tractable issues from all other economic issues should be sealed once and for all.<sup>20</sup>

Modeling techniques introduced by Edmund Phelps<sup>21</sup> and developed by Robert Barro<sup>22</sup> require that the border guards stand elbow to elbow. The world about which they theorize consists of a number of island economies. No trade occurs between islands. There is only one commodity being supplied and demanded. The commodity is nondurable in the extreme—a service, actually, indistinguishable from the labor that renders it. Demanders possess the same information as suppliers. Technical considerations require that the service is such that one individual must render it to another. (This feature is needed to prevent the model from collapsing into a model of complete autarchy.) The full specification of such models taxes the imagination, but Barro<sup>23</sup> achieves a degree of

<sup>20</sup>Arjo Klamer’s conversations with Lucas, Sargent, and Townsend lend support to this interpretation. See Arjo Klamer, *Conversations with Economists* (Totowa, N.J.: Roman and Allanheld, 1984).

<sup>21</sup>Edmund S. Phelps, “The New Microeconomics in Employment and Inflation Theory,” in Phelps et al., *Microeconomic Foundations of Employment and Inflation Theory* (New York: W. W. Norton, 1970), pp. 1–23.

<sup>22</sup>Robert J. Barro, “Rational Expectations and the Role of Monetary Policy,” in Barro, *Money, Expectations and Business Cycles* (New York: Academic Press, 1981), p. 83.

<sup>23</sup>Ibid.

concreteness by suggesting that we think in terms of “back-scratching” services.

New-Classical models of this type allow for no substitutability or complementarity among goods or among factors of production; no capital and hence no heterogeneity of capital; no information flows, entrepreneurial activities, production plans, or market processes except in the most trivial senses. Yet the purpose of such models is to facilitate the analysis of monetary shocks or of alternative monetary policy regimes! (The substantive conclusions derive from a stipulated difference in the cost of acquiring global as opposed to local information about price changes.) But what significance could the implications of such models possibly have for real-world economies?

Thomas Sargent<sup>24</sup> is aware that the techniques of New Classicism have questionable validity: “[I]n order to make general equilibrium models tractable enough for macroeconomic work, their preferences, technology, and endowments have typically been so simplified, and so much has been abstracted, that it is often difficult to take their predictions in some directions seriously.” Research efforts within the New Classicist camp, however, are directed toward further extension of this modeling technique. Questions about validity are neither answered nor seriously contemplated. According to Sargent,<sup>25</sup> the technique “rests on faith that insights about the laws of motion of economic aggregates can be acquired by building models of economies that are internally consistent. Such faith perseveres despite the fact that internal consistency is always purchased with simplification and abstraction.”

In the view of Robert Lucas this faith is strong enough to establish a new method of achieving understanding and a new meaning for the word “theory.” Writing about economic fluctuations, Lucas<sup>26</sup> asserts that “One exhibits understanding of business

<sup>24</sup>Thomas J. Sargent, *Dynamic Macroeconomic Theory* (Cambridge Mass.: Harvard University Press, 1987), p. 7.

<sup>25</sup>*Ibid.*

<sup>26</sup>Robert E. Lucas, Jr., *Studies in Business Cycle Theory* (Cambridge, Mass.: MIT Press, 1981), p. 219.



cycles by constructing a *model* in the most literal sense: a fully articulated artificial economy which behaves through time so as to imitate closely the time series behavior of actual economies. The Keynesian macroeconomic models were the first to attain this level of explicitness and empirical accuracy; by doing so they altered the meaning of the term 'theory' to such an extent that the older business cycle theories could not really be viewed as 'theories' at all."

The spinning continues on the superficial analogy that in Mises's judgment had been spun out too long several decades ago. Economic understanding in Mises's own view is achieved by identifying cause-and-effect relationships between individual actions in the marketplace and the economic phenomena to which they give rise. No amount of faith can transform the articulation of an artificial economy into an understanding of a real one. The mathematical modeling that characterizes New-Classicist literature is not a means of achieving economic understanding but is rather a substitute for it.

### Concluding Remarks

Studies of Mises and his methods and comparisons of his praxeological reasoning with the more modern econometric and mathematical modeling techniques are fruitful pursuits. Such studies, of course, provide no pat formulas for devising economic theories or for establishing their validity and relevance, but they do provide some valuable guidance.

It has become popular to insist that no methodological taboos be issued . . . except for the taboo against issuing taboos. I propose as a second exception the taboo issued earlier in this paper: "Do not allow the applicability of mathematical or statistical methods to define the scope of economics." In terms of the Venn diagram depicting the overlap between mathematics and economics, the taboo translates into the imperatives: Redeploy the border guards. Accept responsibility for demonstrating that mathematically derived results have economic relevance; refrain from

drawing conclusions about real-world economies that hinge critically on some assumption made for the sake of mathematical tractability.

In one sense these imperatives are weak ones. Who could explicitly reject them and expect to maintain intellectual respectability? In another sense they are not so weak. Their implicit rejection pervades modern economic literature. The actual observance of these imperatives would require a radical—and salutary—change in the way modern economists go about their business.

## 4

# *Ludwig von Mises and the Philosophy of History*

David Gordon

**T**he philosophy of history encompasses two distinct though related inquiries. First, writers such as Marx, Spengler, and Toynbee have claimed to demonstrate that history obeys certain general laws or patterns. These laws are not confined to particular events or periods in history. Unlike their less ambitious colleagues, these writers think that historians can go beyond the analysis of topics like the rise of the Industrial Revolution or the origins of World War I. These topics, and others like them, form but passing incidents in schemes of cosmic range.

Most philosophers and historians in the United States and Britain reject the legitimacy of this line of inquiry. In the Anglo-American world, philosophy of history means the study of how 'ordinary' history ought to be written. Problems such as: what is a historical explanation? and do the methods of studying history differ from those of the natural sciences?; occupy the attention of this sort of philosophy of history.<sup>1</sup> In W. H. Dray's terms, this study is critical rather than speculative.<sup>2</sup> A complication to this neat division is that a theme of critical philosophy of history is the legitimacy of the speculative brand of the subject. Nevertheless, the distinction between the two types is fairly clearcut.

<sup>1</sup>See, e.g., Arthur Danto, *Analytical Philosophy of History* (Cambridge, England: Cambridge University Press, 1968), p. 288.

<sup>2</sup>Danto terms the two types "substantive" and "analytical" (*ibid.*, p. 1).

Ludwig von Mises made important contributions to the critical philosophy of history. One of the most important of these concerns is the topic just mentioned. Mises, principally in *Human Action and Theory and History*, offered a devastating criticism of speculative history. He also discussed in intricate detail a large number of 'standard' areas in critical philosophy of history, including, e.g., the construction of ideal types and the meaning of a historical fact. The confines of this essay do not permit a full discussion of all of Mises's contributions. Instead, two are singled out: his criticism of speculative philosophy of history and his view of the use of economics in historical explanation.

## I

Mises thought that speculative philosophies of history were a useless effort, since they flew in the face of sound theory. The basic axiom of praxeology is that human beings act. It does not follow from this that nothing else acts, but Mises took this extension of his axiom as obviously true. If, e.g., one says that France declared war on Germany on September 3, 1939, one does not mean—or at least ought not to mean—that a collective entity, France, literally did something on that date.<sup>3</sup> Rather, persons, standing in relations to others, acted in a certain way. Decisions by Edouard Daladier and Georges Bonnet, among others, brought about the *action* of France.

Once stated, Mises's point seems hard to deny. Maurice Halbwachs, a French philosopher and disciple of Durkheim, believed in collective memories separate from those of individuals, and Josiah Royce thought that animal species were entities with personalities; fortunately, few today give heed to these bizarre suggestions. The point that only individuals act, however commonplace it seems, is nevertheless enough to disqualify most of the major speculative philosophies of history from consideration.

<sup>3</sup>This is adapted from a famous example of Parker Moon.

Particularly blatant examples of disregard for the *obvious* truth of methodological individualism occur in the theories of Oswald Spengler and Arnold Toynbee. Spengler explicitly compares the cultures he studied to organisms:<sup>4</sup> in his view, cultures go through a fixed cycle leading from birth through flowering to eventual death. What individuals wish does not in the last resort matter. In the twentieth century, e.g., European or 'Faustian' culture has reached the point at what Caesarism begins. As technic replaces lyric, struggle for world power *must* dominate the century.

Toynbee's longer and more diffuse *A Study of History* first seemed to accept Spengler's basic schema, modifying it largely by extending the number of civilizations to twenty-one. In his first volume, Toynbee proclaimed a civilization the unit of historical study and looked down upon historians benighted enough to concentrate on individuals. As Toynbee's work expanded, he shifted from his earlier adherence to Spengler's cycles, but his change did not reflect an increased awareness of Mises's point that only individuals act.

Quite the contrary, Toynbee now thought that civilizations were too minor an affair to be studied in isolation. Now the key to history had been vouchsafed to him: it consisted of the rise of universal religions, brought about through the revolt of a civilization's "external proletariat" combined with internal weakness. Into the details of Toynbee's system, and his own peculiar variety of religious syncretism, we fortunately can for our purposes pass by. Suffice it to say that no matter how many insights one can gain from Spengler and Toynbee, one cannot escape the force of Mises's argument.

There are few if any Spenglerians around today, but this fact does not render Mises's analysis otiose. Mises was in fact after much bigger game. Hegel and Marx also should be cast aside because of their blatant disregard for methodological individualism. For Hegel, history is the development of *Geist* (Spirit). On Mises's interpretation, this is an entity, supposedly conscious and acting,

<sup>4</sup>Oswald Spengler, *The Decline of the West* (New York: Alfred A. Knopf, 1939), vol. 2, pp. 3, 4, 7.

yet certainly not a human being.<sup>5</sup> World history is for Hegel the "world's court of justice": the progress of history expresses the coming to consciousness of the Absolute Spirit.

Hegel's system raises an issue that so far has not been directly addressed. Mises believes that only individuals act; but what is an individual? What if a defender of Hegel said that contrary to Mises, *Geist* is an individual? It is, after all, Absolute Mind. Mises would no doubt have refused to do battle in this murky area of metaphysics. By individuals he meant human beings: anyone who thinks that something else can act denies methodological individualism. Mises gives no argument that only human beings act, and he is perhaps overly cavalier in his dismissal of theistic philosophies of history.<sup>6</sup> But his methodological dictum seems exactly on target when applied to theories which ascribe action to a non-mental entity.

A clear case of an approach to history guilty of this failing is Marxism. As Mises trenchantly pointed out, the basis of Marx's historical materialism is the clash between the forces and relations of production. The forces of production, roughly speaking, consist of the technology in use in a society at a particular time. The relations of production form the society's economic system, whose function is to develop the forces of production to the greatest extent possible. On the *base* of the relations of production, a superstructure, which includes political, social, and ideological aspects, arises. At key points of transition, e.g., the overthrow of feudalism, the relations of production become *fetters* on the forces of production. After a revolution in which *the integument of the old order bursts*, new relations of production permit the forces to resume their development.

With keen insight, Mises laid his finger on the crucial weakness of Marx's account. Marx assumed that the forces of production grow automatically. He treats the forces as if they formed an acting

<sup>5</sup>The most important source for Mises's criticism of Hegel and Marx is *Theory and History* (Auburn, Ala.: The Ludwig von Mises Institute, 1985). This reprints the original edition published by Yale University Press in 1957.

<sup>6</sup>Mises's criticism of theism is in his *Socialism* (Indianapolis, Ind.: Liberty Fund, 1981). He contends that a perfect being cannot act, i.e., use means to achieve ends, since it by definition lacks nothing.

individual, ignoring the fact that technology exists only because particular people create it. Marx was of course well aware that people invent new tools; but he neglects this point in postulating the autonomous growth of the forces of production.

Two objections may be raised against Mises. First, some Marxists think that the most important part of Marx's view is class struggle. The battle of particular individuals over economic interests form the sum and substance of history. On this construal, Marx need not be found guilty of ignoring methodological individualism.

This interpretation of Marx falls outside the scope of this essay. Suffice it to say, however, that Mises's interpretation reflects a standard view of Marx. He relied especially in his analysis on Georgi Plekhanov's *The Development of the Monist View of History*, an acknowledged classic of Marxism. Whether or not there are other ways of looking at Marx than his, Mises certainly cannot be rightly accused of destroying a monster of his own creation.

A better objection stems from G. A. Cohen, a leading contemporary 'analytical' Marxist. In his *Karl Marx's Theory of History: A Defence*, he adopts a reading of Marx that in its stress on the growth of the forces of production agrees with Mises. Again, like Mises, Cohen thinks it would be a decisive weakness if these forces were simply assumed to grow by themselves. He differs from Mises in thinking that the continual growth of the forces can be explained in a way that denies neither Marxism nor methodological individualism.

Briefly put, Cohen argues that because individuals are nearly always interested in advancing their material well-being, they will, if rational, develop the forces of production to the greatest extent they can. Doing so will increase their production of the goods and services they want. The tendency to develop the forces forms a near constant in history; yet Cohen does *not* think that the forces of production act by themselves.<sup>7</sup> Thus, Cohen thinks, Marx stands vindicated.

<sup>7</sup>G. A. Cohen, *Karl Marx's Theory of History: A Defence* (Princeton, N.J.: Princeton University Press, 1978), pp. 152ff.

One could deal with Cohen's claim very simply by pointing out that Mises was attempting to refute Marx, who was indeed guilty of the fallacy to which he drew attention. Cohen does not contend that his reconstruction is to be found in Marx: it is his own work. To leave matters here, however, would be an evasion. If one addresses the argument directly, it is evident that it leaves Mises's point completely untouched. All that follows if Cohen is right is that people will use whatever technology exists in the best fashion they know and that they will *try* to develop it further. Whether or not people will *succeed* in developing technology cannot be deduced just from the fact that they try to do so. For Cohen's argument to work, he needs to add the premise: "if people try to develop their technology, they will be able to do so." But this is in turn to suggest that technology can readily be developed: all people have to do is devote attention to the matter. Otherwise, why should the premise be presumed true? In effect, then, Cohen has not deviated very much from Marx's assumption that the forces develop automatically. Cohen thinks they develop automatically so long as a near constant human tendency is in operation. He too then falls before Mises's methodological point. Given a human *push*, technology still in Cohen's reconstruction behaves like an acting, growing individual.

Mises did not confine his criticism of speculative philosophies of history to their flouting of individualism. Another principal failing of many of these theories was what Mises somewhat inelegantly termed "polylogism."<sup>8</sup> This term designates the view that not all civilizations, or classes of people within a given society, think in the same fashion. Thought is not in essence one but varies over time. The exact sense of 'same' can best be understood after an example.

Once again Spengler's "historical morphology" provides the clearest illustration of the fallacy Mises had in mind. Spengler believed that the patterns of thought found in each of his cultures differs entirely: Greek mathematics, e.g., is *not* just an earlier stage of "Faustian" mathematics. A Greek saw space in a way that pre-

<sup>8</sup>Mises's principal treatment of this topic is in *Human Action* (New Haven, Conn.: Yale University Press, 1949).



cluded his grasp of the infinite. All of a culture's main pursuits, including its science, art, and philosophy, are unified by a common pattern. One culture cannot take over the thought that properly belongs to another. If it attempts to do so, the result will be a "pseudomorphosis"—a distorted copy of the original. Spengler thought that the adoption of Christianity during the Middle Ages was a prime example of this process. Faustian Christianity *cannot*, in Spengler's view, be identical with a product of "Magian" culture.

Here one grasps immediately what Mises meant by polylogism and why he condemned it. If, as Spengler believed, each culture was limited to its own pattern of thought, the study of other cultures becomes impossible. If cultures think in completely different ways, how can one understand them? Spengler saws off the branch on which he sits. If cultures differ so much that someone cannot understand the thought of another, how can Spengler purport to describe the cultures his own theory declares one cannot understand?

The difficulties of Spengler's position are easy to see; by looking at them, one can get a clear idea of the meaning of "polylogism." The name suggests a doctrine that denies that the laws of logic are universally valid. Mises sometimes takes the term in just this way. He criticizes, e.g., the contention of Lucien Lévy-Bruhl that primitives do not accept the Law of Excluded Middle. But the discussion of Spengler shows that polylogism can be used in an extended sense. Spengler did not argue that the laws of logic changed over time. Rather, he believed that certain general categories, such as space, time, and causality, differed from culture to culture. In the extended sense, then, polylogism is the view that denies either that logic or the general categories of thought are universal.

Hegel and Marx sinned in this area as well, and more than venially. Hegel regarded formal logic as a mere affair of the "understanding." Reason proceeded by a dialectical logic. The exact meaning of dialectics, as Hegel conceived of it, has aroused considerable controversy. On some interpretations, Hegel's dialectic proceeds from category to category through outright logical contradiction. Others deny this, claiming that the antithesis in

a Hegelian triad does not contradict the thesis: it is usually its logical contrary, not contradictory. But even on this view, it seems an odd analysis of logic to think that a concept in some way produces its contrary. A reader of J. M. E. McTaggart's *Commentary on Hegel's Logic* can have little doubt that stages in Hegel's system "follow" one another in no logical fashion.

This topic is important for our purposes because Hegel's philosophy of history forms part of his general philosophy. In Hegel's jargon, history is part of the "self-externalization" of *Geist*. The course of history *must* proceed toward freedom, culminating in the Prussian state of Hegel's time: such are the demands of Hegel's logic. Each culture grasps only certain categories of the dialectic: the system has come to full consciousness of itself only in Hegel's own thought. Here exactly lies the polylogist element of Hegel's approach to history. Different cultures use varying categories of thought, just because they are aware of only parts of the dialectic. Hegel falls before Mises's devastating question: if other cultures used different categories of thought, how can he profess to understand them?

Hegel would probably reply that the 'higher' categories incorporate all truth present in the lower categories that earlier cultures have used: his own *Philosophy of History* provides the general scheme by which each culture can be understood. Although this reply seems to me unconvincing, space precludes further discussion.

Fortunately, the application of polylogism to Marx's historical system is direct and straightforward. Marx thought that economic class determined ethical and political thinking, and, to some extent, scientific theories as well. If, e.g., James and John Stuart Mill supported utilitarianism, they did so not because this system resulted from their objective investigations into the nature of ethics. Instead, their views reflect the class interests of the bourgeoisie. There are no universally binding principles of ethics: what one class thinks good another will not.

Marx himself did not discuss logic at length after his early works commenting on Hegel. But his closest associate Friedrich

Engels explicitly adopted the view that logic is changeable rather than universally valid; in his posthumously published *Dialectics of Nature*, he attempted to show the presence of “contradictions” in, e.g., the development of an oak tree from an acorn. Marx himself spoke favorably of the “proletarian philosopher” Joseph Dietzgen, whose system rested on the assumption that logic varied with class.

Mises amusingly points out a problem Marx’s class-based version of polylogism raises for his own system. Marx claims that class position determines thought; but Marx himself was a middle-class academic married to a Prussian noblewoman and his collaborator Engels a wealthy manufacturer. However hard Marx and Engels tried to arrive at a proletarian position, would not their own class position render their attempt self-defeating? Mises notes that at least one Marxist philosopher adopted just this view of the founders of Marxism and accordingly attempted to “correct” Marxism by purging it of the bourgeois remnants present in it.

More importantly, Mises’s fundamental criticism of polylogism applies to its Marxist variety. If class position plays the all-embracing role Marx ascribes to it, then one cannot obtain a true picture of the past. One’s speculations will, if Marx is right, inevitably be colored by class position. This is not a mere matter of bias, amenable to correction by further inquiry and the comparison and contrast of histories written from the perspectives of different classes. In Marx’s system, class position does not *bias* one’s grip on truth. There *is* no truth beyond that of the various class positions. On Marx’s own doctrine, then, it is difficult to see how his system can be true in the ordinary sense. If it is true, it is not true, because one of its doctrines denies objective truth; and if it is false, it is not true. Therefore, it is false.

Mises has thus dealt crippling blows to the historical systems of Hegel, Marx, Spengler, and Toynbee. One might at this point raise an objection, however. Even if Mises has shown that these systems ignore methodological individualism and practice polylogism, he has not proved that any speculative philosophy of history must have these debilitating features. If so, he leaves open the possibility for a valid speculative approach to history.

Mises would not have acknowledged the force of this objection. He presents an argument, which if correct rules out the possibility of laws of history. The argument does not assume that a claim that there are historical laws must commit one of the fallacies discussed previously.

If laws of history could be discovered, what sort of laws would they be? Two possibilities exist, in Mises's opinion: they can be arrived at purely a priori, or they can result from induction. Mises of course ardently professed deductivism in economics; but the praxeological method could not be directly applied to history.

The axiom of action, and all supplementary postulates used in praxeology, are universal statements, e.g., "all men act." No conclusions about the occurrence of particular events follow from them, or the theorems derived from them. From the theorem that "everyone uses means to achieve ends," e.g., nothing follows about the accession to power of Napoleon III in 1848. Although historical explanations may use general laws, including laws of praxeology, these laws are applied to particular events; and statements that these have happened are not logically necessary truths.

Mises's argument appears airtight: (1) only general statements follow from general premises; (2) historical events are particular; (3) no statement that a historical event has occurred follows from a conjunction of general statements. There is, however, one escape. Someone might hold that a statement about a particular event can be logically necessary. This view Mises certainly would have found repugnant: on his Kantian view, necessary statements are a priori and universal. But the question would get us into technicalities far distant from our topic and will not be further taken up here.

Mises's denial of deductively true laws of history would arouse wide agreement. But what about laws of history that do not claim to be the products of logical deduction? After all, the natural sciences are not pure products of deduction, either; why, then, can there not be a science of history?

Mises quickly dismissed this possibility. Science, in his view, follows an inductive procedure. A scientist notes various regularities in the world: from these, he infers a law, stating that if  $x$

happens,  $y$  will happen. The law will either state that a constant conjunction exists between  $x$  and  $y$ , or that  $x$  and  $y$  merely occur together with a certain frequency.

Many philosophers of science would dismiss Mises's inductivist position as old-fashioned. In the influential view of Karl Popper, there is "no such animal" as induction. Scientists arrive at hypotheses through creative thought, not by applying fixed methods to given facts in order to discover regularities present in them. The hypotheses arrived at can be refuted but not verified. Although we cannot here evaluate Mises's position against that of Popper, let alone philosophers such as Paul Feyerabend with still more divergent views, it is worth a digression to make one point. As the very brief remarks just made suffice to show, Mises in no sense was a Popperian, the close alliance of Popper with Mises's student Friedrich von Hayek to the contrary notwithstanding. Mises in *The Ultimate Foundation of Economic Science* dismisses Popper's demarcation between scientific and non-scientific statements as a positivist error.<sup>9</sup>

To return to our topic, how does it follow from Mises's approach to induction that there cannot be inductive laws of history? To arrive at laws of this type, events must be grouped into classes. To revert to our earlier example, the statement 'if  $x$ , then  $y$  is about any case of  $x$  and  $y$ : it is not limited to a particular occurrence. The fact that a particular chemist at 10:30 A.M. on November 22, 1963 mixed together atoms of hydrogen and oxygen to form water is of no interest to science apart from the fact that it is an example of a general law.

In history the situation differs entirely. Just what is of concern to the historian is the individual event. But a particular event, though it may exemplify various laws, is not in itself the subject of them. To get a constant conjunction of events, one must abstract from the individual features of an event; and history is found in just what the scientist has cut away. The conclusion remains the same if probabilistic inductive laws are at issue. The probability calculus,

<sup>9</sup>Ludwig von Mises, *The Ultimate Foundation of Economic Science* (Princeton, N. J.: D. Van Nostrand, 1962).

Mises held, can be applied only to classes of events. Another sort of probability, termed case probability, does apply to particular events; but this does not permit the derivation of laws.

Mises's denial of the possibility of inductive laws of history rests on a similar assumption to that of his criticism of deductive laws. In the latter, he implicitly denied that statements about individual events can be logically necessary. Here, he implicitly denies that two particular events can display a necessary connection. The 'necessity' of the connection between events just *is* the fact that events of certain classes always occur together. An individual event is not connected to another individual event in any way closer than by the other occurring at the same time.

To clarify the point, suppose that one could see the causal connection between events without having to group them in classes. Then, perhaps, laws of history could be found out: a historian might just be able to see, e.g., that Napoleon had to become Emperor, given preceding events. Whether Mises missed anything important by omitting this view from discussion is unfortunately another topic that would take us too far afield.

If one accepts Mises's avenue of approach to both deduction and induction, has he successfully shown that there cannot be laws of history? To the discussion so far, it might be objected that Mises has at most shown that if one claims to have discovered there are laws of history, there is no way of validating these claims. But this does not show there are no necessities in history. Perhaps Napoleon had to become Emperor, even though no deductive or inductive laws we can discover will show that this is true.

Mises does not directly address this question, except when combined with another view; but his opinion about this combined position is emphatic. People who think that historical events 'had to happen' as they did usually are not content to leave this as an unknowable possibility. Often they claim that by a process of direct insight, neither deductive nor inductive, they can see the necessities in events. Oswald Spengler, who claimed to have grasped the 'physiognomy' of culture, probably is the best case of someone adhering to this position.

Mises regarded this sort of intuitive insight as irrational and dismissed it totally from consideration. Like Leonard Nelson in his satiric *Spuk*, he regarded Spengler and his ilk as mystics and purveyors of nonsense. This point has been mentioned not as a prelude to a discussion of Mises's theory of knowledge or his negative assessment of mysticism. Rather, this issue is important because of a peculiar misunderstanding that has recently arisen about Mises's doctrine of historical understanding. Mises discusses at great length the understanding of particular events (*Verstehen*) which he contrasts with the methods of the natural sciences. But historical understanding, though not scientific, is not intuitive or non-rational. Quite the contrary, it usually consists of judging which laws apply to particular events. Those contemporary devotees of hermeneutics who, because Mises used the word *Verstehen*, try to foist on him the intuitive procedures of Hans-Georg Gadamer misrepresent the case entirely.

## II

Mises's vast campaign against speculative philosophy of history by no means exhausted his contributions to historiography. A further topic, economists are likely to find both interesting and important, emerges clearly in Mises's own historical works. (Unlike many philosophers who discuss history, Mises actually was a historian.) What role does economic interest play in understanding history?

Mises's response, at least for the history of Europe in the nineteenth and twentieth centuries, was "a very great deal indeed." Mises believed that few people were likely to act against what they thought to be their direct material interests. Unlike the Marxists, he did not think that non-economic interests always reflected economic ones. Certainly, in Mises's view, people might be interested in all sorts of subjects that have no direct connection with economics: religion, friendship, romance, science, etc. His view was rather that material interests are usually of overriding importance. In his assessment of the merits of capitalism, e.g., Mises thought that if people agreed that this system best promoted prosperity,

few would find preferable the competing values present in other systems. He did not think many people would pay much of a price either to support the egalitarianism present in socialism, or to put into effect the various tenets advanced by different religions about the proper ordering of society.

A further difference from Marxism illustrates one of Mises's key views. Mises did *not* say that individuals usually act in accord with the economic interests of their class. On the contrary, each individual, he thought, was concerned with his own interests. Mises himself strictly observed the same precept of methodological individualism he used to criticize Marx and others.

One further clarification is needed before we examine how Mises applied his view of motivation in his historical writing. Mises did not claim that his view of motivation was a law of praxeology. People did not have to put their material interests first, and many people have not. It was simply Mises's opinion, not a law that he professed to have discovered, that people usually act in the way he assumed.

In one way the picture given so far of Mises's view of economic motivation in history has been misleading. So far, Mises sounds as if he were a precursor of the Chicago School with its attempts to show that virtually all behavior is economically rational. This is an entirely wrong account of Mises's position. Unlike Gary Becker, Richard Posner, and other members of the Chicago School who have attempted to show how, among other institutions, marriage and legal customs maximize economic welfare, Mises does not assume that most people act rationally to advance their economic interests. They advance their interests, as said before, as they see them: people may have entirely wrong ideas about the best way of doing so.

Mises's avoidance of the Chicagoites' assumption of rationality permits him to escape a paradox that threatens the position of anyone who emphasizes the importance of material prosperity. Mises has provided a powerful case that only the market system will 'work' economically. Socialism cannot withstand the force of the calculation argument, and interventionist measures fail to achieve their proposed purpose of "improving" the way the market works.



Here then is the paradox. Mises has readily demonstrated the beneficial consequences of the market in promoting prosperity. Though few match him in consistency, many other economists, including those of the Chicago School, adhere to a large extent to the free market. Yet most countries do not operate on a capitalist basis: they are either socialist or very strongly interventionist. If people are interested in material wealth, why is there so little capitalism in the world?

Mises easily avoids the paradox, since he does not assume that people act rationally to secure their economic interests. But this raises a further question. The case for free enterprise advanced by Mises seems in its essence easy to grasp. Why then have people failed to see it?

Mises placed primary blame for this on intellectuals who in his view taught false doctrine. In alliance with interests that sought to benefit by using the power of the state to their own advantage, these intellectuals either forced out entirely or drastically restricted the teaching of correct economics. This series of events, which began in Europe during the nineteenth and twentieth century, and continues to the present, not only explains the lack of popular demand for capitalism but also principally accounts for the rise of our century's extreme nationalism and militarism.

These opinions form the principal thesis of *Omnipotent Governments*,<sup>10</sup> Mises's discussion of German history from Bismarck to Hitler. As he sees it, the German "socialists of the chair," who dominated the major universities, prevented the free market views of Carl Menger and his disciples from receiving adequate consideration. Instead, these 'anti-economists' contended that economic laws varied from one historical period to another. The era of laissez-faire had passed: now the time of the powerful state had arrived.

Their views had very practical consequences. They enabled large cartels to gain a dominant position in the German economy through the use of the state's tariff system. Without the intellectuals' propaganda,

<sup>10</sup>Ludwig von Mises, *Omnipotent Government* (New Haven, Conn.: Yale University Press, 1944).

these tariff schemes could not have gained popular acceptance, since they resulted in higher prices at home.

Mises sees in this effort at control of the economy a principal cause of aggressive nationalism and militarism. The free market principle that exchange is to the mutual benefit of participants was abandoned: now the economic sphere was regarded as an arena in which one country's gain was another's loss.

Although he does not downplay the importance of nationalism, Mises regards it as largely explicable on economic grounds. The chauvinist effusions and military aggression common in Wilhelmine Germany and to an even greater extent in the Nazi era were not, in Mises's view, a return to pre-capitalist ethics in which military glory was considered the highest goal. (This was the thesis of Joseph Schumpeter's, *Imperialism and Social Classes*.) On the contrary, people deluded by false doctrine thought that military aggression would lead to economic growth and prosperity.

Mises applied his analysis of nationalism to the tangled situation of post-World War I Europe. In Czechoslovakia, Hungary, Romania, and elsewhere, ethnic minorities claimed that the dominant group was subjecting them to oppressive and discriminatory policies. Once more, Mises did not see conflicting nationalist passions as beyond explanation. Each group attempted to control the state in order to advance its own economic interests. If there were a complete free market, nationalist feelings would no longer assume these harmful forms. A non-interventionist state would not find itself the object of constant ethnic conflict. Since the state would play no role in promoting the economic interests of some at the expense of others, there would be no strong desire to have it manned by the members of one's own ethnic group.<sup>11</sup>

Mises's view of nationalism, whether right or wrong, is provocative and worthy of much more attention from historians than it has so far received. Like his criticism of speculative philosophy of history, it is the product of a thinker of surpassing originality and power.

<sup>11</sup>Mises's views on nationalism are discussed in greatest detail in *Nation, State, and Economy* (New York: New York University Press, 1983); and *The Free and Prosperous Commonwealth* (Princeton, N. J.: D. Van Nostrand, 1962).

## 5

# *On Praxeology and the Praxeological Foundations of Epistemology and Ethics*

Hans-Hermann Hoppe

### I

**A**s have most great and innovative economists, Mises intensively and repeatedly analyzed the problem of the logical status of economic propositions, i.e., how we come to know them and how we validate them. Indeed, Mises ranks foremost among those who hold that such a concern is indispensable in order to achieve systematic progress in economics. For any misconception regarding the answer to such fundamental questions of one's intellectual enterprise would have to lead to intellectual disaster, i.e., to false economic doctrines. Accordingly, three of Mises's books are devoted entirely to clarifying the logical foundations of economics: His early *Epistemological Problems of Economics*, published in German in 1933; his *Theory and History* of 1957; and his *Ultimate Foundations of Economic Science* of 1962, Mises's last book, appearing when he was already well past his eightieth birthday. And his works in the field of economics proper also invariably display the importance which Mises attached to the analysis of epistemological problems. Most characteristically, *Human Action*, his masterpiece, deals in its first hundred odd pages exclusively with such problems, and the other nearly 800 pages of the book are permeated with epistemological considerations.

Quite in line with the tradition of Mises, then, the foundations

of economics are also the subject of this paper. I have set myself a two-fold goal. First, I want to explain the solution which Mises advances regarding the problem of the ultimate foundation of economic science, i.e., his idea of a pure theory of action, or "praxeology," as he himself terms it. And second, I want to demonstrate why Mises's solution is much more than just an incontestable insight into the nature of economics and economic propositions.

It provides an insight that also enables us to understand the foundation on which epistemology and ethics ultimately rest. In fact, as my title here suggests, I want to show that it is praxeology which must be regarded as the very foundation of epistemology and ethics, and hence that Mises, aside from his great achievements as an economist, also contributed invaluable insights regarding the justification of the entire enterprise of rationalist philosophy.<sup>1</sup>

## II

Let me turn to Mises's solution. What is the logical status of typical economic propositions such as the law of marginal utility (that whenever the supply of a good whose units are regarded as of equal serviceability by a person increases by one additional unit, the value attached to this unit must decrease as it can only be employed as a means for the attainment of a goal that is considered less valuable than the least valuable goal previously satisfied by a unit of this good); or of the quantity theory of money (that whenever the quantity of money is increased while the demand for money to be held in cash reserve on hand is unchanged, the purchasing power of money will fall)?

In formulating his answer, Mises faced a double challenge. On the

<sup>1</sup>On all of the following see also Hans-Hermann Hoppe, *Kritik der kausalwissenschaftlichen Sozialforschung. Untersuchungen zur Grundlegung von Soziologie und Ökonomie* (Opladen, 1983); idem, "Is Research Based on Causal Scientific Principles Possible in the Social Sciences?" *Ratio* 25 (1983); idem, *Praxeology and Economic Science* (Auburn, Ala.: The Ludwig von Mises Institute, 1988); idem, "In Defense of Extreme Rationalism," *Review of Austrian Economics* 3 (1988): 179–214.

one hand, there was the answer offered by modern empiricism. The Vienna Ludwig von Mises knew was in fact one of the early centers of the empiricist movement: a movement which was then on the verge of establishing itself as the dominant academic philosophy of the Western world for several decades, and which to this very day shapes the image that an overwhelming majority of economists have of their own discipline.<sup>2</sup>

Empiricism considers nature and the natural sciences as its model. According to empiricism, the just mentioned examples of economic propositions have the same logical status as laws of nature: Like laws of nature they state hypothetical relationships between two or more events, essentially in the form of if-then statements. And like hypotheses of the natural sciences, the propositions of economics require continual testing vis-à-vis experience. A proposition regarding the relationship between economic events can never be validated once and for all with certainty. Instead, it is forever subject to the outcome of contingent, future experiences. Such experience might confirm the hypothesis. But this would not prove the hypothesis to be true, since the economic proposition would have used general terms (in philosophical terminology: universals) in its description of the related events, and thus would apply to an indefinite number of cases or instances, thereby always leaving room for possibly falsifying future experiences. All a confirmation would prove is that the hypothesis had not yet turned out wrong. On the other hand, the experience might falsify the hypothesis. This would surely prove that something was

<sup>2</sup>On the Vienna Circle see V. Kraft, *Der Wiener Kreis* (Vienna, 1950); for empiricist-positivist interpretations of economics see such representative works as T. W. Hutchison, *The Significance and Basic Postulates of Economic Theory* (London: Macmillan, 1938); Hutchison, an adherent of the Popperian variant of empiricism, has since become much less enthusiastic about the prospects of a Popperized economics, see, for instance, his *Knowledge and Ignorance in Economics* (Chicago: University of Chicago Press, 1977); yet he still sees no alternative but to cling to Popper's falsificationism anyway. Milton Friedman, "The Methodology of Positive Economics," in *Essays in Positive Economics* (Chicago: Chicago University Press, 1953); Mark Blaug, *The Methodology of Economics* (Cambridge: Cambridge University Press, 1980); a positivist account by a participant in Mises's *privatseminar* in Vienna is F. Kaufmann, *Methodology of the Social Sciences* (Atlantic Highlands, N. J.: Humanities Press, 1944); the dominance of empiricism in economics is documented by the fact that there is probably not a single economics textbook which does not explicitly classify economics as—what else?—an empirical (*aposteriori*) science.

wrong with the hypothesis as it stood. But it would not prove that the hypothesized relationship between the specified events could never be observed. It would merely show that considering and controlling in one's observations only what up to now had been actually accounted for and controlled, the relationship had not yet shown up. It cannot be ruled out, however, that it might show up as soon as some other circumstances have been controlled.

The attitude that this philosophy fuels and that has indeed become characteristic of most contemporary economists and their way of conducting their business is one of skepticism: the motto being "nothing can be known with certainty to be impossible in the realm of economic phenomena." Even more precisely, since empiricism conceives of economic phenomena as objective data, extending in space and subject to quantifiable measurement—in strict analogy to the phenomena of the natural sciences—the peculiar skepticism of the empiricist economist may be described as that of a social engineer who will not guarantee anything.<sup>3</sup>

The other challenge came from the side of the historicist school. Indeed, during Mises's life in Austria and Switzerland, the historicist philosophy was the prevailing ideology of the German speaking universities and their establishment. With the upsurge of empiricism this former prominence has been reduced considerably. But over roughly the last decade historicism has again gained momentum among the Western world's academia. Today it is with us everywhere under the names of hermeneutics, rhetoric, deconstructivism, and epistemological anarchism.<sup>4</sup>

For historicism, and most conspicuously for its contemporary

<sup>3</sup>On the relativistic consequences of empiricist skepticism see in addition to the literature cited in note 1 also Hans-Hermann Hoppe, "The Intellectual Cover for Socialism," *Free Market* (The Ludwig von Mises Institute, February, 1988).

<sup>4</sup>See Ludwig von Mises, *The Historical Setting of the Austrian School of Economics* (Auburn, Ala.: The Ludwig von Mises Institute, 1984); idem, *Erinnerungen* (Stuttgart, 1978); idem, *Theory and History* (Auburn, Ala.: The Ludwig von Mises Institute, 1985), chap. 10; for a critical survey of historicist ideas, see also Karl R. Popper, *The Poverty of Historicism* (London: Routledge & Kegan Paul, 1957); for a representative of the older version of a historicist interpretation of economics see W. Sombart, *Die drei Nationalökonomien* (Munich, 1930); for the modern, hermeneutical twist Donald N. McCloskey, *The Rhetoric of Economics* (Madison, Wis.: University of Wisconsin Press,

versions, the model is not nature but a literary text. Economic phenomena, according to the historicist doctrine, are not objective magnitudes that can be measured. Instead, they are subjective expressions and interpretations unfolding in history to be understood and interpreted by the economist just as a literary text unfolds before and is interpreted by its reader. As subjective creations, the sequence of their events follows no objective law. Nothing in the literary text, and nothing in the sequence of historical expressions and interpretations is governed by constant relations. Of course, certain literary texts actually exist, and so do certain sequences of historical events. But this by no means implies that anything had to happen in the order it did. It simply occurred. In the same way, however, as one can always invent different literary stories, history and the sequence of historical events, too, might have happened in an entirely different way. Moreover, according to historicism, and particularly visible in its modern hermeneutical version, the formation of these always contingently related human expressions and their interpretations are also not constrained by any objective law. In literary production anything can be expressed or interpreted concerning everything; and, along the same line, historical and economic events are whatever someone expresses or interprets them to be, and their description by the historian and economist is then whatever he expresses or interprets these past subjective events to have been.

The attitude that historicist philosophy generates is one of relativism. Its motto is “everything is possible.” Unconstrained by any objective law, for the historicist-hermeneutician history and economics, along with literary criticism, are matters of esthetics. And accordingly, his output takes on the form of disquisitions on what someone feels about what he feels was felt by somebody else—a literary form which we are only too familiar with, in particular in such fields as sociology and political science.<sup>5</sup>

I trust that one senses intuitively that something is seriously

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1985); Ludwig Lachmann, “From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society,” *Journal of Economic Literature* 54 (1976).

<sup>5</sup>On the extreme relativism of historicism-hermeneutics see Hoppe, “In Defense of Extreme Rationalism”; Murray N. Rothbard, “The Hermeneutical Invasion of Philosophy

amiss in both the empiricist as well as the historicist philosophies. Their epistemological accounts do not even seem to fit their own self-chosen models: nature on the one hand and literary texts on the other. And in any case, regarding economic propositions such as the law of marginal utility or the quantity theory of money their accounts seem to be simply wrong. The law of marginal utility certainly does not strike one as a hypothetical law subject forever for its validation to confirming or disconfirming experiences popping up here or there. And to conceive of the phenomena talked about in the law as quantifiable magnitudes seems to be nothing but ridiculous. Nor does the historicist interpretation seem to be any better. To think that the relationship between the events referred to in the quantity theory of money can be undone if one only wished to do so seems absurd. And the idea appears no less absurd that concepts such as money, demand for money, and purchasing power are formed without any objective constraints and refer merely to whimsical subjective creations. Instead, contrary to the empiricist doctrine, both examples of economic propositions appear to be logically true and to refer to events which are subjective in nature. And contrary to historicism, it would seem that what they state, then, could not possibly be undone in all of history and would contain conceptual distinctions which, while referring to subjective events, were nonetheless objectively constrained, and would incorporate universally valid knowledge.

Like most of the better known economists before him Mises shares these intuitions.<sup>6</sup> Yet in quest of the foundation of economics, Mises goes beyond intuition. He takes on the challenge posed by empiricism

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and Economics," *Review of Austrian Economics* 3 (1988); Henry Veatch, "Deconstruction in Philosophy: Has Rorty Made it the Denouement of Contemporary Analytical Philosophy?", *Review of Metaphysics* 39 (1985); Jonathan Barnes, "A Kind of Integrity," *Austrian Economics Newsletter* (Summer, 1987); David Gordon, *Hermeneutics vs. Austrian Economics* (Auburn, Ala.: The Ludwig von Mises Institute, 1987); for a brilliant critique of contemporary sociology see St. Andreski, *Social Sciences as Sorcery* (New York: St. Martin's Press, 1972).

<sup>6</sup>Regarding the epistemological views of such predecessors as John-Baptist Say, N. W. Senior, J. E. Cairnes, John Stuart Mill, Carl Menger, and Friedrich Wieser see Ludwig von Mises, *Epistemological Problems of Economics* (New York: New York University Press, 1981), pp. 17–23; Murray N. Rothbard, "Praxeology: The Methodology of Austrian Economics," in Edwin Dolan, ed., *The Foundations of Modern Austrian Economics* (Kansas City, Kans.: Sheed and Ward, 1976).



and historicism in order to reconstruct systematically the basis on which these intuitions can be understood as correct and justified. He thereby does not want to help bring about a new discipline of economics. But in explaining what formerly had only been grasped intuitively, Mises goes far beyond what had ever been done before. In reconstructing the rational foundations of the economists' intuitions, he assures us of the proper path for any future development in economics and safeguards us against systematic intellectual error.

Empiricism and historicism, Mises notes at the outset of his reconstruction, are self-contradictory doctrines.<sup>7</sup> The empiricist notion that all events, natural or economic, are only hypothetically related is contradicted by the message of this very basic empiricist proposition itself: For if this proposition were regarded as itself being merely hypothetically true, i.e., a hypothetically true proposition regarding hypothetically true propositions, it would not even qualify as an epistemological pronouncement. For it would then provide no justification whatsoever for the claim that economic propositions are not, and cannot be, categorically, or a priori true, as our intuition informs us they are. If, however, the basic empiricist premise were assumed to be categorically true itself, i.e., if we assume that one could say something a priori true about the way events are related, then this would belie its very own thesis that empirical knowledge must invariably be hypothetical knowledge, thus making room for a discipline such as economics claiming to produce a priori valid empirical knowledge. Further, the empiricist thesis that economic phenomena must be conceived of as observable and measurable magnitudes—analogueous to those of the natural sciences—is rendered inconclusive, too, on its own account: For, obviously, empiricism wants to provide us with meaningful empirical knowledge when it

<sup>7</sup>In addition to Mises's works cited at the outset of this paper and the literature mentioned in note 1, see Murray N. Rothbard, *Individualism and the Philosophy of the Social Sciences* (San Francisco: Cato Institute, 1979); for a splendid philosophical critique of empiricist economics see Martin Hollis and Edward J. Nell, *Rational Economic Man* (Cambridge: Cambridge University Press, 1975); as particularly valuable general defenses of rationalism as against empiricism and relativism—without reference to economics, however,—see Brand Blanshard, *Reason and Analysis* (LaSalle, Ill.: Open Court, 1964); F. Kambartel, *Erfahrung und Struktur. Bausteine zu einer Kritik des Empirismus und Formalismus* (Frankfurt/M., 1968).

informs us that our economic concepts are grounded in observations. And yet, the concepts of observation and measurement themselves, which empiricism must employ in claiming what it does, are both obviously not derived from observational experience in the sense that concepts such as hens and eggs or apples and pears are. One cannot observe someone making an observation or measurement. Rather, one must first understand what observations and measurements are in order to then be able to interpret certain observable phenomena as the making of an observation or the taking of a measurement. Thus, contrary to its own doctrine, empiricism is compelled to admit that there is empirical knowledge which is based on understanding—just as according to our intuitions economic propositions claim to be based on understanding—rather than on observations.<sup>8</sup>

And regarding historicism, its self-contradictions are no less manifest. For if, as historicism claims, historical and economic events—which it conceives of as sequences of subjectively understood rather than observed events—are not governed by any constant, time-invariant relations, then this very proposition also cannot claim to say anything constantly true about history and economics. Instead, it would be a proposition with, so to speak, a fleeting truth value: it may be true now, if we wish it so, yet possibly false a moment later, in case we do not, with no one ever knowing anything about whether we do or do not. Yet, if this were the status of the basic historicist premise, it, too, would obviously not qualify as an epistemology. Historicism would not have given us any reason why we should believe any of it. If, however, the basic proposition of historicism were assumed to be invariantly true, then such a proposition about the constant nature of historical and economic phenomena would contradict its own doctrine denying any such constants. Furthermore, the historicist's—and even more so its modern heir, the hermeneutician's—claim that historical and economic events are mere subjective creations, unconstrained by any objective factors, is proven false by the very statement making it. For evidently, a historicist must assume this very statement to be

<sup>8</sup>For an elaborate defense of epistemological dualism see also K. O. Apel, *Transformation der Philosophie*, 2 vols. (Frankfurt/M., 1973); Jürgen Habermas, *Zur Logik der Sozialwissenschaften* (Frankfurt/M., 1970).

meaningful and true; he must presume to say something specific about something, rather than merely uttering meaningless sounds like abracadabra. Yet if this is the case, then, clearly, his statement must be assumed to be constrained by something outside the realm of arbitrary subjective creations. Of course, I can say what the historicist says in English, German or Chinese, or in any other language I wish, and in so far as historical and economic expressions and interpretations may well be regarded as mere subjective creations. But whatever I say in whatever language I choose must be assumed to be constrained by some underlying propositional meaning of my statement, which is the same for any language, and exists completely independent of whatever the peculiar linguistic form may be in which it is expressed. And contrary to historicist belief, the existence of such a constraint is not such that one could possibly dispose of it at will. Rather, it is objective in that we can understand it to be the logically necessary presupposition for saying anything meaningful at all, as opposed to merely producing meaningless sounds. The historicist could not claim to say anything if it were not for the fact that his expressions and interpretations are actually constrained by laws of logic as the very presupposition of meaningful statements as such.<sup>9</sup>

With such a refutation of empiricism and historicism, Mises notices, the claims of rationalist philosophy are successfully reestablished, and the case is made for the possibility of a priori true statements, as those of economics seem to be. Indeed, Mises explicitly regards his own epistemological investigations as the continuation of the work of western rationalist philosophy. With Leibniz and Kant he stands opposite the tradition of Locke and Hume.<sup>10</sup> He sides with Leibniz when he answers Locke's famous dictum "nothing is in the intellect that has not previously been in the senses" with his equally famous one "except the intellect itself." And he recognizes his task as a philosopher of economics as strictly analogous to that of Kant's as a philosopher of pure reason, i.e., of epistemology. Like Kant,

<sup>9</sup>See on this in particular Hoppe, "In Defense of Extreme Rationalism."

<sup>10</sup>See Ludwig von Mises, *The Ultimate Foundation of Economic Science* (Kansas City, Kans.: Sheed Andrews and McMeel, 1978), p. 12.

Mises wants to demonstrate the existence of true a priori synthetic propositions, or propositions whose truth values can be definitely established, even though in order to do so the means of formal logic are insufficient and observations are unnecessary.

My criticism of empiricism and historicism has proved the general rationalist claim. It has proved that we indeed do possess knowledge which is not derived from observation and yet is constrained by objective laws. In fact, our refutation of empiricism and historicism contains such a priori synthetic knowledge. Yet what about the constructive task of showing that the propositions of economics—such as the law of marginal utility and the quantity theory of money—qualify as this type of knowledge? In order to do so, Mises notices in accordance with the strictures traditionally formulated by rationalist philosophers, economic propositions must fulfill two requirements: First, it must be possible to demonstrate that they are not derived from observational evidence, for observational evidence can only reveal things as they happen to be; there is nothing in it that would indicate why things must be the way they are. Instead, economic propositions must be shown to be grounded in reflective cognition, in our understanding of ourselves as knowing subjects. And secondly, this reflective understanding must yield certain propositions as self-evident material axioms. Not in the sense that such axioms would have to be self-evident in a psychological sense, that is, that one would have to be immediately aware of them or that their truth depends on a psychological feeling of conviction. On the contrary, like Kant before him, Mises very much stresses the fact that it is usually much more painstaking to discover such axioms than it is to discover some observational truth such as that the leaves of trees are green or that I am 6 foot 2 inches tall.<sup>11</sup> Rather, what makes them self-evident material axioms is the fact that no one can deny their validity without self-contradiction, because in attempting to deny them one already presupposes their validity.

<sup>11</sup>See Immanuel Kant, *Kritik der reinen Vernunft*, in *Werke*, ed. W. Weischedel, vol. 2 (Wiesbaden, 1956), p. 45; Ludwig von Mises, *Human Action* (Chicago: Contemporary Books, 1966), p. 38.

Mises points out that both requirements are fulfilled by what he terms the axiom of action, i.e., the proposition that humans act, that they display intentional behavior.<sup>12</sup> Obviously, this axiom is not derived from observation—there are only bodily movements to be observed but no such thing as actions—but stems instead from reflective understanding. And this understanding is indeed of a self-evident proposition. For its truth cannot be denied, since the denial would itself have to be categorized as an action. But is this not just plain trivial? And what has economics got to do with this? Of course, it had previously been recognized that economic concepts such as prices, costs, production, money, credit, etc. had something to do with the fact that there were acting people. But that all of economics could be grounded in and reconstructed based on such a trivial proposition, and how, is certainly anything but clear. It is one of Mises's greatest achievements to have shown precisely this: that there are insights implied in this psychologically speaking trivial axiom of action that were not themselves psychologically self-evident as well; and that it is these insights which provide the foundation for the theorems of economics as true a priori synthetic propositions.

It is certainly not psychologically evident that with every action an actor pursues a goal; and that whatever the goal may be, the fact that it was pursued by an actor reveals that he must have placed a relatively higher value on it than on any other goal of action that he could think of at the start of his action. It is not evident that in order to achieve his most highly valued goal an actor must interfere or decide not to interfere—which, of course, is also an intentional interference—at an earlier point in time in order to produce a later result; nor is it obvious that such interferences invariably imply the employment of some scarce means—at least those of the actor's body, its standing room, and the time absorbed by the action. It is not self-evident that these means, then, must also have value for an actor—a value derived from that of the goal—because the actor

<sup>12</sup>On the following see in particular Mises, *Human Action*, chap. 4; Murray N. Rothbard, *Man, Economy, and State*, 2 vols. (Los Angeles: Nash Publishing, 1962), chap. 1.

must regard their employment as necessary in order to effectively achieve the goal; and that actions can only be performed sequentially, always involving a choice, i.e., taking up that one course of action which at some given time promises the most highly valued results to the actor and excluding at the same time the pursual of other, less highly valued goals. It is not automatically clear that as a consequence of having to choose and give preference to one goal over another—of not being able to realize all goals simultaneously—each and every action implies the incurrance of costs, i.e., forsaking the value attached to the most highly ranking alternative goal that cannot be realized or whose realization must be deferred, because the means necessary to attain it are bound up in the production of another, even more highly valued goal. And lastly, it is not evident that at its starting point every goal of action must be considered worth more to the actor than its cost and capable of yielding a profit, i.e., a result whose value is ranked higher than that of the foregone opportunity, and yet that every action is also invariably threatened by the possibility of a loss if an actor finds, in retrospect, that contrary to his expectations the actually achieved result in fact has a lower value than the relinquished alternative would have had.

All of these categories which we know to be the very heart of economics—values, ends, means, choice, preference, cost, profit and loss—are implied in the axiom of action. Like the axiom itself, they are not derived from observation. Rather, that one is able to interpret observations in terms of such categories requires that one already knows what it means to act. No one who is not an actor could ever understand them, as they are not “given,” ready to be observed, but observational experience is cast in these terms as it is construed by an actor. And while they and their interrelations were not obviously implied in the action axiom, once it has been made explicit that they are implied, and how, one no longer has any difficulty recognizing them as being a priori true in the same sense as the axiom itself is. For any attempt to disprove the validity of what Mises has reconstructed as implied in the very concept of action would have to be aimed at a goal, requiring means, excluding other courses of action, incurring costs, subjecting the actor to the

possibility of achieving or not achieving the desired goal and so leading to a profit or a loss. Thus, it is manifestly impossible to ever dispute or falsify the validity of Mises's insights. In fact, a situation in which the categories of action would cease to have a real existence could itself never be observed or spoken of, as making an observation or speaking, too, are actions.

All true economic propositions, and this is what praxeology is all about and what Mises's great insight consists of, can be deduced by means of formal logic from this incontestably true material knowledge regarding the meaning of action and its categories. More precisely, all true economic theorems consist of (a) an understanding of the meaning of action, (b) a situation or situational change—assumed to be given or identified as being given—and described in terms of action-categories, and (c) a logical deduction of the consequences—again in terms of such categories—which are to result for an actor from this situation or situational change. The law of marginal utility, for instance,<sup>13</sup> follows from our indisputable knowledge of the fact that every actor always prefers what satisfies him more over what satisfies him less, plus the assumption that he is faced with an increase in the supply of a good (a scarce mean) whose units he regards as of equal serviceability, by one additional unit. From this it follows with logical necessity that this additional unit can then only be employed as a means for the removal of an uneasiness that is deemed less urgent than the least valuable goal previously satisfied by a unit of such a good. Provided there is no flaw in the process of deduction, the conclusions which economic theorizing yields, no different in the case of any other economic proposition from the case of the law of marginal utility, must be valid a priori. Their validity ultimately goes back to nothing but the indisputable axiom of action. To think, as empiricism does, that these propositions require continual empirical testing for their validation is absurd, and a sign of outright intellectual confusion. And it is no less absurd and confused to believe, as historicism does, that economics has nothing to say about constant and invariable

<sup>13</sup>On the law of marginal utility see Mises, *Human Action*, pp. 119–27; Rothbard, *Man, Economy, and State*, pp. 268–71.

relations but merely deals with historically accidental events. To say so meaningfully is to prove such a statement wrong, as saying anything meaningful at all already presupposes acting and a knowledge of the meaning of the categories of action.

### III

This will suffice here as an explanation of Mises's answer regarding the quest for the foundations of economics. I shall now turn to my second goal: the explanation of why and how praxeology also provides the foundation for epistemology and ethics. As regards epistemology, Mises had been well aware of this and he was convinced of the great importance of this insight for rationalist philosophy. Yet Mises did not treat this matter in a systematic fashion. There are no more than a few brief remarks concerning this problem, interspersed throughout his massive body of writing.<sup>14</sup> And as regards ethics, there can be no doubt that Mises was not at all aware of the implications of praxeology—in fact, as a utilitarian, Mises denied the very possibility of a rational ethics.<sup>15</sup> Thus, in the following I must try to break new ground. However, I should hasten to add that my remarks on the praxeological foundations of epistemology and ethics here will have to remain on the

<sup>14</sup>Mises writes in the *Ultimate Foundation of Economic Science* (pp. 35–36) that “knowledge is a tool of action. Its function is to advise man how to proceed in his endeavors to remove uneasiness. . . . The category of action is the fundamental category of human knowledge. It implies all the categories of logic and the category of regularity and causality. It implies the category of time and that of value. . . . In acting, the mind of the individual sees itself as different from its environment, the external world, and tries to study this environment in order to influence the course of the events happening in it.” Or: “Both, a priori thinking and reasoning on the one hand and human action on the other, are manifestation of the mind. . . . Reason and action are congeneric and homogeneous, two aspects of the same phenomenon” (ibid., p. 42). Yet he leaves the matter more or less at this and concludes that “it is not within the scope of praxeology to investigate the relation of thinking and action” (Mises, *Human Action*, p. 25).

<sup>15</sup>On Mises's utilitarianism and his opposition against, in particular, natural rights doctrines see his *Liberalism* (New York: New York University Press, 1978); for a similar position see Henry Hazlitt, *The Foundations of Morality* (Los Angeles: Nash Publishing, 1964); as a critic of Mises's utilitarianism see Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, N.J.: Humanities Press, 1982), pp. 205–12; for a highly perceptive discussion of utilitarianism and its implied interventionism and statism see A. de Jasay, *The State* (New York: Basil Blackwell, 1985), pp. 88–103.



level of general considerations. Partly because concerning epistemology, as I am painfully aware, my own thinking on this matter has not yet led me much beyond such a level of understanding.<sup>16</sup> And concerning ethics, because in this case, where I believe I have reached a satisfactory solution to the problem, a much more detailed explanation has already been provided elsewhere.<sup>17</sup>

I shall begin my explanation by introducing a second a priori axiom and clarifying its relation to the axiom of action. Such an understanding is the key to solving our problem. The second axiom is the so-called “a priori of argumentation,” which states that humans are capable of argumentation and hence know the meaning of truth and validity.<sup>18</sup> As in the case of the action axiom, this knowledge is not derived from observation: there is only verbal behavior to be observed and prior reflective cognition is required in order to interpret such behavior as meaningful arguments. And the validity of the axiom, like that of the action axiom, is indisputable. It is impossible to deny that one can argue, as the very denial would itself be an argument. In fact, one could not even silently say to oneself “I cannot argue” without thereby contradicting oneself. One cannot argue that one cannot argue. Nor can one dispute knowing what it means to make a truth or validity claim without implicitly claiming the negation of this proposition to be true.

It is not difficult to detect that both a priori axioms—of action and argumentation—are intimately related. On the one hand, actions are more fundamental than argumentations with whose existence the idea of validity emerges, as argumentation is only a

<sup>16</sup>See the following by Hoppe, *Kritik der kausalwissenschaftlichen Sozialforschung. Untersuchungen zur Grundlegung von Soziologie und Ökonomie*; “Is Research Based on Causal Scientific Principles . . .?”; *Praxeology and Economic Science*; “In Defense of Extreme Rationalism.”

<sup>17</sup>See Hans-Hermann Hoppe, *Eigentum, Anarchie und Staat. Studien zur Theorie des Kapitalismus* (Opladen, 1986); idem, “From the Economics of Laissez Faire to the Ethics of Libertarianism,” in W. Block and L. Rockwell, Jr., eds., *Man, Economy, and Liberty: Essays in Honor of Murray N. Rothbard* (Auburn, Ala.: The Ludwig von Mises Institute, 1988); idem, “The Justice of Economic Efficiency,” *Austrian Economics Newsletter* (Spring 1988).

<sup>18</sup>On the a priori of argumentation see also K. O. Apel, *Transformation der Philosophie*, vol. 2.

subclass of action. On the other hand, to recognize what has just been recognized regarding action and argumentation and their relation to each other requires argumentation, and so, in this sense, argumentation must be considered more fundamental than action: without argumentation nothing could be said to be known about action. But then, as it is in argumentation that the insight is revealed that—while it might not be known to be so prior to any argumentation—in fact the possibility of argumentation presupposes action in that validity claims can only be explicitly discussed in the course of an argumentation if the individuals doing so already know what it means to act and to have knowledge implied in action—both, the meaning of action in general and argumentation in particular must be thought of as logically necessary interwoven strands of a priori knowledge.

What this insight into the interrelation between the a priori of action and the a priori of argumentation suggests is the following: Traditionally, the task of epistemology has been conceived of as that of formulating what can be known to be true a priori and also what can be known a priori not to be the subject of a priori knowledge. Recognizing, as we have just done, that knowledge claims are raised and decided upon in the course of argumentation and that this is undeniably so, one can now reconstruct the task of epistemology more precisely as that of formulating those propositions which are argumentatively indisputable in that their truth is already implied in the very fact of making one's argument and so cannot be denied argumentatively; and to delineate the range of such a priori knowledge from the realm of propositions whose validity cannot be established in this way but require additional, contingent information for their validation, or that cannot be validated at all and so are mere metaphysical statements in the pejorative sense of the term metaphysical.

Yet what is implied in the very fact of arguing? It is to this question that our insight into the inextricable interconnection between the a priori of argumentation and that of action provides an answer: On a very general level, it cannot be denied argumentatively that argumentation presupposes action and that arguments,

and the knowledge embodied in them, are those of actors. And more specifically, it cannot then be denied that knowledge itself is a category of action; that the structure of knowledge must be constrained by the peculiar function which knowledge fulfills within the framework of action categories; and that the existence of such structural constraints can never be disproved by any knowledge whatsoever.

It is in this sense that the insights contained in praxeology must be regarded as providing the foundations of epistemology. Knowledge is a category quite distinct from those that I have explained earlier—from ends and means. The ends which we strive to attain through our actions, and the means which we employ in order to do so, are both scarce values. The values attached to our goals are subject to consumption and are exterminated and destroyed in consumption and thus must forever be produced anew. And the means employed must be economized, too. Not so, however, with respect to knowledge—regardless of whether one considers it a means or an end in itself. Of course, the acquisition of knowledge requires scarce means—at least one's body and time. Yet once knowledge is acquired, it is no longer scarce. It can neither be consumed, nor are the services that it can render as a means subject to depletion. Once there, it is an inexhaustible resource and incorporates an everlasting value—provided that it is not simply forgotten.<sup>19</sup> Yet knowledge is not a free good in the same sense as air, under normal circumstances, it is a free good. Instead, it is a category of action. It is not only a mental ingredient of each and every action, quite unlike air, but more importantly, knowledge, and not air, is subject to validation, which is to say that it must prove to fulfill a positive function for an actor within the invariant constraints of the categorical framework of actions. It is the task of epistemology to clarify what these constraints are and what one can thus know about the structure of knowledge as such.

While such recognition of the praxeological constraints on the structure of knowledge might not immediately strike one as in itself of great significance, it does have some highly important implications.

<sup>19</sup>On this fundamental difference between economic, i.e., scarce means, and knowledge see Mises, *Human Action* pp. 128, 661.

For one thing, in light of this insight one recurring difficulty of rationalist philosophy finds its answer. It has been a common quarrel with rationalism in the Leibniz-Kant tradition that it seemed to imply some sort of idealism. Realizing that a priori true propositions could not possibly be derived from observations, rationalism answered the question how a priori knowledge could then be possible by adopting the model of an active mind, as opposed to the empiricist model of a passive, mirror-like mind in the tradition of Locke and Hume. According to rationalist philosophy, a priori true propositions had their foundation in the operation of principles of thinking which one could not possibly conceive of as operating otherwise; they were grounded in categories of an active mind. Now, as empiricists were only too eager to point out, the obvious critique of such a position is, that if this were indeed the case, it could not be explained why such mental categories should fit reality. Rather, one would be forced to accept the absurd idealistic assumption that reality would have to be conceived of as a creation of the mind, in order to claim that a priori knowledge could incorporate any information about the structure of reality. And clearly, such an assertion seemed to be justified when faced with programmatic statements of rationalist philosophers such as the following by Kant: "So far it has been assumed that our knowledge had to conform to reality," instead it should be assumed "that observational reality should conform to our mind."<sup>20</sup>

Recognizing knowledge as being structurally constrained by its role in the framework of action categories provides the solution to such a complaint. For as soon as this is realized, all idealistic suggestions of rationalist philosophy disappear, and an epistemology claiming that a priori true propositions exist becomes a realistic epistemology instead. Understood as constrained by action categories, the seemingly unbridgeable gulf between the mental on the one hand and the real, outside physical world on the other is

<sup>20</sup>Kant, *Kritik der reinen Vernunft*, p. 25. Whether or not such an interpretation of Kant's epistemology is indeed correct is, of course, a very different matter. Clarifying this problem is, however, of no concern here. For an activist or operative interpretation of Kantian philosophy see F. Kambartel, *Erfahrung und Struktur*, chap. 3; also Hans-Hermann Hoppe, *Handeln und Erkennen* (Bern, 1976).

bridged. So constrained, a priori knowledge must be as much a mental thing as a reflection of the structure of reality, since it is only through actions that the mind comes into contact with reality, so to speak. Acting is a cognitively guided adjustment of a physical body in physical reality. And thus, there can be no doubt that a priori knowledge, conceived of as an insight into the structural constraints imposed on knowledge qua knowledge of actors, must indeed correspond to the nature of things. The realistic character of such knowledge would manifest itself not only in the fact that one could not think it to be otherwise, but in the fact that one could not undo its truth.

Yet there are more specific implications involved in recognizing the praxeological foundations of epistemology—apart from the general one that in substituting the model of the mind of an actor acting by means of a physical body for the traditional rationalist model of an active mind a priori knowledge immediately becomes realistic knowledge (so realistic indeed that it can be understood as being literally not undoable). More specifically, in light of this insight decisive support is given to those deplorably few rationalist philosophers who—against the empiricist *Zeitgeist*—stubbornly maintain on various philosophical fronts that a priori true propositions about the real world are possible.<sup>21</sup> Moreover, in light of the recognition of praxeological constraints on the structure of knowledge these various rationalist endeavors become systematically integrated into one, unified body of rationalist philosophy.

In explicitly understanding knowledge as displayed in argumentation as a particular category of action, it becomes clear immediately why the perennial rationalist claim that the laws of logic—beginning here with the most fundamental, i.e., of propositional logic and of

<sup>21</sup>See works mentioned in note 7, and Brand Blanshard, *The Nature of Thought* (London, 1964); M. Cohen, *Reason and Nature* (London, 1931); idem, *Preface to Logic* (New York: Meridian Books, 1944); A. Pap, *Semantics and Necessary Truth* (New Haven, Conn.: Yale University Press, 1958); S. Kripke, "Naming and Necessity," in D. Davidson and G. Harman, eds., *Semantics of Natural Language* (New York, 1972); H. Dingler, *Die Ergreifung des Wirklichen* (Munich, 1955); idem, *Aufbau der exakten Fundamentalwissenschaft* (Munich, 1964); W. Kamlah and P. Lorenzen, *Logische Propädeutik* (Mannheim, 1968); P. Lorenzen, *Methodisches Denken* (Frankfurt/M., 1968); idem, *Normative Logic and Ethics* (Mannheim, 1969); Apel, *Transformation der Philosophie*.

Junctors (“and,” “or,” “if-then,” “not”) and Quantors (“there is,” “all,” “some”)—are a priori true propositions about reality and not mere verbal stipulations regarding the transformation rules of arbitrarily chosen signs, as empiricist-formalists would have it. They are as much laws of thinking as of reality, because they are laws that have their ultimate foundation in action and could not be undone by any actor. In each and every action, an actor identifies some specific situation and categorizes it one way rather than another in order to be able to make a choice. It is this which ultimately explains the structure of even the most elementary propositions (like “Socrates is a man”) consisting of a proper name or some identifying expression for the naming or identifying of something, and a predicate to assert or deny some specific property of the named or identified object; and which explains the cornerstones of logic: the laws of identity and contradiction. And it is this universal feature of action and choosing which also explains our understanding of the categories “there is,” “all” and, by implication, “some,” as well as “and” “or,” “if-then” and “not.”<sup>22</sup> One can say, of course, that something can be “a” and “non-a” at the same time, or that “and” means this rather than something else. But one cannot *undo* the

<sup>22</sup>On rationalist interpretations of logic see Blanshard, *Reason and Analysis*, chaps. 6, 10; P. Lorenzen, *Einfuehrung in die operative Logik und Mathematik* (Frankfurt/M., 1970); K. Lorenz, *Elemente der Sprachkritik* (Frankfurt/M., 1970); idem, “Die dialogische Rechtfertigung der effektiven Logik,” in Kambartel and Mittelstrass, eds., *Zum normativen Fundament der Wissenschaft* (Frankfurt/M., 1973); on the propositional character of language and experience, in particular, see Kamlah and Lorenzen, *Logische Propaedeutik*, chap. 1; Lorenzen, *Normative Logic and Ethics*, chap. 1. “I call a usage a convention if I know of another usage which I could accept instead. . . . However I do not know of another behavior which could replace the use of elementary sentences. If I did not accept proper names and predicators, I would not know how to speak at all. . . . Each proper name is a convention, . . . but to use proper names at all is not a convention: it is a unique pattern of linguistic behavior. Therefore, I am going to call it ‘logical.’ The same is the case with predicators. Each predicator is a convention. This is shown by the existence of more than one natural language. But all languages use predicators” (ibid., p. 16); J. Mittelstrass, “Die Praedikation und die Wiederkehr des Gleichen,” *Ratio* 10 (1966); on the law of contradiction and identity, in particular, see Blanshard, *Reason and Analysis*, pp. 276ff, 423ff; on a critical evaluation of three or more-valued logics as either meaningless symbolic formalisms or as logically presupposing an understanding of the traditional two-valued logic see W. Stegmüller, *Hauptströmungen der Gegenwartsphilosophie*, vol. 2 (Stuttgart, 1975), pp. 182–91; Blanshard, *Reason and Analysis*, pp. 269–75 (Blanshard notes, for instance, regarding the many-valued or open-textured logic proposed by F. Waismann: “We can only agree with Dr. Waismann—and with Hegel—that the black-and-white distinctions of formal

law of contradiction; and one cannot undo the real definition of “and.” For simply by virtue of acting with a physical body in physical space we invariably affirm the law of contradiction and invariably display our true constructive knowledge of the meaning of “and” and “or.”

Similarly, the ultimate reason for arithmetic’s being an a priori and yet empirical discipline, as rationalists have always understood it, now also becomes discernible. The prevailing empiricist-formalist orthodoxy conceives of arithmetic as the manipulation of arbitrarily defined signs according to arbitrarily stipulated transformation rules, and thus as entirely void of any empirical meaning. For this view, which evidently makes arithmetic nothing but play, however skillful it might be, the successful applicability of arithmetic in physics is an intellectual embarrassment. Indeed, empiricist-formalists would have to explain away this fact as simply being a miraculous event. That it is no miracle, however, becomes apparent once the praxeological or—to use here the terminology of the most notable rationalist philosopher-mathematician Paul Lorenzen and his school—the operative or constructivist character of arithmetic is understood. Arithmetic and its character as an a priori-synthetic intellectual discipline is rooted in our understanding of repetition—the repetition of action. More precisely, it rests on our understanding the meaning of “do this—and do this again, starting from the present result.” And arithmetic then deals with real things: with constructed or constructively identified units of something. It demonstrates what relations are to hold between such units because of the fact that they are constructed according to the rule of repetition. As Paul Lorenzen has demonstrated in detail, not all of what presently poses as mathematics can be constructively founded—and those parts, then, should of course be

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logic are quite inadequate to living thought. But why should one say, as Dr. Waismann does, that in adopting a more differentiated logic one is adopting an alternative system which is incompatible with black-and-white logic? What he has actually done is to recognize a number of gradations *within* the older meaning of the word ‘not.’ We do not doubt that such gradations are there, and indeed as many more as he cares to distinguish. But a refinement of the older logic is not an abandonment of it. It is still true that the colour I saw yesterday was either a determinate shade of yellow or not, even though the ‘not’ may cover a multitude of approximations, and even though I shall never know which was the shade I saw” (*ibid.*, pp. 273–74).

recognized for what they are: epistemologically worthless symbolic games. But all of the mathematical tools that are actually employed in physics, i.e., the tools of classical analysis, can be constructively derived. They are not empirically void symbolisms, but true propositions about reality. They apply to everything insofar as it consists of one or more distinct units, and insofar as these units are constructed or identified as units by a procedure of "do it again, construct or identify another unit by repeating the previous operation."<sup>23</sup> Again, one can say, of course, that 2 plus 2 is sometimes 4 but sometimes 2 or 5 units, and in observational reality, for lions plus lambs or for rabbits, this may even be true,<sup>24</sup> but in the reality of action, in identifying or constructing those units in repetitive operations, the truth that 2 plus 2 is never anything but 4 could not possibly be undone.

Further, the old rationalist claims that geometry, that is, Euclidean geometry is a priori and yet incorporates empirical knowledge about space becomes supported, too, in view of our insight into the praxeological constraints on knowledge. Since the discovery of non-Euclidean geometries and in particular since Einstein's relativistic

<sup>23</sup>On a rationalist interpretation of arithmetic see Blanshard, *Reason and Analysis*, pp. 427–31; on the constructivist foundation of arithmetic, in particular, see Lorenzen, *Einfuehrung in die operative Logik und Mathematik*; idem, *Methodisches Denken*, chap. 6, 7; idem, *Normative Logic and Ethics*, chap. 4; on the constructivist foundation of classical analysis P. Lorenzen, *Differential und Integral—Eine konstruktive Einfuehrung in die klassische Analysis* (Frankfurt/M.: 1965); for a brilliant general critique of mathematical formalism see F. Kambartel, *Erfahrung und Struktur*, chap. 6, esp. pp. 236–42; on the irrelevance of the famous Goedel-theorem for a constructively founded arithmetic see P. Lorenzen, *Metamathematik* (Mannheim, 1962); also C. Thiel, "Das Begrueendungsproblem der Mathematik und die Philosophie," in Kambartel and Mittelstrass, eds., *Zum normativen Fundament der Wissenschaft*, esp. pp. 99–101. (K. Goedel's proof—which, as a proof incidentally supports rather than undermines the rationalist claim of the possibility of a priori knowledge—only demonstrates that the early formalist Hilbert program cannot be successfully carried through, because in order to demonstrate the consistency of certain axiomatic theories one must have a metatheory with even stronger means than those formalized in the object theory itself. Interestingly enough, the difficulties of the formalist program had led the old Hilbert already several years before Goedel's proof of 1931 to recognize the necessity of reintroducing a substantive interpretation of mathematics à la Kant, which would give its axioms a foundation and justification that was entirely independent of any formal consistency proofs. See F. Kambartel, *Erfahrung und Struktur*, pp. 185–87.)

<sup>24</sup>Examples of this kind are used by Karl R. Popper, see *Conjectures and Refutations* (London: Routledge & Kegan Paul, 1969), p. 211 in order to "refute" the rationalist idea of rules of arithmetic being laws of reality.



theory of gravitation, the prevailing position regarding geometry is once again empiricist and formalist. It conceives of geometry as either being part of empirical, a posteriori physics, or as being empirically meaningless formalisms. Yet that geometry is either mere play, or forever subject to empirical testing seems to be irreconcilable with the fact that Euclidean geometry is the foundation of engineering and construction, and that nobody there ever thinks of such propositions as only hypothetically true.<sup>25</sup> Recognizing knowledge as praxeologically constrained explains why the empiricist-formalist view is incorrect and why the empirical success of Euclidean geometry is no mere accident. Spatial knowledge is also included in the meaning of action. Action is the employment of a physical body in space. Without acting there could be no knowledge of spatial relations, and no measurement. Measuring is relating something to a standard. Without standards, there is no measurement; and there is no measurement, then, which could ever falsify the standard. Evidently, the ultimate standard must be provided by the norms underlying the construction of bodily movements in space and the construction of measurement instruments by means of one's body and in accordance with the principles of spatial constructions embodied in it. Euclidean geometry, as again Paul Lorenzen in particular has explained, is no more and no less than the reconstruction of the ideal norms underlying our construction of such homogeneous basic forms as points, lines, planes and distances, which are in a more or less perfect but always perfectible way incorporated or realized in even our most primitive instruments of spatial measurements such as a measuring rod. Naturally, these norms and normative implications cannot be falsified by the result of any empirical measurement. On the contrary, their cognitive validity is substantiated by the fact that it is they which make physical measurements in space possible. Any actual measurement must already presuppose the validity of the norms leading to the construction of one's measurement standards. It is in this sense that geometry is an *a priori* science; and that it must simultaneously be regarded as an empirically meaningful discipline, be-

<sup>25</sup>See Mises, *The Ultimate Foundation of Economic Science*, pp. 12–14.

cause it is not only the very precondition for any empirical spatial description, it is also the precondition for any active orientation in space.<sup>26</sup>

In view of the recognition of the praxeological character of knowledge, these insights regarding the nature of logic, arithmetic and geometry become integrated and embedded into a system of epistemological dualism.<sup>27</sup> The ultimate justification for this dualist position, i.e., the claim that there are two realms of intellectual inquiry that can be understood a priori as requiring categorically distinct methods of treatment and analysis, also lies in the praxeological nature of knowledge. It explains why we must differentiate between a realm of objects which is categorized causally and a realm that is categorized teleologically instead.

I have already briefly indicated during my discussion of praxeology that *causality* is a category of action. The idea of causality—that there are constant, time-invariantly operating causes which allow one to project past observations regarding the relation of events into the future is something (as empiricism since Hume has noticed) which has no observational basis whatsoever. One cannot observe the connecting link between observations. Even if one could, such an obser-

<sup>26</sup>On the aprioristic character of Euclidean geometry see Lorenzen, *Methodisches Denken*, chaps. 8, 9; idem, *Normative Logic and Ethics*, chap. 5; H. Dingler, *Die Grundlagen der Geometrie* (Stuttgart, 1933); on Euclidean geometry as a necessary presupposition of objective, i.e., intersubjectively communicable measurements and in particular of any empirical verification of non-Euclidean geometries (after all, the lenses of the telescopes which one uses to confirm Einstein's theory regarding the non-Euclidean structure of physical space must themselves be constructed according to Euclidean principles) see Kambartel, *Erfahrung und Struktur*, pp. 132–33; P. Janich, *Die Protophysik der Zeit* (Mannheim, 1969), pp. 45–50; idem, "Eindeutigkeit, Konsistenz und methodische Ordnung," in Kambartel and Mittelstrass eds., *Zum normativen Fundament der Wissenschaft*. Following the lead of H. Dingler, P. Lorenzen and other members of the so-called Erlangen school have worked out a system of protophysics which contains all aprioristic presuppositions of empirical physics, including, apart from geometry, also chronometry and hylometry (i.e., classical mechanics without gravitation, or "rational" mechanics). "Geometry, chronometry and hylometry are a-priori theories which make empirical measurements of space, time and materia 'possible.' They have to be established before physics in the modern sense of an empirical science, with hypothetical fields of forces, can begin. Therefore, I should like to call these disciplines by a common name: protophysics" (Lorenzen, *Normative Logic and Ethics*, p. 60).

<sup>27</sup>On the fundamental nature of epistemological dualism see Mises, *Theory and History*, pp. 1–2.

vation would not prove it to be a time-invariant connection. Instead, the principle of causality must be understood as implied in our understanding of action as an interference with the observational world, made with the intent of diverting the “natural” course of events in order to produce a different, preferred state of affairs, i.e., of making things happen that otherwise would not happen—and thus presupposes the notion of events which are related to each other through time-invariantly operating causes. An actor might err with respect to his particular assumptions about which earlier interference produced which later result. But successful or not, any action, changed or unchanged in light of its previous success or failure, presupposes that there are constantly connected events *as such*, even if no particular cause for any particular event can ever be preknown to any actor. Without such an assumption it would be impossible to ever categorize two or more observational experiences as falsifying or confirming each other rather than interpreting them as logically incommensurable events. Only because the existence of time-invariantly operating causes as such is already assumed can one ever encounter particular instances of confirming or disconfirming observational evidence, or can there ever be an actor who can learn anything from past experience by classifying his actions as successful and confirming some previous knowledge, or unsuccessful and disconfirming it. It is simply by virtue of acting and distinguishing between successes and failures that the a priori validity of the principle of causality is established; even if one tried, one could not successfully refute its validity.<sup>28</sup>

In so understanding causality as a necessary presupposition of

<sup>28</sup>On the aprioristic character of the category of causality see Mises, *Human Action*, chaps. 1, 5; Hoppe, *Kritik der kausalwissenschaftlichen Sozialforschung*; idem, “Is Research Based on Causal Scientific Principles . . .?”; on the causality principle as a necessary presupposition in particular also of the indeterminacy principle of quantum physics and the fundamental misconception involved in interpreting the Heisenberg-principle as invalidating the causality principle see Kambartel, *Erfahrung und Struktur*, pp. 138–40; also Hoppe, “In Defense of Extreme Rationalism,” p. 36n; Mises, *Theory and History*, pp. 87–89. In fact, it is precisely the indisputable praxeological fact that separate measurement acts can only be performed sequentially which explains the very possibility of irreducibly probabilistic—rather than deterministic—predictions as they are characteristic of quantum physics; and yet, in order to perform any experiment in the field of quantum mechanics, and in particular to repeat two or more experiments and state this to be the case, the validity of the causality principle must evidently already be presupposed.

action, it is also immediately implied that its range of applicability must then be delineated a priori from that of the category of teleology. Indeed, both categories are strictly exclusive and complementary. Action presupposes a causally structured observational reality, but the reality of action which we can understand as requiring such structure, is not itself causally structured. Instead, it is a reality that must be categorized teleologically, as purpose-directed, meaningful behavior. In fact, one can neither deny nor undo the view that there are two categorically different realms of phenomena, since such attempts would have to presuppose causally related events qua actions that take place within observational reality, as well as the existence of intentionally rather than causally related phenomena in order to interpret such observational events as meaning to deny something. Neither a causal, nor a teleological monism could be justified without running into an open contradiction: physically stating either position, and claiming to say something meaningful in so doing, the case is in fact made for an indisputable complementarity of both, a realm of causal *and* teleological phenomena.<sup>29</sup>

Everything which is not an action must necessarily be categorized causally. There is nothing to be known a priori about this range of phenomena except that it is structured causally—and that it is structured according to the categories of propositional logic, arithmetic and geometry.<sup>30</sup> Everything else there is to know about this range of phenomena must be derived from contingent observations and thus represents a posteriori knowledge. In particular, all knowledge about two or more specific observational events being causally related or not is a posteriori knowledge. Obviously, the range of phenomena described in this way coincides (more or less) with what is usually considered to be the field of the empirical natural sciences.

<sup>29</sup>On the necessary complementarity of the categories of causality and teleology see Mises, *Human Action*, p. 25; idem, *The Ultimate Foundation of Economic Science*, pp. 6–8; Hoppe, *Kritik der kausalwissenschaftlichen Sozialforschung*; idem, “Is Research Based on Causal Scientific Principles . . .?”; also G. Wright, *Norm and Action* (Ithaca, N.Y.: Cornell University Press, 1963); idem, *Explanation and Understanding* (Ithaca, N.Y.: Cornell University Press, 1971); K. O. Apel, *Die Erklären: Verstehen Kontroverse in transzendental-pragmatischer Sicht* (Frankfurt/M., 1979).

<sup>30</sup>More precisely still: it is structured according to the categories of logic, arithmetic and protophysics (including geometry).

In contrast, everything that is an action must be categorized teleologically. This realm of phenomena is constrained by the laws of logic and arithmetic, too. But it is not constrained by the laws of geometry as incorporated in our instruments of measuring spatially extending objects, because actions do not exist apart from subjective interpretations of observable things; and so they must be identified by reflective understanding rather than spatial measurements. Nor are actions causally connected events, but events that are connected meaningfully within a categorical framework of means and ends.

One *cannot* know a priori what the *specific* values, choices and costs of some actor are or will be. This would fall entirely into the province of empirical, a posteriori knowledge. In fact, which particular action an actor is going to undertake would depend on his knowledge regarding the observational reality and/or the reality of other actors' actions. And it would be manifestly impossible to conceive of such states of knowledge as predictable on the basis of time-invariantly operating causes. A knowing actor cannot predict his future knowledge before he has actually acquired it, and he demonstrates, simply by virtue of distinguishing between successful and unsuccessful predictions, that he must conceive of himself as capable of learning from unknown experiences in as yet unknown ways. Thus, knowledge regarding the particular course of actions is only a posteriori. And since such knowledge would have to include the actor's own knowledge—as a necessary ingredient of every action whose every change can have an influence on a particular action being chosen—teleological knowledge must also necessarily be reconstructive, or historical knowledge. It would only provide ex-post explanations which would have no systematic bearing on the prediction of future actions, because, in principle, future states of knowledge could never be predicted on the basis of constantly operating empirical causes. Obviously, such a delineation of a branch of a posteriori and reconstructive science of action fits the usual description of such disciplines as history and sociology.<sup>31</sup>

<sup>31</sup>On the logic of history and sociology as reconstructive disciplines see in addition to the works of Mises cited at the outset of this paper Hoppe, *Kritik der kausalwissenschaftlichen Sozialforschung*, chap 2; idem, "Is Research Based on Causal Scientific Principles . . .?"

What *is* known to be true a priori regarding the field of action, and what would then have to constrain any historical or sociological explanation is this: For one thing, any such explanation, which essentially would have to reconstruct an actor's knowledge, would invariably have to be a reconstruction in terms of knowledge of ends and means, of choices and costs, of profits and losses and so on. And secondly, since these are evidently the categories of praxeology as conceived of by Mises, any such explanation must also be constrained by the laws of praxeology. And since these laws are, as I have already explained, a priori laws, they must also operate as logical constraints on any future course of action. They are valid independent of any specific state of knowledge that an actor might have acquired, simply by virtue of the fact that whatever this state might be, it must be described in terms of action categories. And as referring to actions as such, the laws of praxeology must then be coextensive with all the predictive knowledge there can be in the field of the science of action. In fact, ignoring for the moment that the status of geometry as an a priori science was ultimately grounded in our understanding of action and in so far praxeology would have to be regarded as the more fundamental cognitive discipline, the peculiar role of praxeology proper within the entire system of epistemology can be understood as somewhat analogous to that of geometry. Praxeology is for the field of action what Euclidean geometry is for the field of observations (non-actions). As the geometry incorporated in our measuring instruments constrains the spatial structure of observational reality, so praxeology constrains the range of things that can possibly be experienced in the field of actions.<sup>32</sup>

In so establishing the place of praxeology proper, I have come full circle in outlining the system of rationalist philosophy as ultimately grounded in the action axiom—except for ethics. How is a rational, a priori ethic also implied in praxeology? In order to

<sup>32</sup>On the categorical distinctiveness of praxeological theory and history and sociology and the logical constraints that praxeology imposes on historical and sociological research and social and economic predictions see Mises, *Human Action*, pp. 51–59, 117–18; Hoppe, “In Defense of Extreme Rationalism”; idem, *Praxeology and Economic Science*.

recognize this, one need only go back to our previously explained insight into the nature of the connection between the a priori of action and the apriori of argumentation (if it were not for the bad connotations of the term, one might say: the insight into the “dialectic” nature of their relationship). Obviously, what we have done here all along—I in writing this paper and you in reading and internally analyzing my thoughts—is engage in argumentation. If it were not for argumentation there would be no such thing as a discipline of praxeology. Praxeology is a body of thought, too; and like all thoughts its validity claims would have to be made and decided upon nowhere else but in the course of an argumentation. This is the a priori of argumentation. On the other hand, it is by means of argumentation that we can come to understand that argumentation in fact presupposes action and that the categorical structure of action must then be understood as imposing an a priori constraint on the structure of all validity claiming arguments. This is the a priori of action.

Epistemology reconstructs these praxeological constraints on the structure of arguments. It explains what cannot argumentatively be denied, because in making one’s argument its validity already must have been presupposed. The epistemological status of logic, arithmetic, geometry etc. as a priori and yet empirical sciences has its explanation in the fact that the content, the semantic information of their respective arguments cannot be actually disputed without implicit self-contradiction. The epistemological status of ethics as an a priori valid system of norms has its explanation in the fact that argumentation as such, apart from whatever its content may be, presupposes the validity of certain norms; norms which no one could ever challenge argumentatively, because they would already have been accepted as valid simply because of the fact that one was engaging in argumentation as such.<sup>33</sup>

Arguing does not consist of free-floating sounds. It is an activity. Thus, the norms that any argumentation has to presuppose must

<sup>33</sup>See on the following my writings cited in note 17; also Apel, “Das Apriori der Kommunikationsgemeinschaft und die Grundlagen der Ethik,” in *Transformation der Philosophie*, vol. 2; J. Habermas, *Moralbewusstsein und kommunikatives Handeln* (Frankfurt/M., 1983).

be such that they acquire meaning in the means-ends framework of action and praxeology. They must be norms regarding the proper means and ends which an actor must choose if he wants to engage in any argumentation whatsoever. As I will show now, the normative foundation of argumentation as such is the recognition of the institution of private property as valid.<sup>34</sup>

Recognizing that argumentation is a form of action and requires an acting person implies recognizing the fact that any argumentation requires that a person have exclusive control over the scarce resource of his body. As long as there is argumentation, there is a mutual recognition of each individual's property right in his own body. It is this recognition of each other's exclusive control over his own body, presupposed by any argumentation, which explains the unique feature of verbal communication that, while one may disagree about what has been said, it is still possible to agree at least on the fact that there is such disagreement. In fact, such a property right in one's body must be said to be justified a priori: For anyone who would try to justify anything would already have to presuppose an exclusive right of control over his body as a valid norm simply in order to say "I propose such and such." And any person who would try to dispute the property right in his body would become caught in a contradiction. If he were right, he could not even open his mouth.

A second argument simply extends the idea of private property as a priori justified from the very prototype of a good, i.e., a person's body, to other goods. The argument consists of two steps. First, if no one had the right to control anything except his own body, then we would all cease to exist and the problem of justifying norms—as well as all other human problems—simply would not exist. We do not live on air alone, and hence, simply by virtue of the fact of being alive, property rights to other things must be presupposed to be valid, too. No one who is alive could argue otherwise. And second, only the Lockean idea of establishing property claims in goods by homesteading is a just principle of property acquisition. For if a

<sup>34</sup>On the justification of the ethics of private property see Rothbard, *The Ethics of Liberty*; idem, *For a New Liberty* (New York: Macmillan 1973).



person did not acquire the right of exclusive control over other goods by his own work, i.e., if other people who had not previously used such goods had the right to dispute the homesteader's ownership claim, then this would only be possible if one could acquire property titles not through labor, i.e., by establishing some objective link between a particular person and a particular scarce resource, but simply by means of verbal declaration. Yet this solution—apart from the obvious fact that it would not even qualify as a solution in a purely technical sense in that it would not provide a basis for deciding between *rivaling* declarative claims—is incompatible with the already justified ownership of a person over his body. For if one could indeed appropriate property by decree, this would imply that it would also be possible for one to simply declare another person's body to be one's own. Yet, as we have already seen, to say that property is acquired not through homesteading action but through declaration involves a practical contradiction: nobody could say and declare anything, unless his right to use his body was already assumed to be valid simply because of the fact that regardless of what he said, it was he, and nobody else, who had homesteaded it as his instrument of saying anything.<sup>35</sup>

<sup>35</sup>Two supplementary arguments may be required to explain why all other ethical proposals are argumentatively indefensible. (1) According to the private property ethic, property rights and, *mutatis mutandis*, aggression, are defined in objective, physical terms. A popular deviation from this is the idea of defining aggression as an invasion of the value of someone's property. Such a proposal is untenable: While every person can have control over whether or not his actions cause the physical integrity of something to change, control over whether or not one's actions affect the value of someone's property rests with other people and their evaluations. Thus, nobody could ever know—*ex ante*—whether or not his planned actions were allowed. Moreover, the idea that property value should be protected is argumentatively indefensible. For simply in order to argue anything it must be presupposed that actions must be allowed *prior* to any intersubjective agreement on values, because if they were not, one could not even argue so. Yet if one can, then this is evidently only possible because of borders of property rights which every person can recognize as such on his own, without having to agree first with anyone else with respect to one's system of values and evaluations. (2) The second popular deviation is this: Instead of recognizing the vital importance of the prior-later distinction in deciding between conflicting property claims, the claim is made that priority is irrelevant and that late-comers have rights to ownership just as first-comers. However, if this were so, then literally no one would be allowed to do anything with anything as one would have to have all of the late-comers' consent prior to ever doing what one wanted to do. Neither we, our forefathers, nor our progeny could, do or will survive if one were to follow this rule. Simply in order to survive and be able to argue anything, then, property rights cannot be conceived of as being timeless and non-specific

#### IV

I will have to conclude with this, let me repeat, very general description of the system of rationalist philosophy as grounded in praxeology.

It has been my goal here to reaffirm Mises's claim that economics is praxeology; that the case for praxeology is an indisputable one; and that empiricist or historicist-hermeneuticist interpretations of economics are self-contradictory doctrines. And it has been my objective to indicate that the Misesian insight into the nature of praxeology also provides the very foundation on which traditional rationalist philosophy can be successfully reconstructed, and systematically integrated.

For the rationalist philosopher this would seem to imply that he should take account of praxeology. For it is precisely the insight into the praxeological constraints on the structure of knowledge which provides the missing link in his intellectual defense against skepticism and relativism. For the economist in the tradition of Mises it means, I claim, that he should explicitly come to recognize his place within the wider tradition of western rationalism; and that he should learn to incorporate the insights provided by this tradition in order to construct an even more impressive and profound case for praxeology and Austrian economics than the one made by the great Mises himself.

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regarding the number of people concerned. Rather, they must necessarily be thought of as originating through acting at specific points in time for specific acting individuals. Otherwise, it would be impossible for anyone to first say anything at a definite point in time and for someone else to be able to reply. Simply saying, then, that the prior-later distinction can be ignored implies a contradiction, as one's being able to say so must presuppose one's existence as an independent decision-making unit at a given point in time.

## 6

# *The Pure Time-Preference Theory of Interest: An Attempt At Clarification*

Israel M. Kirzner

**F**or almost a century a particular theory of interest has been again and again discussed, refuted, defended, ignored, forgotten, and rediscovered; somehow it has managed to survive. This theory is the pure time-preference theory (often to be referred to in this paper as PTPT). For the most part this theory has, especially during the last half-century, languished as a basically discredited, definitely unfashionable, point of view. Yet the theory was never finally interred—nor did it even wholly expire. The theory is often described as Austrian, but, as we shall see, it is not the only and not the best known Austrian theory of interest. In recent decades a certain revival of discussion has emerged surrounding this pure time-preference theory (partly, no doubt, as a result of the modest revival of interest in Austrian economics generally). Almost invariably contemporary economists have reacted to renewed discussions of the pure time-preference theory with utter disbelief and plain bewilderment. These critics have found the theory simply incredible; the idea that the phenomenon of interest is in *no* way dependent upon physical productivity is one

This paper owes much to countless discussions with Ingo Pelligahr, over a two-year period. His open-minded but persistent questioning concerning troublesome aspects of PTPT helped (and compelled) the writer toward the present clarification. For Pelligahr's own perspective on the matters dealt with in this paper see references to Pelligahr.

that the critics find patently absurd; that serious thinkers should accept this absurdity, they find quite incomprehensible. The present paper does not seek to argue any superiority of PTPT over its competitors in the field of interest theories. Rather we seek to dispel the bewilderment that moderns display in regard to it. This task of clarification will turn out to involve certain “philosophical,” extra-economic, issues that are of significance for economists in their own right, in several respects.

### The Interest Problem

Much—perhaps all—will turn out to depend on the way in which the interest problem is formulated. For present purposes we adopt a modern formulation of the problem, but wish to emphasize that this formulation is very similar in spirit and character to classic formulations going back to Schumpeter<sup>1</sup> and Böhm-Bawerk.<sup>2</sup> The modern formulation we cite is that of Hausman.<sup>3</sup> Hausman points out that an “individual’s capital . . . enables that individual to earn interest. If the capital is invested in a machine, the sum of the rentals the machine earns over its lifetime is greater than the machine’s cost. Why?” Common observation, that is, tells us that possession of a given stock of capital funds can, by judicious investment (say, in a machine) yield a continuous flow of income (annual rentals net of depreciation) without impairing the ability of the capital funds to serve indefinitely as a source of income. The problem is, how this can occur. *Why is not the price of the machine (paid by the capitalist at the time he invests in the machine) bid up (by the competition of others eagerly seeking to capture the net surplus of rentals over cost)—to the point where no such surplus*

<sup>1</sup>Joseph A. Schumpeter, *The Theory of Economic Development* (Cambridge, Mass.: Harvard University Press, 1934.)

<sup>2</sup>Eugen von Böhm-Bawerk, *Capital and Interest* (1889; Sping Mills, Penn.: Libertarian Press, 1959). Contains translations of three volumes: vol. 1, originally published in 1884; vol. 2, originally published in 1889; vol. 3, originally published in 1921.

<sup>3</sup>Daniel M. Hausman, *Capital, Profits and Prices* (New York: Columbia University Press, 1981), p. 3.

*remains?* We are seeking, then, an explanation for an observed phenomenon which is, in the absence of a theory of interest, unable to be accounted for. Absent a theory of interest, no interest income ought to be forthcoming, except as a transient phenomenon; competition ought to squeeze it out of existence.

Neoclassical theory has, in a variety of versions, seen interest as obtained and paid in return for special productive services of one kind or another. J. B. Clark and F. H. Knight saw capital as providing a flow of productive services, of which interest is the irrepressible expression. Competition does not erode it; ownership of a stock of capital inevitably confers title to a corresponding income flow. (We do not discuss, in this paper, the extent to which this theory in fact addresses the interest problem as formulated above.) For “Austrian” versions<sup>4</sup> of the neoclassical explanation, again, ownership of capital expresses the provision of a special productive service (“waiting”) required in order to enjoy the enhanced fruits of more lengthy (“roundabout”) processes of production. Competition cannot erode interest income: it *has* to be offered if potential capitalists (with positive time-preference) are to be persuaded to provide the waiting (needed in order to be able to enjoy the enhanced output available through capital-using production). And, given the productivity of waiting, it *pays* to offer interest in order to elicit that waiting. In the celebrated “Cambridge Controversy” of some years back, this neoclassical view of interest was the *only* view advanced as an alternative to the neo-Ricardian perspective on interest as a surplus (to be explained, not by appeal to market exchange relations, but by “the relations between workers and capitalists including possibly their relative bargaining power.”)<sup>5</sup>

It will be useful for us to examine more carefully the above-cited “Austrian” variant of the productivity view (actually most carefully developed by Irving Fisher) in order to point up features of the

<sup>4</sup>As we shall see, there were two “Austrian” theories of interest, both deriving from Böhm-Bawerk, see F. A. Hayek, *The Pure Theory of Capital* (London: Routledge and Kegan Paul, 1941), app. 1. One of these, which (unlike Hayek) we identify with Fisher (and describe as neoclassical), is that discussed here in the text. The second is the PTPT, the subject of this paper.

<sup>5</sup>Hausman, *Capital, Profits and Prices*, p. 167.

alternative Austrian theory of interest, the pure time-preference theory. The pure time-preference theory (PTPT) was developed, largely from roots in Böhm-Bawerk, by Frank Fetter<sup>6</sup> in the United States, and later by Mises.<sup>7</sup> As Fetter pointed out, Böhm-Bawerk's own position appears in a number of ways to be an inconsistent one, demonstrating at some points the pure time-preference view, at other points the Fisherian physical productivity view. Let us note certain features of the Fisherian "productivity of waiting" theory.

We should note, first of all, that this theory is *not* necessarily vulnerable to the basic Böhm-Bawerkian criticism of all productivity-of-capital theories of interest. Böhm-Bawerk had criticized such theories of interest because they ignore the essential interest problem (as formulated above). It will not do to say that the machine yields interest (in the form of a flow of rentals that is greater than the cost of the machine) because the machine is physically productive. The interest problem consisted in asking why, given this physical productivity, did not the market value of the machine rise to reflect fully the rentals it is able to generate. Of course a tree produces fruit; the interest problem consists in the dilemma posed by the apparent failure of the market price of the tree to equal the value of the total fruit output. Simple theory tells us, after all, that the value of inputs and the value of outputs tend to equality in competitive markets.

The productivity-of-waiting theory of interest escapes this criticism by arguing that *besides* the machine, *besides* the tree, yet another "input" is required in order to command the flow of rentals (or fruit). This additional input is "waiting"; once the services of waiting are properly included in the list of needed inputs, the interest dilemma evaporates. Competition indeed squeezes out all surplus above marginal productivity returns. Interest *is*, in this view, the marginal productivity return on a scarce factor, viz., waiting.

<sup>6</sup>Frank A. Fetter, "The 'Roundabout Process' in the Interest Theory," *Quarterly Journal of Economics* 17 (November 1902); reprinted in *Capital, Interest, and Rent: Essays in the Theory of Distribution*, M. N. Rothbard, ed. (Kansas City, Kans.: Sheed Andrews and McMeel, 1977). Also, Fetter, "Capitalization versus Productivity: Rejoinder," *American Economic Review* (December 1914).

<sup>7</sup>Ludwig von Mises, *Human Action* (New Haven: Yale University Press, 1949).

The Fisherian “productivity-of-waiting” theory emphatically recognizes the significance of time-preference. It is the circumstance of positive time-preference that renders waiting a scarce, costly factor (to which interest can be attributed as a productivity return). But the interest income that might be considered the reward received by investors to induce them to provide waiting, is at the same time seen as *made possible only by the productivity of waiting*. (It is in this respect, particularly, that PTPT differs from the Fisher theory. For PTPT it is incorrect to see interest income as the “fruit” of anything. Rather PTPT sees interest income as a receipt that results from the pattern of prices governing inter-temporal exchanges, with these prices expressing the prevalently positive time-preferences of the participants.)

As a matter of logic, the Fisher productivity-of-waiting theory deals with the interest problem (as formulated above) in impeccable manner. The only way through which the validity of the productivity-of-waiting view (at least insofar as we have presented it thus far) can be challenged, is by disagreeing with the concept of “waiting” as a productive factor service. The critic may refuse to recognize that waiting (or “time”) is productive, or is regarded by prospective producers as a scarce factor. The fact that an inevitable time delay must be accepted before current efforts bear fruit, need not mean that time is a necessary *ingredient* in the production process; it may simply mean that this production process is a slow one, yielding a result less valuable (in terms of anticipated attractiveness) than an otherwise similar, more speedy process.

Clearly this question of whether to treat waiting as a productive ingredient must be recognized as a strictly “philosophical” question. No economic reasoning (and certainly no amount of empirical research) can reveal whether time is (or should be treated as) itself an active productive agent or only a medium permitting the flows of inputs to cumulate into the product.<sup>8</sup> Moreover it is conceivable that a given observer may be prepared to recognize time as an active

<sup>8</sup>On this see T. Haavelmo, *A Study in the Theory of Investment* (Chicago: University of Chicago Press, 1960), p. 47; Israel M. Kirzner, *An Essay on Capital* (New York: Augustus M. Kelley, 1966), p. 97.

productive agent in some processes of production (the maturing of wine, perhaps?) while refusing to recognize it as such in other time-consuming processes of production (as, perhaps, in considering the operation of an old-fashioned, slower machine as compared with that of a faster, more modern generation of machines). In any event the relevance of the “productivity-of-waiting” theory depends *entirely* on this “philosophical” question. (Part of the dilemma posed by Böhm-Bawerk’s own statement of the theory of interest was that on the one hand he explicitly refused to accept time or waiting as an independent factor to stand with labor and nature,<sup>9</sup> yet seemed on the other hand to attribute interest to the physical circumstance that roundabout processes of production are more productive. If time and waiting are not themselves to be considered productive agents, no interest could emerge as a result of the productivity of time-consuming processes of production (any more than interest can be ascribed to the fruitfulness of a tree).<sup>10</sup>

The basis on which the PTPT is dissatisfied with the Fisher (productivity-of-waiting) solution to the interest problem is thus strictly a non-economic “philosophic” one—viz., a view of time (and thus of waiting) that sees it (as Böhm-Bawerk himself apparently saw it) as a neutral background medium, rather than as a positive, active ingredient in productive processes. It is this philosophic perspective that underlies the pure time-preference theory to be discussed in this paper. Given this philosophic perspective, then, we note that the interest problem has, therefore, thus far not been touched in the slightest by any productivity-of-roundaboutness considerations.

## The Pure Time-Preference Theory of Interest

The alternative “Austrian” theory of interest that we wish to clarify in this paper, the PTPT, is that pursued consistently by the American Frank Fetter and by Ludwig von Mises. This theory solves the interest problem by appeal to widespread (possibly universal) positive time preference. If, in fact, people do prefer

<sup>9</sup>Böhm-Bawerk, *Capital and Interest*, pp. 97–98.

<sup>10</sup>Fetter, “The ‘Roundabout Process’ in the Interest Theory.”



(other aspects of the situation aside) to achieve their goals sooner rather than later, then the dilemma posed by the machine and its rentals, or by the tree and its fruit, dissolves. The price paid for a tree tends systematically to fall short of the sum of its annual fruit yields, because when the tree is bought, the yields are only prospective yields. One is simply not prepared to pay \$100 today in order to command \$100 worth of fruit in five or ten years time, no matter how ironclad the contract for the fruit delivery may be. The prospect of \$100 available in the future has less attractive power than does the prospect of \$100 available immediately. The PTPT argues that this solution of the interest problem is entirely sufficient to account for the interest phenomena we observe, in *all* their manifestations, in the simplest consumption loan context (in the pure-exchange economy), or in the most complex of financial-industrial situations. After all, production processes do take time, hence the present price of input services must, given positive time preference, systematically and repeatedly, fall short of the nominal value yielded in the future by their marginal productivity. A portion of currently emerging output must then regularly be retained each year by the capitalist who has, some time in the past, advanced the sums needed to pay for the input services whose output is now emerging. This retained interest income is not caused by, or made possible by the physical productivity of anything.

Such time preference considerations are able, then, to account completely for the phenomenon of interest. They are able, entirely without any appeal to productivity of roundaboutness, to answer the question formulated in the interest problem. On the other hand, as we have seen, the productivity of roundaboutness offered no solution at all to that problem (for those not recognizing waiting or time as a productive agent). Hence, in the view of its protagonists, this "pure" time-preference theory<sup>11</sup> is entirely adequate for

<sup>11</sup>See Ingo Pelligahr, "Austrians Versus Austrians I: A Subjectivist View of Interest," M. Faber, ed. *Studies in Austrian Capital Theory, Investment and Time* (Berlin, Heidelberg, and New York: Springer-Verlag, 1986), pp. 10–11 for several senses in which the adjective "pure" may be understood in the present context. Also, Pelligahr, "Austrians Versus Austrians II: Functionalist Versus Essentialist Theories of Interest," M. Faber, ed. *Studies in Austrian Capital Theory, Investment and Time* (Berlin, Heidelberg, and New York: Springer-Verlag, 1986).

its objective; *no productivity considerations can possibly enter at all into the explanation offered for interest.*

It is the latter contention that many theorists, from Böhm-Bawerk's time down to our own, have found simply incredible. These critics of PTPT find it unbelievable that the claim can be made that the market phenomenon of interest is never, in any way, under any circumstances, to be attributed to the productivity of capital or of roundaboutness, waiting, or time. It will be instructive to examine a recurring theme pursued by these critics in expressing their incredulity.

### Sheep, Rice, and Austrian Hocus-Pocus

These critics argue that simple hypothetical examples demonstrate that, at least under certain conditions, a positive rate of interest necessarily emerges, being strictly determined by physical productivity. These examples, the critics maintain, demonstrate that the old argument with which Böhm-Bawerk had demolished the simple productivity theories (viz., the argument that competition ought to drive the market price of the productive agent to the point where it no longer yields a value surplus) cannot entirely drive productivity considerations out of the interest-theoretic picture. Whether or not we can find a logical flaw in the Böhm-Bawerkian argument, the stylized "facts" of these examples prove the argument to be specious. Productivity considerations are clearly sufficient to account for interest. It cannot, therefore, be the case that the explanation of interest must run in *purely* time-preference terms. The examples used by these critics vary in their details. H. G. Brown talked of fruit trees,<sup>12</sup> Irving Fisher talked of sheep,<sup>13</sup> Knight talked of his Crusonia plant (an edible plant that grew at a fixed rate continuously)<sup>14</sup>; quite recently Samuelson constructed a

<sup>12</sup>H. G. Brown, "The Discount Versus the Cost-of-Production Theory of Capital Valuation," *American Economic Review* (June 1914).

<sup>13</sup>Irving Fisher, *The Theory of Interest* (New York: Macmillan, 1930), p. 193.

<sup>14</sup>Frank H. Knight, "Diminishing Returns from Investment," *Journal of Political Economy* (March 1944): 52.

rice example to drive home an essentially similar point. What these examples have in common is (1) that they postulate a given rate of physical productivity to the capital stock, a rate invariant to scale of production, or level of wealth; (2) that these examples *appear*, at least at first glance, to escape the impact of the traditional Böhm-Bawerkian argument (against productivity theories of interest) by confining the example to the context of a single good world (in which the critics believe value productivity measures must coincide with physical productivity rates).<sup>15</sup> Let us examine the most recent of these examples, Samuelson's rice case (which he raised in a discussion of a different doctrinal issue).

Samuelson's case was introduced in the course of a recent critical reconsideration of Schumpeter's zero-interest doctrine.<sup>16</sup> Schumpeter had argued (on the basis of reasoning reflecting Böhm-Bawerk's arguments against the productivity theories of interest) that in a world in circular-flow equilibrium, the rate of interest must be zero, with all output value decomposed into land, rent, and labor wages, with nothing left for any interest share. Samuelson objects that a *possible* technological case refutes the Schumpeterian argument. The case Samuelson identifies is that of 100 units of rice ripening into 110 units of rice during the period of one year, without the input of any labor or any scarce land. This case shows, Samuelson claims, that final value need *not* necessarily be wholly swept back through the market as factor payments to labor and land; apparently we have 10 units of rice ("real interest income") that can be attributed to no factor service—only to the productivity through time of the initial rice stock. Mere ownership of rice capital confers title to a possible perpetual flow of annual rice consumption income. This annual income is clearly interest earned by the rice capitalist. This income is accounted for entirely by the physical productivity of rice. Samuelson hastens to anticipate the obvious

<sup>15</sup>Brown was dismayed at having been thought by Fetter to have failed to recognize the problem of value productivity. He believed himself to have successfully avoided this pitfall by his example. See H. G. Brown, *Economic Science and the Common Welfare*, 3rd ed. (Columbia, Mo.: Lucas Brothers, 1926), p. 125, n. 13.

<sup>16</sup>P. A. Samuelson, "Schumpeter as an Economic Theorist," H. Frisch, ed. *Schumpeterian Economics* (New York: Praeger, 1981).

Schumpeterian response. Schumpeter had emphasized that, with interest zero, "the greater magnitude of the forest is *already* imputed back in value to the saplings." So that today's 100 units of rice already have the value of next year's 110 units: "these foreseen changes . . . only conserve the already calculated value of the process," without involving any creation of new value. But Samuelson hotly denounces this response as "pure deception. Real rice *is* being produced net. Kuznets can measure it. You can eat 10 [units of] rice every year and still not impair your circular flow income. . . . No hocus-pocus of backward imputation—of forest to sapling, or rice grain to rice grain—evades the naive fact of productive interest."<sup>17</sup>

It may be instructive to note how this kind of example *appears* to escape the Böhm-Bawerkian critique. Naive productivity theories explain the interest on the capital sum invested in a tree, by virtue of the tree's physical fecundity. Böhm-Bawerk's criticism pointed out that physical productivity does not necessarily mean value productivity. In value terms it is surely still possible, in principle, for the value of the tree to be equal to the sum of the values of all future fruit crops. The presently-considered fruit tree, sheep, and rice examples *seem* to escape this problem. One writer has in fact claimed<sup>18</sup> that this is the outstanding virtue of the single-good economy (he is thinking specifically of Knight's Crusonia-plant economy). Rates of productivity can be arrived at directly, since "capital stock" and "income" consist of the same physical entities. No resort need be had to calculation in "value terms," with all its attendant pitfalls. So that these productivity examples, from sheep to Crusonia to rice, do indeed demonstrate that, even with zero rate of time preference, present rice exchanges for future rice at a rate that expresses the physical productivity of rice. If *this* demonstration were enough to settle the problem posed by the phenomenon of interest, the issue would indeed be closed. Time preference need have nothing to do with the emergence of interest; interest as a phenomenon, and the particular *rate* of

<sup>17</sup>Ibid., p. 23.

<sup>18</sup>Donald Dewey, *Modern Capital Theory* (New York and London: Columbia University Press, 1965), p. 80.

interest established in the market *can*, it is clear, be entirely explained by physical productivity (at least in certain contexts). Yet the matter is far less simple than this.

### **Interest, Own-Rates of Interest, and Intertemporal Exchange**

What these examples demonstrate is that physical productivity affects (or even “determines”) the intertemporal exchange rate (the own-rate of interest) on sheep, on rice, and on Crusonia, respectively. One hundred units of 1987 rice exchange, in 1987, for 110 promised units of 1988 rice. With this trade repeated each year, the rice owner can consume 10 units of rice each year (“real interest income”) without eroding the (“capital”) base that yields this annual income. We shall attempt to show, however, that from the Fetter-Mises PTPT view, these demonstrations do nothing to advance understanding of the general phenomenon of interest; nor do they, as we shall see, demonstrate the impotence or irrelevancy of Böhm-Bawerk’s refutation of simple productivity theories.

It may be useful to review the impasse we have apparently reached. On the one hand these sheep and rice stories show that an annual consumption income drawn from the physical fecundity of a source, can in principle be indefinitely enjoyed without eroding the continued existence and productiveness of that source. On the other hand the *logic* of the Böhm-Bawerkian reasoning refuting productivity theories of interest has not itself been addressed—the reasoning has been denounced as hocus-pocus not because of any demonstrated logical fallacy but apparently because these sheep and rice cases are supposed to serve as counter-examples showing precisely that phenomenon which the Böhm-Bawerkian reasoning purported to have proven to be impossible.

Reflection should surely convince us: (a) that the Böhm-Bawerkian reasoning must still be reckoned with—after all, no flaw in its logic has as yet been identified in these examples; (b) that these examples demonstrate the possibility of an income *different* from that for which Böhm-Bawerk sought an explanation; these

examples demonstrate the possibility, that is, of an income *which the Böhm-Bawerkian reasoning never questioned*; that (c) since it was the Böhm-Bawerkian reasoning that underlay what we have called the interest problem, *that interest problem has not been touched at all by these sheep and rice stories*. Let us try to explain all this. We must return to our original statement of the interest problem.

The interest problem, we recall, asked how it is possible for an individual to invest capital funds in a way that yields a perpetual net income. Why does not the market bid up the price of all the "machines" (in which the individual might plan to invest his capital) so that no net annual yield remains. This question, it should be noted, did not challenge the physical possibility of a tree of infinite life producing an annual crop of fruit; (or a tree of finite life producing an annual crop of fruit large enough to permit the planting, out of fruit output, of a replacement tree when the parent tree dies). The question merely asked why, in the absence of any other theory of interest, the market does not bid up the price of the tree to the point where in fact no net annual financial yield is possible from investing in trees. This is what Fetter hammered away at, the distinction between goods and values in this context. "A theory of interest must be *essentially* a value-theory."<sup>19</sup> Samuelson has proven that ownership of rice permits an indefinite stream of annual rice consumption; he has not disproved the contention that the anticipated perpetual flow of rice consumption is already fully recorded in the market valuation of the initial rice source. Samuelson does not, in fact, appear to wish to deny this contention; he appears merely to conclude that this contention constitutes a meaningless incantation which does not affect the undeniable realities of perpetual annual consumption flows—duly measured by Kuznets, or somebody.

One can sympathize with Samuelson's impatience at verbal mysticism that seems out of touch with palpable reality. Moreover we can go a little further; Samuelson was dealing not with any

<sup>19</sup>Fetter, "Capitalization versus Productivity: Rejoinder," p. 257.

theory of interest, but with Schumpeter's belief that—regardless of productivity—in the state of circular flow no interest at all would emerge. It is easy to sympathize with Samuelson's sense of conviction that his rice example has shown that productivity-interest can indeed emerge in this state of affairs. Yet it must be pointed out that when we turn to a world somewhat richer in assumptions than Samuelson's rice model, it becomes clear that his example (and also the earlier fruit tree, sheep, and Crusonia stories) have in fact failed to identify interest income (in the sense in which we have identified the interest problem) as a productivity return.

One hundred units of 1987 rice are expected to ripen into 110 units of 1988 rice. Suppose that the "value" of the 100 units of 1987 rice has indeed risen to anticipate this physical growth. Then in terms of the interest problem (formulated at the outset of this paper) the perpetual annual rice consumption income so made possible *does not present an example of interest*. The annual flow of rice income is indeed adequately explained by productivity—more to the point, there was no "problem" that demanded explanation, at all. There is, after all, no problem constituted by the circumstance that a tree yields fruit annually.

The interest problem would begin, in the context of the rice example, only if in fact the "value" of the 100 units of 1987 rice is somehow lower than that of 110 units of 1988 rice. *Then* we would have the possibility of a sum of abstract capital value serving as a financial source somehow generating a flow of *greater* subsequent value. *That* would indeed appear to fly in the face of economic intuition (since competition ought—absent a theory of interest—to be expected to exclude such a phenomenon). And it is of course *this* interest problem that PTPT solves by reference to the general subjective preference for the achievement of goals sooner rather than later.

What the preceding asserts, then, is that what Brown, Fisher, Knight, and Samuelson have identified as interest income—and which they apparently view as the *only* interest income needed to be discussed—*is in fact not interest income at all* (from the perspective of the interest problem formulated above). On the other hand,

that interest income which PTPT deals with—an income which *does* fit the specifications of interest as formulated above—turns out to be something the very existence of which the critics appear to deny. (We recall that Schumpeter, too, was (in this respect only!) on the side of the critics of PTPT: he believed that in the circular-flow no pure interest would be present.) Obviously the entire debate appears to have degenerated into a squabble about the meaning of terms.

From the Fisherian perspective the semantic bickering may appear even more deplorable. After all, the Fisherian view is that interest, the income received in return for providing services of “waiting,” is *at the same time*, the reward received by the capitalists (who provide these services) for their sacrifices (sacrifices which obtain their poignancy from the prevalence of positive time preferences). A discussion such as the above (in which the issue is made to appear whether the term interest income is to refer to the fruits of rice fecundity *or* to a value differential attributed to time preference) must seem doubly regrettable. Let us go back to basics.

### **The Interest Problem that Calls For Solution: The Competing Versions**

The attention of economists over the centuries has been attracted to the real-world, palpable, phenomenon of interest income largely due to its “surplus” character. Apparently it is possible, in the market economy, to command a steady, regular income merely by possession of a capital stock. As Böhm-Bawerk introduced the phenomenon, “Whoever is the owner of a capital sum is ordinarily able to derive from it a permanent net income . . . This income . . . arises independently of any personal act of the capitalist. It accrues to him even though he has not moved a finger in creating it . . . It can be derived from any capital, no matter what be the kind of goods of which the capital consists, from naturally fruitful, as well as from barren goods, from perishable as well as from durable goods, from replaceable as well as from irreplaceable goods, from money as well



as from commodities. And, finally, it flows without ever exhausting the capital from which it arises, and therefore without any necessary limit to its continuance. . . . And so the phenomenon of interest presents, on the whole, the remarkable picture of a lifeless thing, capital, producing an everlasting and inexhaustible supply of goods."<sup>20</sup> With this starting point for discussions of the interest phenomenon, it is easy to see how physical fecundity (while it offers a tempting ingredient for interest theorizing) came to be dismissed (in Böhm-Bawerk's chapter refuting the productivity theories). The point is that the entire discussion begins with the assertion that *value* productivity is a common fact of life; this fact of life was, after all, asserted to hold for barren goods and for money just as it holds for naturally fruitful goods and for commodities. It was this Böhm-Bawerkian identification of the problem as referring to value-productivity that was at the heart of the formulation of the interest problem cited at the start of this paper. Now, the prospective interest theorist can choose one or the other of only two options: he can deny that this interest phenomenon in fact exists (so that there is nothing to be explained), or he must seek an explanation for it within its own framework. Schumpeter chose the first option. Others, implicitly denying the phenomenon that Böhm-Bawerk took as his starting point, focus on physical productivity as a sufficient basis for the (undeniable) *market* phenomenon of interest. But in so doing they have not offered a new explanation for the Böhm-Bawerkian phenomenon: they have simply denied its existence, and chosen instead to talk about something else—something easily confused with it (because both might serve plausibly as underlying basis for the *surface* phenomenon of market interest). PTPT theorists are then entitled to accept the existence of the Böhm-Bawerkian phenomenon and to offer their own explanation for it. From this perspective, then, the situation can be summed up as follows:

First, there is a commonly observed phenomenon of market interest. No one disputes this observation. Second, for Böhm-Bawerk this

<sup>20</sup>Böhm-Bawerk, *Capital and Interest*, p. 1.

phenomenon of market interest is simply the expression of the existence of an underlying phenomenon of pure value-productivity. This interpretation of market interest renders the phenomenon insoluble through reference to physical productivity, and leaves it calling out for alternative explanation. Third, PTPT accepts this Böhm-Bawerkian interpretation (and offered time preference insights to account for the phenomenon of value-productivity). Fourth, Schumpeter, while not disputing the Böhm-Bawerkian interpretation of the observed phenomenon of market interest, held that this entire phenomenon is a transient one that would disappear in the state of circular flow. Fifth, other theorists dispute Böhm-Bawerk's interpretation of the observed phenomenon of market interest. In effect these writers deny the existence of the (underlying "value-productivity") phenomenon which Böhm-Bawerk asserted to be reflected in the observed phenomenon of market interest. For these writers the observed phenomenon of market interest reflects nothing more than physical productivity; there *is* no "value-productivity" to be explained. Sixth, finally, for modern theorists following Fisher, the entire discussion in the present section represents an incomprehensible lapse into meaningless mysticism and metaphysics. For these theorists the task of a theory of interest is *not at all that of solving the problem formulated at the start of this paper* (and expressive of the Böhm-Bawerkian formulation at the start of this section). Were the Fisherians to consider *that* (Böhm-Bawerkian) question, they would consider it solved immediately once one has identified "waiting" as a missing factor. Since waiting is a scarce, costly factor, its market value tends to equal *both* its marginal product *and* its marginal cost (in terms of foregone sooner consumption). Interest is *both* the reward for sacrificed earlier consumption *and* the fruits of the enhanced output made possible by waiting. For Fisher and the modern writers the interesting question and thus the task of interest theory, is (quite apart from possible disputes concerning the existence of the phenomenon to which the Böhm-Bawerkian formulation refers) *nothing more than that of identifying the determinants of intertemporal prices*. In undertaking this latter task, Fisher develops a perfectly adequate framework in which *both* physical productivity *and* time preference considerations have their place.

We may conclude then: (a) most of the modern bewilderment of PTPT stems, we would argue, from the Fisherian unconcern with the interest problem that was posed by Böhm-Bawerk. Most moderns, following Fisher, do not see the task of interest theory to be to account for a phenomenon that somehow (in the absence of a theory of interest) “ought not to exist.” As a result, the Fisherian approach finds the PTPT view bizarre (since their own approach finds time preference and physical productivity *both* valuable elements in their theory). We shall return to consider this Fisherian view of PTPT in the subsequent section. (b) Sheep, rice and other stories introduced to demonstrate the adequacy of a purely productivity theory (and thus to refute PTPT) express a different misunderstanding of PTPT. Without recognizing it, the authors of these examples have in effect denied the very existence of the phenomenon which Böhm-Bawerk identified as that calling for explanation (i.e., the underlying phenomenon of pure value-productivity). From the Böhm-Bawerkian point of view, therefore, these stylized examples deal with a phenomenon which (1) is other than the one Böhm-Bawerk is concerned with, and (2) offers no theoretical challenges (“of course” trees produce fruit!).

We have thus identified *two* distinct sources of modern bewilderment with PTPT. One source stems from an implicit denial of the value-productivity phenomenon seen as calling for explanation in Böhm-Bawerk’s view (and in PTPT’s view). From this denial it was easy to move to assuming that the phenomenon to be explained by a theory of interest is that which would underlie the market rate of interest *in the absence of* the value-productivity phenomenon—viz., physical productivity. From this latter perspective, PTPT’s refusal to accord to physical productivity any role, appears simply incomprehensible. The *second* source of modern bewilderment stems, not from any denial of the phenomenon that Böhm-Bawerk sought to explain, but from an entirely different conception of what constitutes the function of a theory of interest. Whereas for Böhm-Bawerk a theory of interest is called for to account for an otherwise inexplicable phenomenon, for Fisher a theory of interest is called for to identify the determinants of a particular market rate of exchange (viz., the intertemporal rate, which implicitly expresses

the rate of interest). From this Fisherian perspective it is easy to understand how bizarre it appears for anyone to deny any role for physical productivity in a theory of interest. We turn to elaborate on this last point. The point turns out to involve an old dispute between Fisher and Böhm-Bawerk, that throws considerable light on the entire issue.

### **The Existence of Interest vs. the Rate of Interest**

“Some writers,” Fisher wrote, “have chosen, for purposes of exposition, to postulate two questions involved in the theory of the rate of interest, viz., (1) why any rate of interest exists and (2) how the rate of interest is determined.”<sup>21</sup> Fisher dismisses this distinction as being unilluminating, “since to explain how the rate of interest is determined involves the question of whether the rate can or cannot be zero . . .”<sup>22</sup> The purpose of the present section of this paper is (a) to present the case for the distinction criticized by Fisher—a distinction in fact made by Böhm-Bawerk, as we shall see—and (b) to show how failure to understand the rationale for the distinction has generated the widespread modern bewilderment with PTPT referred to earlier.

No better defense for Böhm-Bawerk’s distinction need be found than the lucid discussion that he himself provided. Böhm-Bawerk was criticizing Fisher for not distinguishing between “originating forces” and “determining forces.” “All interest-originating causes undoubtedly are also determining factors for the actual rate. But not all rate-determining factors are also interest-creating causes . . . When we inquire into the causes of a flood we certainly cannot cite the dams and reservoirs built to prevent or at least mitigate inundations. But they are a determining factor for the actual water-mark of the flood. . . . Similarly, there are other circumstances besides the

<sup>21</sup>Fisher, *The Theory of Interest*, pp. 13f and 474 (where Böhm-Bawerk is identified, without specific citation, as having argued for this distinction).

<sup>22</sup>*Ibid.* See also J. W. Conard, *An Introduction to the Theory of Interest* (Berkeley and Los Angeles: University of California Press, 1959), pp. 13–14.

actual interest-creating causes that bring about or enhance the value advantage of present goods over future goods.”<sup>23</sup> It will be observed that Böhm-Bawerk’s distinction faithfully expresses the formulation of the interest problem that he offered (as cited in the preceding section). There is a phenomenon (the existence of interest income) which calls for explanation (just as the occurrence of floods calls for explanation). The required explanation need not necessarily invoke all those “forces” which may be relevant for the determination of the particular rate of interest prevailing in the market. It is true that a complete listing of all aspects of all the “rate-determining forces” would at the same time explain why the interest-rate is other than zero. But to say that all these forces are responsible for the interest phenomenon would be highly misleading. If someone stands amazed at the flow of city traffic along one of its central avenues during morning rush hour, and asks, “Why is traffic so heavy?”, the answer to the question should presumably run in terms of the need of people to get to work. It will simply not do to invoke the traffic-light system as an explanation (even partially) for the volume of traffic (even though it is certainly the case that the size of that volume has been, in part, determined by that traffic-light system). For Fisher, it is quite clear, the “problem” of interest is simply to provide a full catalogue of the rate-determining forces. Fisher’s analysis leads him, inevitably, to recognize the interaction, among these forces, of physical productivity and time preference. Modern theorists, following Fisher, are understandably bewildered by PTPT statements denying any role for physical productivity. But to endorse the PTPT denial of a role for physical productivity is not necessarily to deny that physical productivity is to be listed among the forces combining to determine intertemporal rates of exchange. The PTPT’s denial refers strictly to the problem of accounting for the phenomenon of interest. For the solution of *this* problem, PTPT finds physical productivity to be no more relevant than traffic lights are (for accounting for the phenomenon of morning rush-hour traffic) or than dams are (for Böhm-Bawerk’s example of accounting for the occurrence of floods).

<sup>23</sup>Böhm-Bawerk, *Capital and Interest*, p. 192.

PTPT exponents often drive home the irrelevance of physical productivity by pointing out that physical productivity is neither necessary nor sufficient for an explanation for interest (in the sense of value-productivity).<sup>24</sup> They point out how, in the absence of time preference, physical productivity, no matter how great, cannot generate value-productivity. And they point out how, even in a pure exchange world without production processes of any kind, the phenomenon of value-productivity could arise as a result of time-preference considerations exclusively. One critic responded to this reasoning by asking whether, based on parallel reasoning, one would conclude that the striking of matches is irrelevant to the causation of fire (since not every match that is struck produces fire, and not all matches that ignite do so as a result of having been struck). The response should surely be that the striking of matches is certainly *highly* relevant to the prevalence of match-ignition, but the striking of matches is indeed far less relevant for other questions, such as, e.g., why ignition occurs among matches rather than among Q-tips.

Admittedly, some expositions of PTPT have sometimes unfortunately permitted it to be thought that, since only time-preference accounts for the *existence* of interest, it follows that a change in the conditions of physical productivity would invariably leave the rate of interest unchanged. But in fact PTPT implies nothing of the kind.<sup>25</sup> It is one thing to maintain that normal daily nutritional needs are in no way responsible for the existence of hospitals; it in no way follows that the extent of such needs is not a factor helping determine the size (and conceivably even the number) of hospitals. *Given* the presence of sickness (upon which the existence of hospitals does depend) a host of unrelated matters may participate in the determination of hospital size. Similarly PTPT theorists do recognize that since the prevalence of positive time preference does generate the phenomenon of interest, it cannot

<sup>24</sup>Charles W. Baird, *Prices and Markets, Intermediate Microeconomics*, 2nd ed. (St. Paul, Minn.: West Publishing, 1982), pp. 303f.

<sup>25</sup>Fetter was quite explicit on this point, see "Capitalization versus Productivity: Rejoinder," p. 247.

at all be ruled out that other factors (including physical productivity) may affect the determination of its rate. For example, physical productivity may significantly affect the level of wealth, and thus the marginal rate of time preference. All PTPT insists on is that, no matter how significant a role physical productivity may play among the complete list of variables affecting the rate of interest, it is fallacious to refer to interest income (expressing value-productivity) as the fruit of the physical productivity of agents of production. No matter how heavily the costs of the hospital meal service weigh in the determination of hospital size, it remains a fallacy to see a hospital as a sleep-in restaurant.<sup>26</sup>

### Some Remarks on Methodological Essentialism

It will be observed that our defense of PTPT against the bewilderment evinced by its various critics, amounts to a partial affirmation of what has sometimes been termed “methodological essentialism.” Several historians of thought have noticed that for Menger, economic science is a search for *the reality underlying economic phenomena*—for their *essence (das Wesen)*. In a letter to Walras, Menger asks, “How can we attain to a knowledge of this essence, for example, the essence of value, the essence of land rent, the essence of entrepreneur’s profit . . . by mathematics?”<sup>27</sup> This

<sup>26</sup>Economists have frequently argued (e.g., F. A. Hayek, “Time Preference and Productivity: A Reconsideration,” *Economica* 12 [1945]: 22–25) that whether time preference or physical productivity is to be considered the more important explanatory variable for interest, depends on which of them is expressed, in the standard Fisher diagram, by a curve having greater convexity. This makes good sense in regard to the determinants of the interest *rate*. It may be highly relevant to know whether the interest rate is more sensitive to a given marginal change in time preferences, than to a similar marginal change in physical productivity. But for the explanation of the *existence* of interest, these comparisons are hardly relevant. Even if hospital size were somehow more sensitive to changing nutritional standards than to change in the incidence of disease, the *raison d’être* of the hospital remains unaffected.

<sup>27</sup>This letter is cited in Terence W. Hutchison, *A Review of Economic Doctrines, 1870–1929* (Oxford: Clarendon Press, 1953), p. 148.

search for essences, reflecting a philosophical approach attributed to Aristotelian influence,<sup>28</sup> would focus, then, not on the land rent paid for a particular parcel of real-estate in a particular year, but upon those essential features of land rent that would be common to all examples of the phenomenon. Similarly an essentialist approach to the interest problem as posed by Böhm-Bawerk, would focus not on the list of elements which together determine specific interest rates, but on those elements upon which the interest phenomenon essentially depends, elements without which the phenomenon could in fact not exist. PTPT finds these essential elements for the interest phenomenon in time-preference. Physical productivity is *not* such an essential element of interest; but, to repeat, to affirm all this is not to deny that market rates of interest may be related to physical productivity conditions. To assert that, absent time preference, physical productivity is unable to generate *any* interest (in the sense of value-productivity) is not to assert that, *given* time-preference, the intertemporal rate of exchange, even in the form of the rate of value-productivity, is unaffected by changes in the physical productivity of machines or of trees. All that is being asserted is that whatever role is played by physical productivity does not permit us to say that interest (value-productivity) *is* the fruit of productive capital. (Rush-hour traffic as a phenomenon may indeed be vitally affected by the timing of traffic lights; nonetheless we understand why it is accurate to describe the phenomenon of rush-hour traffic as “people getting to work,” rather than as “the result of traffic-light timing.”)

From a modernist perspective impatient with metaphysical discussion, some of this defense of PTPT against modernist “bewilderment,” may appear wholly unhelpful; in fact it may confirm the critics’ impression that it is all empty philosophizing unrelated to objective phenomena. If one sees the objective of science as being to account for empirical reality, and one sees the objective of price

<sup>28</sup>See E. Kauder, *A History of Marginal Utility Theory* (Princeton, N.J.: Princeton University Press, 1965), p. 97; Samuel Bostaph, “The Methodological Debate Between Carl Menger and the German Historicists,” *Atlantic Economic Journal* (September 1978): 11.



theory to explain the structure and levels of particular prices, then it will seem only natural to seek for an interest theory that explains particular rates of interest. All else must appear metaphysical, irrelevant, and plain confusing. So long as our theory of interest, say, in the form of Fisher's standard diagram (incorporating both intertemporal productive possibilities and time preferences) can show how the market in fact generates its intertemporal rates of exchange (with respect to given physically defined commodities identified at different dates), surely our scientific task has been accomplished—without any essentialist pursuit of some metaphysical reality underlying the explained phenomena. But this modernist impatience can be shown to be unreasonable. Such a demonstration requires that we recognize the nature of the delicate interface between science and ideology. It will prove convenient to present our discussion in the context of brief reference to the celebrated Cambridge Capital Controversy of recent decades.

### **Science And Ideology: The Cambridge Controversy and PTPT**

For present purposes, we compress our account of the Cambridge Controversy to its barest relevant elements. One side of the debate, representing neoclassical orthodoxy, sees the phenomena of the capitalist economy, especially the assignment of income shares (including interest income) as being phenomena to be understood within the framework of market equilibrium. Market prices (and thus interest) have to be paid if consumers are to receive that which the productive capacity of the market is able to provide, and for which the consumers are prepared to pay. Interest is rendered necessary and thus, in a sense, "justified" by efficiency (i.e., consumer sovereignty) considerations.

On the other hand, the Cambridge (England) critics vigorously deny that interest incomes are "caused by individual exchanges as constrained by technology and the availability of factors of

production.”<sup>29</sup> These critics see the distribution of income between wage-earners and interest-receivers as being determined by such considerations as the power balance between workers and capitalists, rather than by marginal products, consumer preferences, and factor supplies.

It is not difficult to recognize the ideological implications that can be drawn from each of these two views. As Robert Solow (representing the neoclassical side of the debate) observed, the Cambridge school saw neoclassical theory as “an important part of an apology for private capitalism. It sounds as if capitalists are entitled to their profits . . .”<sup>30</sup> Indeed, Joan Robinson, leading figure in the Cambridge school asserted very explicitly: “The unconscious preoccupation behind the neoclassical system was chiefly to raise profits to the same level of moral respectability as wages.”<sup>31</sup> Clearly the Cambridge critics believe that their own theory of capital provides no such comfort and solace for the capitalist system.

It may be submitted that these asserted ideological implications of alternative capital theories are profoundly important for one’s appreciation of what economic science can reveal. While Solow and others<sup>32</sup> believe the Cambridge attack on neoclassicism expresses an anti-capitalist animus, they do not deny the responsibility to deal dispassionately with the Cambridge substantive criticisms and theory. Nor do the Cambridge critics fail to recognize that any ideological dissatisfaction with the implications of neoclassicism must yield to a dispassionate search for logical flaws in that theory. The important point is that such dispassionate scientific debate holds the key to the normative, non-scientific characterization of specific income categories. The neoclassical view of interest permits it to be seen as a productivity return (parallel to the way in which market wages are perceived). This is seen to permit the

<sup>29</sup>See Hausman, *Capital, Profits and Prices*, p. 167.

<sup>30</sup>Robert Solow, “Cambridge and the Real World,” *Times Literary Supplement* (March 14, 1975).

<sup>31</sup>Joan Robinson, *Economic Philosophy* (Chicago: Aldine, 1962), p. 58.

<sup>32</sup>Mark Blaug, *The Cambridge Revolution: Success or Failure? A Critical Analysis of Cambridge Theories of Value and Distribution* (London: Institute of Economic Affairs, 1974).

view that interest is on the “same level of moral respectability as wages.” The Cambridge theory is one from which such innate respectability for interest income does *not* emerge. We wish to argue briefly here that the Cambridge Capital Controversy offered an array of alternative theoretical positions that was not exhaustive. A third point of view, not represented in the discussion, but one highly relevant to the underlying ideological concerns, is in fact to be found in the PTPT.

The neoclassical side of the debate saw interest as a productivity return. Any ideological defense of capitalist interest based on this side of the debate will consist in “justifying” interest as the proceeds of enhanced productivity made possible by scarce, costly, waiting. In denying this defense, the Cambridge position will argue that interest *is* not the “justified” proceeds of productivity. (Rather it is a share of “social surplus” somehow acquired by owners of capital.) What needs now to be pointed out is that PTPT offers an understanding of interest income that may be seen as supporting its moral “respectability,” but *without* seeing it as the fruits of productivity. From the PTPT perspective, the neoclassically-implied defense of capitalism is flawed. We have again and again pointed out how PTPT does not recognize market interest income as constituting a productivity return; that is not what interest income *is*. On the other hand, PTPT very definitely sees market interest as expressing a market-determined rate of intertemporal exchange. So that PTPT provides a basis, if one chooses to use it for such a purpose, for a justification of interest (as a legitimate expression of consumer preferences) that nonetheless agrees with Cambridge critics that interest is not a productivity return.

The point of all this is that we cannot, surely, close our eyes to possible ideological implications of science. Our science may well be, perhaps, ideologically untainted and value-free (or, at any rate, honest efforts in this direction may be undertaken), but human beings are, as valuing citizens, vitally interested in the character of controversial phenomena. If one is asked: “What justifies interest?”, it will simply not do to defend it as reward for productivity, if analysis shows that that is not what it *is*. Note that for ideological

(i.e., for normative, evaluative) purposes, methodological essentialism is highly relevant. One can hardly arrive at a judgment concerning the defensibility of interest income by showing that its size depends upon physical productivity. A “theory of hospitals” that fails to identify hospitals in terms of the essentiality of their medical character, is likely to be less than helpful for the purposes of normative evaluation by citizens. Citizens asked to vote to support hospitals seen as sleep-in restaurants, may respond differently than when hospitals are correctly seen as institutions fighting to contain dread diseases. There is every reason for science to take note of the non-scientific purposes for which scientific results may be helpfully consulted. From this perspective, the methodologically essentialist aspects of PTPT may be considered valuable features of it, rather than as obfuscating metaphysics.

## Conclusion

Our defense of PTPT against modern “bewilderment” has dealt primarily with its apparently astounding assertion that physical productivity has *nothing* essentially to do with the phenomenon of interest. Our discussion has: (1) made it clear that PTPT does not necessarily deny a role for physical productivity in interest rate determination; (2) emphasized that what PTPT addresses is a question that is *different* from that of interest rate determination; (3) identified the problem dealt with by PTPT as the interest problem addressed by Böhm-Bawerk, viz., what accounts for the phenomenon of net *value*-productivity (in the face of market competition that might be expected to squeeze it out of existence); (4) shown that PTPT refusal to recognize any physical productivity role in the explanation for the existence of interest income, rests on (the admittedly arbitrary) view that time and waiting are not to be seen as productive agents; (5) recognized the methodologically essentialist aspects of PTPT, and argued for their relevance, especially in the context of the Cambridge Capital Controversy, for citizens’ normative understanding of interest income; (6) made it clear how numerous stylized examples (sheep, rice, Crusonia, etc.) designed to demonstrate the essential role played by physical

productivity in interest income generation, in fact concern a phenomenon quite different from that upon which the Böhm-Bawerkian discussion focused. Regardless of one's opinion of the significance of income generated by physical productivity, we have emphasized the legitimacy of distinguishing between that income and the quite different income concept identified by Böhm-Bawerk, and addressed by PTPT.

The upshot of the discussion, then, is that PTPT affirms the phenomenon of pure value-productivity, that is, the phenomenon in which a source of value at a given date generates a flow of values during subsequent periods that exceeds, in total, the value of the source. PTPT accounts for this phenomenon by reference to widespread (possibly universal) preference for the earlier, rather than later, achievement of goals. Market rates of interest, and market interest income, are expressions of this underlying phenomenon of value productivity (and of its PTPT roots).

## *Mises and the Role of the Economist in Public Policy*

Murray N. Rothbard

**I**n contemplating the life and career of Ludwig von Mises, one is struck by the nobility and grandeur, the high courage, of his lonely and lifelong struggle on behalf of truth and laissez-faire.<sup>1</sup> It is easy to advocate free markets now that Mises's prophetic analysis of nearly seven decades ago has been demonstrated to be correct to virtually everyone. For socialism is collapsing all over the world and even the socialists themselves have acknowledged the abject failure of their cherished economic and social system. It is easy for anyone to follow the tide of events, and to join in the mainstream of opinion. But what led Mises to fly in the teeth of both intellectual and popular opinion, and to pursue his lonely and seemingly doomed struggle until the very end?

In the ultimate sense, of course, no outside person, no historian, no psychologist, can fully explain the mystery of each individual's free choice of values and actions. There is no way that we can fully comprehend why one man trims his sails to the prevailing winds, why he "goes along to get along" in the infamous phrase, while another will pursue and champion the truth regardless of cost. We can only regard the nobility of the life and actions of Ludwig von Mises as an exemplar, as an inspiration and a guide for us all.

We can, however, discuss certain intellectual problems that arise when we consider that Mises was a passionate champion of

<sup>1</sup>See Murray N. Rothbard, *Ludwig von Mises: Scholar, Creator, Hero* (Auburn, Ala.: The Ludwig von Mises Institute, 1988).

laissez-faire and militant critic of the rising tide of statism and collectivism. First, we can ponder what might be called “the Rappard Problem,” raised in a *Festschrift* for Mises by his close friend and colleague, William E. Rappard, head of the Graduate Institute of International Studies of the University of Geneva.<sup>2</sup> Mises was a utilitarian, who did not believe in the existence of a rational or objective ethic. Indeed, the bulk of economists in the last two centuries have been utilitarians. Most utilitarians, however, take a cautious, *ad hoc*, cost-benefit view of public policy, and eschew the broad, sweeping policy commitments that are more typical of those who do believe in an absolute or objective ethic for public affairs. I have elsewhere been critical of the adequacy of Mises’s solution to this problem: Mises as utilitarian economist accepts common social ends—i.e. abundance and prosperity—but points out that statist measures will cripple that prosperity while freedom and property rights will advance it.<sup>3</sup> However, I am concerned here not to belabor that critique but to ponder how Mises *as a person* could continue to fight so passionately in the face of a general social rejection of his arguments and of his entire world outlook. Mises’s well-known “intransigence” shines in particularly stark contrast to all too many other utilitarian economists who are ready to bend the knee and to perform as efficiency experts in the service of whatever goals “society” (translated as the State) demands of them.

A second corollary puzzle has been raised by some modern Austrian economists. Why didn’t Mises stick to his forte, to the pure, ethereal realms of economic theory: to praxeology, marginal utility, business cycle theory and the rest? Why did he “lower himself”—and Austrian economics—by descending from the realm of high scholarship to the muddy, far less respectable, more provocative and controversial realm of politics? Why didn’t he stick to the ivory tower of value-free theory and scholarship?

<sup>2</sup>William E. Rappard, “On Reading von Mises,” in M. Sennholz, ed., *On Freedom and Free Enterprise: Essays in Honor of Ludwig von Mises* (Princeton: D. Van Nostrand, 1956), pp. 17–33.

<sup>3</sup>See Murray N. Rothbard, *The Ethics of Liberty*, 2nd ed. (Atlantic Highlands, N.J.: Humanities Press, 1983), pp. 205–13.

In the first place, the latter question, although common, totally distorts the role of the economist in public policy. The founders of economics were (a) all deep in advocacy of political programs, and (b) often participated directly in government policy. Turgot was an ardent advocate of laissez-faire as well as a great pioneer theorist; and his two-year term as economic minister and reformer proved to be the last chance for the ancien regime to reform itself before the French Revolution. Adam Smith's work was largely prompted by a critique of mercantilism and adherence to a moderate free-market policy; and he ended his years happily as one of the leading customs commissioners in Scotland. J. B. Say, as a young man, was one of the leading members of the ruling French Tribunat during the Directory period, and he virtually founded the dominant nineteenth-century school of French laissez-faire economics. James Mill, in addition to his leading role in classical British theory, was a high official of the East India Company in governing India, and he was the undisputed leader (if from outside Parliament) of a bloc of twenty to thirty Philosophical Radicals in Parliament during the 1830s. David Ricardo, tutored by Mill, not only followed his mentor on deep interest in public policy; he was also an ardent monetary reformer as well as monetary theorist. After he wrote his *Principles*, he was persuaded by Mill to enter Parliament to promote the Radical cause. Mill's son, John Stuart, succeeded his father as leader of the Parliamentary Radicals, as well as to his office in the ruling East India Company. In France, the Anglo-French treaty of 1860, the high-water mark of free-trade in Europe, was negotiated by the laissez-faire economist Michel Chevalier.

But how about after the mid-nineteenth century? Couldn't we say that then, when economics became more specialized and academic, and theory became more arcane, that theorists retired from policy and repaired to their ivory tower? Not really. First, among the statist dissenters from orthodoxy, there was an overriding preoccupation with policy. The German Historical School were conscious "monarchical socialists," and their leader, Gustav Schmoller, referred, quite correctly, to himself and his colleagues at the University of Berlin as the "intellectual bodyguard of the House of Hohenzollern [of Prussia]." Marx and Marxism have been,



of course, *political* economy in every sense. The American Institutional professoriat—men such as Richard T. Ely and John R. Commons—were constantly in and out of government posts, beginning with the setting up of welfare and regulatory state interventions in Wisconsin at the turn of the twentieth century.

Among more mainstream theorists, the Austrian professors were largely devoted to the free market and hard money, and often assumed governmental posts. Böhm-Bawerk was several times Minister of Finance in the Austro-Hungarian Empire, and Menger was the tutor and mentor of Crown Prince Rudolf, whom Menger had primed to pursue free-market policies if he had become Emperor. Even an aggressively pure theorist such as Schumpeter served a stint (disastrously) as Finance Minister of post-World War I Austria.

Even among mathematical neoclassical economists, whose pure formalism might incline them away from substantive political views, Vilfredo Pareto was a militant laissez-faire liberal and battler for free trade, heavily influenced by the French anarcho-capitalist Gustave de Molinari. Despairing of freedom and the free market after the turn of the twentieth century, Pareto retreated into cynical critiques of political action, but he was never *not* interested in political economy.<sup>4</sup> Irving Fisher of Yale, the grandfather of the Chicago monetarist school, was always tinkering—always advocating schemes of government intervention and planning—from commodity baskets and other proposals for stabilizing the “price level” and thereby allegedly providing a fixed yardstick to “measure” values, to plans for inflation to prohibition and to purging the world of “such iniquities of civilization as alcohol, tea, coffee, refined sugar and bleached white flour . . .”<sup>5</sup>

Later in the century, of course, Keynes and his Keynesian followers have been nothing if not political; Keynes served in key

<sup>4</sup>On this neglected aspect of Pareto, see P. Bucolo, ed. *The Other Pareto* (London: Scholar Press, 1980); and S. E. Finer, “Pareto and Pluto-Democracy: the Retreat to Galapagos,” *American Political Science Review* 62 (June 1968): 440–50.

<sup>5</sup>Irving Norton Fisher, *My Father Irving Fisher* (New York: Comet Press, 1956), pp. 146–47. Also see Murray N. Rothbard, “World War I as Fulfillment: Power and the Intellectuals,” *Journal of Libertarian Studies* 9 (Winter 1989), pp. 107–08, 115.

government posts, and his followers have been happy to fill the planning positions that have been opened up by propagation of theoretical Keynesian doctrine.

So where is this alleged tradition of requiring economic theorists to take up the monkish cowl and abstain from all thoughts or implications of their work, let alone take direct posts in government? Moreover, the call for political abstinence is almost always directed to economists *outside* the mainstream politics of the day. If economists advocate generally accepted policies, this is somehow subsumed under the rubric of "value-neutrality"; only adhering to policies *opposed* to the conventions of the day is decried as an intrusion of unclean political considerations into the virtuous realm of economic science.

Ludwig von Mises had the bad luck to be one of the foremost champions of laissez-faire in the history of economic thought, but during a century of aggravated statism. All his life he swam vigorously against the dominant ideological and political statist tides of his age. The twentieth century has been the century of socialism, collectivism and government-propelled inflation, and Mises battled valiantly against them all, in the realm of academic theory and in the world of practical politics.

Those of us who met Mises in his American years, after World War II, were familiar with his justly legendary *privatseminar* in Vienna that had provided the setting and stimulus for the most important work going on in Europe during the 1920s in economics and in the social sciences. But we had little idea how active and influential he had been in those years in government and in public policy.

Part of the reason for Mises's focus on government work was practical; for it is to the abiding disgrace of academia, both in Austria and the United States, that this brilliant, creative, and remarkably productive scholar and inspiring teacher was never able to obtain a paid professorial post.<sup>6</sup> Mises received the Ph.D. in

<sup>6</sup>Mises's only paid academic post was at the University of Geneva, where he held a chair of International Economic Relations at the Graduate Institute for International Studies from 1934 until he fled Nazi-occupied Europe to the United States in 1940. The chair was only for a one-year term, though it was renewed each year until Mises left Geneva.

1906, and his full-time position, from 1909 until he left Vienna in 1934, was as economist for the Vienna Chamber of Commerce.<sup>7</sup> Unlike similarly named groups in the United States today, the Chambers were a form of economic parliament created by the Austrian government, with delegates elected by businessmen and financed by taxation. The task of the Chambers was to give economic advice to the government. The various local and regional Chambers in Austria elected delegates to a General Assembly. By the turn of the twentieth century, economists working in the secretary's office of the Vienna Chamber of Commerce—the most important of the various Chambers—had become important economic advisers to the government. By the end of World War I, Ludwig von Mises had become the principal economic adviser to the Austrian government.

After the publication in 1912 of his path-breaking work on monetary theory, *The Theory of Money and Credit*, Mises was appointed to a teaching position at the University of Vienna, where he lectured and taught a seminar in economic theory for two decades. But his position was that of a *privatdozent*, i.e., unpaid, and he was passed over four times for a paid university chair. His highly influential and prestigious *privatseminar* was a purely private creation of his own, and he held it one evening a week at his offices in the Chamber of Commerce. In his academic post, Mises and his students were systematically belittled and discriminated against by his chaired colleagues.<sup>8</sup>

In his memoirs, Mises wrote that “The Chamber offered me the only field in which I could work in Austria.” He states that he did not aspire to a career in government service, but that a “university

<sup>7</sup>From 1909 to 1914, Mises was also an economist for the Central Association for Housing Reform. Mises soon became the Association's expert on real estate taxation, concluding that the abysmal housing conditions in Austria were brought about by high tax rates on incomes and capital gains in real estate. Mises pointed out that lowering the high taxes on real estate would raise its market value and thereby lead to greater investment in housing. He succeeded in pushing through a substantial reduction in housing taxes. Mises notes that his work with the Central Association “offered me great satisfaction.” Ludwig von Mises, *Notes and Recollections*, Hans F. Sennholz, trans. (Spring Mills, Penn.: Libertarian Press, 1978), p. 21.

<sup>8</sup>See Rothbard, *Ludwig von Mises: Scholar, Creator, Hero*, pp. 25–27.

professorship was closed to me inasmuch as the universities were searching for interventionists and socialists.”<sup>9</sup> Yet despite the unpopularity and vast resistance to his views, and his independent status unaided by political parties, Ludwig von Mises, by dint of his brilliance and energy, commanded the attention and respect, if not the agreement, of the Austrian state. In addition to Mises’s numerous tasks at the Chamber dealing with Austro-Hungarian finance and trade relations before the War, and debt problems afterwards, Mises’s major thrust as the chief adviser of the Austrian government was to wage a titanic battle against statism and inflation. Mises writes that:

In the Austria of the postwar world I was the economic conscience. Only a few helped me and all political parties distrusted me. And yet, all secretaries and party leaders sought my advice and opinion. I never tried to press my opinion on them. I never sought out a statesman or politician. Unless I was formally invited I never appeared in the lobbies of Parliament and government departments. Secretaries and party leaders visited my Chamber office more often than I visited theirs.<sup>10</sup>

Mises’s most important activity as economic adviser to the Austrian government was a gallant and determined effort to stop the rampant inflation, and hence to reverse the hyperinflationary thrust of post-war Austrian monetary policy. Here Mises had one staunch ally: the noted business economist and jurist Wilhelm Rosenberg, a former student of Carl Menger. Valiantly the two fought against the Austrian policy of huge deficits and the creation of paper money. If Mises and Rosenberg had not fought with such determination, the Austrian *krone* would have gone the way of the hyperinflation of the German mark in 1923. By 1922, after three years of struggle, Mises and Rosenberg succeeded in getting the Austrian currency stabilized at the rate of 14,400 paper *krone* to one pre-war gold *krone*, the *krone* of the gold standard. If not for their battle, the *krone* “in early 1922 would have fallen to one-millionth or

<sup>9</sup>Mises, *Notes and Recollections*, p. 73.

<sup>10</sup>*Ibid.*, p. 75.

one-billionth of its gold parity in 1892,” as would happen in Germany a year later.<sup>11</sup> The problem was that the stabilization was a half-way house, and despite Mises’s best efforts, the Austrian government continued a policy of inflation, bank credit expansion, deficits and welfare-state measures that steadily and gravely consumed the capital of Austria, and also pushed the commercial banks into an ever-more inflated and shakier financial position. As the Austrian banks became more inflated during the late 1920s, Mises was prevented, because of his official position, from speaking out publicly and thereby endangering their already highly wobbly status. Mises was caught in an impossible Catch-22 trap:

In public these things could not be freely discussed, as the credit reputation of the Austrian economy had to be protected with care. It would have been very easy, indeed, to present the facts in such a way that everyone would have seen the necessity for halting the policy of capital consumption, but such action would have undermined the banks’ foreign credits making instant bankruptcy unavoidable. Therefore, I was forced to use extraordinary restraint in my efforts to change economic policies lest I frighten the public and jeopardize the credit of banks and industry.

This restraint guided my conduct during the . . . period from the crown [*kron*e] stabilization in 1922 to the collapse of the *Kreditanstalt* [bank] in the spring of 1931. The worse the situation grew through the continuation of the disastrous policy, the greater became the danger of a credit crisis and the more important it became not to disquiet the foreign markets.<sup>12</sup>

It would of course have been better if the banking system and the *kron*e had gone hang long before, and Mises, in retrospect and in despair, acknowledged that fact.

<sup>11</sup>Ibid., p. 78.

<sup>12</sup>Mises notes that the main banking adviser of the Christian-Social government of Austria, Gottfried Kunwald, saw the basic problem but refused to act to diminish the venal role of himself and his powerful friends. “He [Kunwald] saw the true situation of the banks and big enterprises and occasionally made remarks that were no less pessimistic than mine. But he was convinced that to present the plain truth about the state of affairs would diminish his influence with the secretaries, through whom he secured licenses and other favors for his clients, and thus jeopardize his income as an attorney and financial agent” (ibid., p. 82).

[Because of his and Rosenberg's efforts] the Austrian currency did not collapse like the German currency in 1923. The crackup boom did not occur. Nevertheless, the country for many years had to suffer from the destructive consequences of continuous inflation. . . . The consumption of capital could not be halted. We met too much resistance; our victory [in 1922] came too late. It delayed the ultimate collapse by several years, but could no longer save Austria.

And again:

I was the economist of the country. This does not mean that my recommendations were followed or that my warnings were heeded. Supported by only a few friends, I waged a hopeless fight. All I achieved was to delay the catastrophe.<sup>13</sup>

In a moving passage, Mises recalls that he was often reproached by his friends for being too unyielding, "because I made my point too bluntly and intransigently, and I was told that I could have achieved more if I had shown more willingness to compromise." But Mises responds that "I could be effective only if I presented the situation truthfully as I saw it," and concludes magnificently that, to the contrary, "as I look back today at my activity with the Chamber I regret only my willingness to compromise, not my intransigence."<sup>14</sup>

In contrast to so many of his acquaintances and colleagues, Mises was the reverse of a person out to seize the main chance. Indeed, he notes that, even though the universities were closed to him, his reputation as a monetary economist after the publication of *The Theory of Money and Credit* led to several lucrative offers of employment by large banks in Vienna. "But until 1921 I always declined for the reason that they refused to give assurance that my advice would be followed; after 1921 I declined because I

<sup>13</sup>Ibid., pp. 78, 74. Mises's other political accomplishment, in addition to stabilizing the *krone* in 1922, was to singlehandedly persuade his old friend Otto Bauer, the radical Marxist who was the head of the Social Democratic Party, to suppress an Austrian Bolshevik takeover that he had previously welcomed during 1918–19. Mises convinced Bauer that the Allies would shut off the Viennese food supply, and doubtless Mises was aided in this crucial effort by the fact that Bauer had been a long-time student at Böhm-Bawerk's seminar, and had conceded that Böhm was right in his refutation of the labor theory of value (ibid.), pp. 16–19, 39–40, 77.

<sup>14</sup>Ibid., p. 74.

considered all banks insolvent and irretrievably lost. Events bore me out.”<sup>15</sup>

Why did Mises do it? Why did he continue to battle for the truths of laissez-faire against all odds, against the tides of history, against the *Zeitgeist* itself, in what seemed a hopeless cause? As I’ve written above, in the last analysis we cannot fully explain or rationalize the choices of an individual; we can only admire or revile them. But more can be said about Mises’s passionate devotion to laissez-faire and his assaults upon its host of enemies. For Mises was not really a utilitarian in the standard cost-benefit, calculating sense. He was much more. He was not even a “rule utilitarian” who believed that a certain set of rules was more conducive for human happiness than another set. For Mises was committed to the view that the struggle for laissez-faire was literally a life-and-death struggle for mankind, for human civilization, for the existence of the human race itself.

And here lies the importance of Professor Salerno’s paper in the current volume.<sup>16</sup> Salerno points out two fundamental building-blocks of Mises’s view of human society, which he saw consisted of market exchange based on the division of labor. First, that the survival, growth and flourishing of the human race depends on the progressive extension and expansion of the free market and the increasingly productive division of labor, what Mises called the developing world “oecumene” or “social organism.” A crippling or contraction of that oecumene, a suppressing or thwarting of that free market, spells impoverishment, death, and destruction of the human race. Second, in stark contrast to Hayek’s increasing emphasis on this social organism as a “spontaneous order” that can only be preserved by blindly accepting existing “evolved” rules, Mises realized that this “social evolution” of the market and of the division of labor rests on the *conscious* social cooperation brought about by human reason and human will. In short, Hayek applies the metaphor of biological evolution of allegedly “higher,” or at least fitter, species. Mises, on the other hand, realizes that human action

<sup>15</sup>Ibid., p. 73.

<sup>16</sup>Joseph T. Salerno, “Ludwig von Mises as Social Rationalist,” p. 215.

is radically different from the motions and interactions of stones, atoms, or genes. Human action is individual and rational, in the sense of conscious and purposive, designed to improve a person's lot. As Salerno quotes from Mises's *Human Action*: "Human society is an intellectual and spiritual phenomenon. It is the outcome of a purposeful utilization of a universal law determining cosmic becoming, viz., the higher productivity of the division of labor."

F. A. Hayek's emphasis on spontaneous order, on the *unintended* rather than intended consequences of human action, on irrationalism rather than reason, is grounded on the implicit premise that human beings are not consciously acting men but rather are tropistic organisms, reacting *unconsciously*, in accordance with evolved rules. Hence, for Hayek, at least for the "Hayek II" of the 1940s and afterwards, influenced by the neo-positivist empiricism of Karl Popper, the sharp dualistic Misesian distinction between human action and the motion of stones, atoms, etc. falls away, and human action and the physical sciences are treated with the same epistemology.<sup>17</sup>

But if we reject Hayek's bizarre underlying concept of unconscious action, and we acknowledge that men's actions are conscious and purposive, then, as David Gordon perceptively puts it, people

may consciously desire to have a market system, and their coordinated action in maintaining it is then *not* an "unintended consequence of human action." They may avoid harmful intervention, not because they blindly follow traditional rules, but because they understand the way the market works.<sup>18</sup>

<sup>17</sup>In contrast, Hayek's *Counter-Revolution of Science* (1952; Indianapolis: Liberty Press, 1979), originally published as journal articles before World War II though collected in book form after the war, was decidedly Misesian, or Hayek I. Hayek, though, never accepted Mises's praxeology, which is based on Mises's fundamental view of the nature of purposive, rational human action.

<sup>18</sup>David Gordon, "The Origins of Language: A Review," *Review of Austrian Economics* 3 (1989), p. 246. Gordon adds that, despite Hayek, the market may well have originated through conscious adoption.

Hayek has been using the origin of language as his model how and why social institutions allegedly originated tropistically, outside conscious human design. In his important review, however, Gordon cites recent studies of the origin of language by G. A. Wells and J. N. Hattiangadi that vindicate the eighteenth-century view of language as conscious human invention. *Ibid.*, pp. 245-51.



It should be noted that Hayek's notion of unconscious, spontaneous order was grounded in the eighteenth-century Scottish Enlightenment, in particular Adam Ferguson's stress on "the results of human action, but not of human design." It is little known that Ferguson's concept did not originate in attempts to explain the market, language, or other similar human institutions. Instead, Ferguson, a close friend of Adam Smith, and his fellow youthful ministers of the Presbyterian Church of Scotland, were trying to explain what for them was a deeply traumatic experience: the Jacobite Rebellion of 1745, in which Jacobites captured Scotland and their beloved city of Edinburgh, and almost triumphed for the cause of the Stuarts—losing only at the bloody Battle of Culloden. In sermons after the battle, Ferguson and the Rev. Hugh Blair, another lifelong friend of Smith, felt forced to explain how it is that God permitted consciously evil people such as the Catholic Jacobites to almost triumph over the true Presbyterian Church. Their answer: that the Catholic Jacobites, though consciously evil, were unwittingly carrying out God's deeper purpose, i.e., to shake the Presbyterian Church out of its apathy and loss of zeal. In this way, wicked men may pursue consciously evil goals, but are unconsciously carrying out providential ends—the unintended social consequences of human action, decidedly not of human design.

Thus, in his sermon preached before the general assembly of the Church of Scotland on May 18, 1746, scarcely a month after Culloden, Hugh Blair explained that God had beheld a Scotland blessed with a "happy Constitution" and a "pure Religion," but yet sunk into religious apathy, "Luxury," and the "Corruption of Manners." As a result, God sent forth the "*wrath of man*," i.e., the passions of wicked men, in the form of the Jacobites, in order to "work a Cure for all these Evils." Prodded out of their apathy, the Presbytery revived; hence, God "Makes the unruly Passions of bad Men *work* in a secret Way, towards Ends, by them altogether unseen."<sup>19</sup> Out of apparent evil,

<sup>19</sup>Richard B. Sher, *Church and University in the Scottish Enlightenment: The Moderate Literati of Edinburgh* (Princeton: Princeton University Press, 1985), p. 42. The Scottish Enlightenment, on the other hand, was not a monolith. The distinguished Common Sense philosopher Thomas Reid and Lord Monboddo, eminent leaders of the Enlightenment, both held, for example, that language was a conscious human invention (Gordon, "*The Origins of Language: A Review*," pp. 246–49).

actual good. Unintended consequences indeed! It is not surprising that Hegel, avidly reading Ferguson's sociology—a development of this theme for human institutions—should be inspired to develop his crucial notion of the “cunning of Reason,” in which inevitable and providential historical forces ever guide apparent or conscious evil into achieving the actual good.

To return to Mises, if the market economy and society is the work of men's reason, this means that to sustain and develop that market, the general public must continuously renew their agreement, must understand and continue to understand the importance of *laissez-faire*, and of sustaining the all-important world oecumene. As Salerno summarizes Mises's point: “At any point in history, the evolving oecumene is the *rational and intended* outcome of an intersubjective process, whose purpose is the amelioration of scarcity. It exists not as a thing unto itself but as a complex of social relations which emerges from a common orientation of individual human actions. . . . Because such relations thus emanate from the will, they must be daily affirmed and recreated in human thought and conduct.”<sup>20</sup>

Their different epistemologies led Hayek and Mises to very different strategies on how best to sustain and defend a free market economy. To the tropistic analyst and irrationalist Hayek, the role of the philosopher is to understand that reason is feeble and plays very little role in human affairs, and then to instruct general intellectuals and finally the public in the wisdom of doing nothing and relying on the instinctive wisdom (because “evolved”) of traditionally received social roles. Mises, on the contrary, as someone who understands the pervasive role of reason and purpose in human affairs, believes it to be the role of philosopher and intellectual to instruct the public in the wisdom and the necessity of sustaining and expanding the free-market oecumene, and of the importance of consulting one's “rightly-understood” interests in cultivating that oecumene.

Whereas Hayek conceives of spontaneous order and being unconscious of consequences as both natural and a blessing, Mises

<sup>20</sup>Salerno, “Ludwig von Mises as Social Rationalist,” p. 215.

realizes that people being heedless of the beneficial consequences of the free-market economy is a great danger to that market, and therefore, ultimately, to themselves. The short-run, narrow self-interest that drives people to loot and cripple the free market is due to their lack of consciousness of the importance of the free market economy. As Salerno quotes Mises: “antisocial conduct which shakes the very foundations of social cooperation. . . . is the outcome of a narrow-mindedness which fails to conceive the operation of the market economy and to anticipate the ultimate effects of one’s own actions.”<sup>21</sup> In contrast to Hayek, then, Mises sees it as vital for the social philosopher and the economist, *not only* to expand scholarship and advance high theory, *but also* to educate businessmen and members of the general public in economics and in the vital importance of keeping the market economy free and unhampered. As Salerno sums up Mises’s insight, therefore, “to the extent that social norms, policies, and institutions are ‘undesigned’, are not completely and correctly thought in advance and accounted for in a logically consistent ideology, to that extent does the continued existence of society become problematic.”<sup>22</sup>

For Mises, then, in contrast to Hayek, the fact that many if not most of the consequences of the market economy and society are unintended is a cause for alarm and not celebration. To save that economy, and therefore human existence and civilization, it becomes necessary for economists, social philosophers, and intellectuals to spread the knowledge of those consequences so that they become fully rational and *intended* by most of the public.

The only way to educate the public fully and successfully, Mises realized, was for those who understand the vital importance of the market economy to spread far and wide the *ideology* of classical liberalism, of what would now be called libertarianism. Mises posited the liberal principle—of peaceful trade and exchange—as the great ideology combating the “militarist-imperialist principle,” the “hegemonic principle” of coercion and organized theft. As Salerno pointedly quotes from Mises’s *Socialism*: “In Liberalism humanity

<sup>21</sup>Ibid., p. 242.

<sup>22</sup>Ibid., p. 243.

becomes conscious of the powers which guide its development. The darkness which lay over history recedes. Man begins to understand social life and allows it to develop consciously . . ."<sup>23</sup> It is only a fervently held ideology that allows mankind to overcome desires for coerced special privileges, and to alert them to the vital importance of rebuffing any attempts at wresting special privileges by others. In particular, classical liberal ideology provides the *way out* of the Public Choice trap: the idea that since individuals and consumers are "rationally ignorant" of each small area of their pocketbook, that special groups, each passionately interested in their own aggrandizement over the consumer, are bound to win out, and that therefore the democratic process is inherently hopeless. But Mises saw the democratic process as a method by which classical liberal ideology could be spread to the general public via, for example, the political party system. It should not be forgotten that, before the twentieth century, political parties, in the United States and Western Europe, were vehicles for propagation of a strongly held ideology. In the seventeenth, eighteenth and nineteenth centuries, classical liberal ideologies were often reflected in political parties and in mass movements. If the Public Choice trap could be overcome in the past, there is no reason why it cannot be surmounted in the future. The Public Choicers fall into their trap by dismissing ideology as ever and always trivial and unimportant. Mises, knowledgeable in history as the Public Choicers are not, would never make that mistake.

On the other hand, Mises also realized that the original classical liberals were absurdly optimistic in believing that continuing social progress and expanding liberty were inevitable. Living in the twentieth century and battling all his life against the *Zeitgeist*, Mises could scarcely fall into this particular error of deterministic complacency about the future. On the contrary, Mises realized that man is free to choose foolishly and self-destruct by opting for restrictionism, statism or collectivism. Hence, Mises could not fall back on the Hayekian "pyramid" of focusing only on theorists, and waiting calmly for decades or centuries until the alleged wisdom of doing nothing to

<sup>23</sup>Ibid., p. 244.

alter traditional rules seeps downward toward the masses. Mises was acutely aware that there was not time for that—that the general public, especially in a democratic world, must always be made aware of the vital importance of sustaining the market and of the disastrous consequences of statism, and must be enlisted into a classical liberal ideology.<sup>24</sup>

It should now be clear how Mises's epistemology and social philosophy reinforced his inner tendency to battle unwaveringly for the truth. Civilization and human existence are at stake—and to preserve and expand it, high theory and scholarship, though important, is not enough. Especially in an age of galloping statism, the classical liberal, the advocate of the free market, has an obligation to carry the struggle to all levels of society—to government, to the general public, to political parties. Not for Mises the view that general education or even political action was somehow beneath his dignity as a theorist and a scholar. Not for Mises the artificial separation between theory and practice; with civilization at stake, and with freedom vitally important, there was no time for such pussyfooting. And even though Mises strongly believed that economic science was value-free, and that values are not objective, he also passionately committed himself to the ideology—yes the values—of classical liberalism—of freedom, peace, and free markets. For unlike standard utilitarianism, his insight into social affairs taught him that human life and happiness were at stake, and he was willing to take the “non-objective” step of coming out squarely in favor of human life and high living standards. Never for Mises, in short, the gathering of academic robes around him or refusing to engage in political controversy in the name of “value freedom.” Economic science may be value-free, but men can never be, and Ludwig von Mises never shirked the responsibilities of being human.

<sup>24</sup>Many years ago, some American Austrians were involved in what proved to be an abortive attempt to found a graduate, degree-granting school of Austrian economics. Mises was to be the President, and those of us who were then “young” Austrians constituted the Board of Trustees. Mises kept exhorting us that, in the pursuit of scholarship, we must not neglect giving periodic lectures to businessmen and to the general public. At the time I was a bit puzzled at his insistence, but now it is clear that this program fit in with Mises's epistemology, his rationalist social philosophy, and his overall strategy.

## 8

# *Ludwig von Mises as Social Rationalist*

Joseph T. Salerno

**F**or the most part Ludwig von Mises's writings on society and social evolution have been ignored by the participants in the current revivals of both Austrian economics and classical liberal political philosophy. When his social theory has been addressed, Mises appears to his critics<sup>1</sup> as "a child of the Enlightenment wrongly deposited in the twentieth century." But this assessment is inaccurate for two reasons. First, Mises severely criticizes the social meliorism of the Enlightenment liberals and demonstrates that their position is inconsistent with one that assigns the central position to human reason in social evolution. Second, in developing his own uniquely rationalist position, Mises has much to say about matters of central importance to modern Austrians, libertarians, and classical liberals who are either critics or adherents of the "spontaneous order" and/or social evolutionist positions staked out by Hayek.

I limit myself here to a systematic exposition of Mises's thinking about society and social evolution. I make no attempt to critically analyze Mises's thought or to explicitly compare it to that of other social thinkers. However, I do employ certain well-known positions of Hayek's work as a foil to facilitate the elaboration of Mises's arguments and to demonstrate their contemporary relevance.

<sup>1</sup>Norman P. Barry, *On Classical Liberalism and Libertarianism* (New York: St. Martin's Press, 1987), p. 59.

In the following section I present Mises's view that all social interactions and relationships are thought out in advance and that, therefore, society originates and evolves as a product of reason and teleological striving, as a "man-made mode of acting" and a consciously devised "strategy." Section three sets forth Mises's argument that law, normative rules of conduct, and social institutions are at one and the same time the product of a long evolutionary process and the outcome of attempts by individual human beings to rationally and purposively adjust their behavior to the requirements of social cooperation under division of labor.

Section four highlights the importance which Mises attaches to economic calculation using market prices as the logical precondition of the existence of society. Far from being a "spontaneous" order, society is, for Mises, a "rational" order, because the very possibility of purposive action within the framework of social division of labor depends on the faculty of the human intellect to conceive cardinal numbers and manipulate them in arithmetic operations. Thus, as we shall see in section five, from Mises's viewpoint, *the* social function of the price system is not to facilitate "the use of knowledge in society" but to render possible "the use of calculation in society." And it is speculative future market prices as *appraised* by entrepreneurs and not the realized prices of history which serve this function. Mises argues further that the past prices experienced by entrepreneurs, praxeologically, can never embody the knowledge relevant to their necessarily future-oriented production plans in the real world of changing economic data. Indeed, I argue that this is the long neglected negative implication of Mises's regression theorem of the origin of money.

Section six addresses the question whether and to what extent Mises's position in the socialist calculation debate actually referred to problems of knowledge rather than of calculation. In fact, as we shall see, the answer to this question is quite clear. Particularly in his later discussions of the issue, Mises explicitly assumed, time and again, that the socialist planners had full knowledge, not only of the latest technology, but of what Hayek calls "the particular circumstances of time and place" relating to consumer

value scales and resource availabilities. Even under these conditions of "perfect information," Mises emphatically contended that the problem of calculation, "the crucial and only problem of socialism," remains insoluble.

The Misesian approach to social evolution as the outcome of conscious ideological struggle is outlined in the concluding section. Here I present Mises's speculative hypothesis that continuing ignorance of the remoter consequences of catallactic activity by the masses leads to spreading social maladjustment and spontaneous social disintegration.

### Reason and the Origin of Society

For Mises reason is man's "characteristic feature."<sup>2</sup> Human reason and human action are inseparably linked, because "Every action is always based on a definite idea about causal relations."<sup>3</sup> In addition reason and action are congeneric, a twin product of man's efforts to sustain himself and flourish in a universe of scarcity. Thus, beings inhabiting a "universe of unlimited opportunities . . . would never have developed reasoning and thinking. If ever such a world were to be given to the descendants of the human race, these blessed beings would see their power to think wither away and would cease to be human. For the primary task of reason is to cope consciously with the limitations imposed upon man by nature to fight against scarcity. Acting and thinking man is a product of a universe of scarcity."<sup>4</sup>

As the fruit of conscious thought and the instrument of action, Mises characterizes knowledge as having an "activistic basis." "[K]nowledge is a tool of action. Its function is to advise man how to proceed in his endeavors to remove uneasiness."<sup>5</sup>

<sup>2</sup>Ludwig von Mises, *Human Action: A Treatise on Economics*, 3rd ed. (Chicago: Henry Regnery, 1966), p. 177.

<sup>3</sup>Ibid.

<sup>4</sup>Ibid., pp. 235-36.

<sup>5</sup>Ludwig von Mises, *The Ultimate Foundation of Economic Science: An Essay on Method*, 2nd ed. (Kansas City, Kans.: Sheed Andrews and McMeel, 1978), p. 35.



Mises defines society as “concerted action” or “cooperation” among human beings that is “the outcome of conscious and purposeful behavior.”<sup>6</sup> As such, society is a consciously-devised “strategy,” “a man-made mode of acting” in the war against scarcity.<sup>7</sup> Society is therefore a product of human reason and volition: “Reason has demonstrated that, for man, the most adequate means for improving his condition is social cooperation and division of labor. They are man’s foremost tool in his struggle for survival.”<sup>8</sup>

The provenance of social cooperation, in Mises’s view, is to be found in two fundamental facts. The first is the “natural phenomenon” that human effort expended under the division of labor is more productive than the same quantum of effort devoted to isolated production.<sup>9</sup> The second fact is that, through a deliberate exercise of reason, individuals are able to grasp this first fact and *consciously* use it as a means to improve their welfare.<sup>10</sup> As Mises writes: “Human society is an intellectual and spiritual phenomenon. It is the outcome of a *purposeful utilization* [my emphasis] of a universal law determining cosmic becoming, viz., the higher productivity of the division of labor. As with every instance of action, the recognition of the laws of nature are put into the service of man’s efforts to improve his conditions.”<sup>11</sup>

In identifying the division of labor as “the essence of society” and “the fundamental social phenomenon,” Mises establishes social evolution as an ontological process amenable to rational investigation.<sup>12</sup> Social evolution thus becomes “the development of the division of labor” and this permits us to “. . . trace the origin of everything concerned with society in the development of the division of labor.”<sup>13</sup>

<sup>6</sup>Ludwig von Mises, *Human Action*, p. 143.

<sup>7</sup>*Ibid.*, p. 26. Mises employs this term to characterize the market economy in particular.

<sup>8</sup>*Ibid.*, p. 176.

<sup>9</sup>Ludwig von Mises, *Theory and History: An Interpretation of Social and Economic Evolution* (Auburn University, Ala.: The Ludwig von Mises Institute, 1985), pp. 38–39.

<sup>10</sup>Mises, *Human Action*, pp. 144–45.

<sup>11</sup>*Ibid.*, p. 14.

<sup>12</sup>Ludwig von Mises, *Socialism: An Economic and Sociological Analysis*, Trans. J. Kahane, 2nd ed. (London: Jonathan Cape, 1969), pp. 299; and Mises, *Human Action*, p. 157.

<sup>13</sup>*Ibid.*, pp. 301 and 303.

As “the great principle of cosmic becoming and evolution,” and “the fundamental principle of all forms of life,”<sup>14</sup> the principle of the division of labor has application in both the social and biological worlds. This insight leads Mises in his earlier writings to compare human society to a biological organism, identifying the division of labor as the *tertium comparationis* of the metaphor.<sup>15</sup>

What distinguishes cooperation among individuals within the “social organism,” however, from the cellular interactions of animal and vegetable organisms is that, in the former only, reason and will are the originating and sustaining forces of the organic coalescence. Human society is thus spiritual and teleological. Writes Mises: “Society is the product of thought and will. It does not exist outside thought and will. Its being lies within man, not in the outer world. It is projected from within outwards.”<sup>16</sup>

Eagerness for improved living standards in conjunction with the recognition of the higher productivity of social cooperation provides the specific motivation that induces an individual to renounce autarkic economic activity and willingly integrate himself into the social division of labor. Accordingly,

Every step by which an individual substitutes concerted action for isolated action results in an immediate and recognizable improvement in his conditions. The advantages derived from peaceful cooperation and division of labor are universal. They immediately

<sup>14</sup>Ludwig von Mises, *Theory and History*, p. 38; and Ludwig von Mises, *Socialism*, p. 291. Elsewhere Mises, in *Human Action*, p. 145, refers to it as “one of the great basic principles of cosmic becoming and evolutionary change.” It is this expression which Butler (Eamonn Butler, *Ludwig von Mises: Fountainhead of the Modern Microeconomics Revolution* [Brookfield, Vt.: Gower Publishing, 1988], p. 336 n.119) cites as “among the most evident” of the “many examples of Mises’s difficulty with English.” This is not “an odd description of the division of labor,” as Butler (*ibid.*) suggests, but a felicitous and perfectly fitting description of its central importance in the ontological structures of the biological and social worlds.

<sup>15</sup>*Ibid.*, pp. 28–92. Mises completely drops the biological metaphor in his later discussion of society in *Human Action* (pp. 143–76), but then reinstates it in *Theory and History* (pp. 252–53) while criticizing its various misinterpretations. In response to the charge that Mises at one point “drifts into the organic fallacy” (Eamonn Butler, *Ludwig von Mises*, p. 108) it should be said that Mises uses the metaphor with complete awareness and with the sole purpose of illustrating the point that the principle of the division of labor operates in the biological as well as the social realm.

<sup>16</sup>Mises, *Socialism*, p. 291.

benefit every generation. . . . When social cooperation is intensified by enlarging the field in which there is division of labor . . . the incentive is the desire of all those concerned to improve their own conditions. In striving after his own—rightly understood—interests the individual works toward an intensification of social cooperation and peaceful intercourse. Society is a product of human action, i.e., the human urge to remove uneasiness as far as possible.<sup>17</sup>

The Torrens-Ricardo law of comparative cost, which identifies the causes of trade and specialization among nations, thus becomes for Mises a formal inference from the more general “law of association,” which explains the universality and permanence of social cooperation on the individual level. In elucidating the incentives that induce individual human beings of varying productive capacities and without explicit agreement to willingly undertake those actions that engender the social division of labor and tend toward its progressive intensification, the law of association provides the key to understanding social evolution.

According to Mises:

The law of association makes us comprehend the tendencies which resulted in the progressive intensification of human cooperation. . . . The task with which science is faced in respect of the origins of society can only consist in the demonstration of those factors which can and must result in association and its progressive intensification. . . . If and as far as labor under the division of labor is more productive than isolated labor, and if and as far as man is able to realize this fact, human action itself tends toward cooperation and association; man becomes a social being not in sacrificing his own concerns for the sake of a mythical Moloch, society, but in aiming at an improvement in his own welfare. Experience teaches that this condition—higher productivity achieved under the division of labor—is present because its cause—the inborn inequality of men and the inequality in the geographical distribution of the natural factors of production—is real. Thus we are in a position to comprehend the course of social evolution.<sup>18</sup>

<sup>17</sup>Mises, *Human Action*, p. 146.

<sup>18</sup>*Ibid.*, pp. 160–61.

The operation of the law of association gives rise to two related tendencies which are detectable in the historical development of society. The first is the progressive extension of the division of labor to encompass greater numbers of individuals and groups. The second is the progressive intensification of the division of labor, as the attainment of an ever increasing variety of individual goals is sought within the social nexus. These evolutionary tendencies are described by Mises in the following terms:

Society develops subjectively and objectively; subjectively by enlarging its membership, objectively by enlarging the aims of its activities. Originally confined to the narrowest circles of people, to immediate neighbors, the division of labor gradually becomes more general until it eventually includes all mankind. This process, still far from complete and never at any point in history completed, is finite. When all men on earth form a unitary system of division of labor, it will have reached its goal. Side by side with this extension of the social bond goes a process of intensification. Social action embraces more and more aims; the area in which the individual provides for his own consumption becomes constantly narrower.<sup>19</sup>

The latter tendency for division of labor to intensify effects “the highest possible concentration of the production of each specialty” consistent with geographical factors, such as the distribution of natural resources and climatic conditions. In the absence of such geographical impediments, social evolution “would finally result in the emergence of one factory supplying the whole oecumene with some particular article.”<sup>20</sup>

As the final and full fruition of social evolution driven by the cosmic ontological principle of division of labor, the “oecumene” embraces all of humanity cooperating in hyperspecialized production processes. At any point in history, the evolving oecumene is the “rational and intended” outcome of an intersubjective process, whose purpose is the amelioration of scarcity. It exists not as a thing unto itself but as a complex of social relations which emerges from a common orientation of individual human actions, i.e., to use the

<sup>19</sup>Mises, *Socialism*, p. 324.

<sup>20</sup>Mises, *Theory and History*, p. 23.

social division of labor as the means to attain individual goals. Because such relations thus emanate from the will, they must be daily affirmed and recreated in human thought and conduct.

### **The Rationalistic Basis of Rules of Conduct and Social Institutions**

If society and social evolution are emanations of the human will, a “will-phenomenon” as Mises says, so are the ancillary social institutions, customs, and rules of conduct which facilitate the establishment and smooth functioning of the system of social relationships. Law, the moral code, marriage and the nuclear family, private property, specialized occupations and professions, linguistic developments, and the market economy itself are the outcome of conscious endeavors by human beings to adjust more effectively to the requirements of the fundamental social relation and thereby make more productive use of the principle of the division of labor in achieving their goals. While these institutions were not created out of whole cloth by a single mind, political fiat or “social contract,” they are indeed the products of rational and intentional planning by human beings, whose thoughts and actions continually reaffirm and reshape them in the course of history.<sup>21</sup>

Thus Mises argues that “Compliance with the moral rules which the establishment, preservation, and intensification of social cooperation require is not seen as a sacrifice to a mythical entity, but as the recourse to the most efficient methods of action, as a price expended for the attainment of more highly valued returns.”<sup>22</sup> In order to reap the benefits of social cooperation, each individual must refrain from seeking ephemeral advantages through actions “detrimental to the smooth functioning of the social system” and, therefore, to his own rightly understood interests.<sup>23</sup>

<sup>21</sup>Mises, *Socialism*, p. 306.

<sup>22</sup>Mises, *Human Action*, p. 883.

<sup>23</sup>*Ibid.*, p. 148.

Law evolves as part of the system of “the rules of conduct indispensable for the preservation of society.”<sup>24</sup> The development of these rules of conduct, like that of society itself, is an evolutionary *and* rational process. Mises emphatically rejects the naive rationalist explanation of society and of the legal order, which construes their origination and development as “a conscious process . . . in which man is completely aware of his motives, of his aims and how to pursue them.”<sup>25</sup> Nonetheless, Mises affirms that evolution of law is crucially dependent on the fact that the “position of social ends in the system of individual ends is perceived by the individual’s reason, which enables him to recognize aright his own interests.”<sup>26</sup> Where the naive rationalist asserts that law sprang into existence full-grown from a set of explicit pre-societal contracts, Mises as social rationalist characterizes law as a “settlement, an end to strife” which emerges naturally from the process of social evolution and spreading awareness of the higher productivity of peaceful integration into the social division of labor.<sup>27</sup> This explains, furthermore, why “The idea of Law is realized at first in the sphere in which the maintenance of peace is most urgently needed to assure economic continuity . . . that is in the relations between individuals [i.e., the realm of private law].”<sup>28</sup>

As an instrument designed to increase mutual prosperity by facilitating social cooperation, the law has a teleological and rationalistic basis: “Like all other social institutions, the Law exists for social purposes.”<sup>29</sup> As such, “Law and legality, the moral code and social institutions . . . are of human origin, and the only yardstick that must be applied to them is that of expediency with regard to human welfare.”<sup>30</sup>

However, the repression of the antisocial conduct of the intellectually defective, the weak-willed, or individuals who heavily

<sup>24</sup>Ibid., p. 149.

<sup>25</sup>Mises, *Socialism*, p. 43.

<sup>26</sup>Ibid., p. 398.

<sup>27</sup>Ibid., p. 44.

<sup>28</sup>Ibid., p. 46.

<sup>29</sup>Ibid., p. 77.

<sup>30</sup>Mises, *Human Action*, p. 147.

discount the future consequences of their actions is not accomplished solely or even mainly by the coercive powers of the legal authorities. Broadly accepted morals and customs evolved as a first line of defense against behavior potentially destructive of social relationships. As Mises points out:

Not every social norm requires that the most extreme coercive measures shall at once be put into force. In many things, morals and custom can wring from the individual a recognition of social aims without assistance from the sword of justice. Morals and custom go further than State law in so far as there may be a difference in extent between them, but no incompatibility of principle.<sup>31</sup>

This is the meaning behind Mises's dictum that "Morality consists in the regard for the necessary requirements of social existence that must be demanded of each individual member of society. A man living in isolation has no moral rules to follow."<sup>32</sup>

Like law and normative rules of conduct, private property is, at the same time, an "outgrowth of an age old evolution" and "a human device."<sup>33</sup> It originated as a rational response to scarcity, when, encountering lowered productivity due to increased population density, people deliberately decided to abandon "predatory methods" of hunting and gathering and to permanently appropriate to themselves the most productive land factors.<sup>34</sup> Moreover, the historical development of private property was powerfully conditioned by ideology, which, as we shall see below, is the product of conscious human thought.

Monogamous marriage and the nuclear family are also social institutions that evolved as products of rational insight into the requirements of the division of labor. "As a social institution marriage is an adjustment of the individual to the social order by which a certain field of activity, with all its tasks and requirements, is assigned to him."<sup>35</sup> In this sense, it is the application of the principle of the division of labor to those extra-catalactic tasks that are

<sup>31</sup>Mises, *Socialism*, p. 399.

<sup>32</sup>Ludwig von Mises, *The Ultimate Foundation of Economic Science*, p. 33.

<sup>33</sup>Mises, *Human Action*, pp. 654 and 683.

<sup>34</sup>*Ibid.*, pp. 656-57.

<sup>35</sup>Mises, *Socialism*, p. 99.

immediately prerequisite to the enjoyment of consumption goods, whether acquired on the market or produced within the household, e.g., the bearing and raising of children. It is a chosen form of social cooperation in the face of the pervasiveness of scarcity in human life.

Marriage and family life are therefore not products of innate sexual drives or natural instincts. These institutions originated and continue to exist as an integral part of social life because ratiocination of individual human beings daily affirms their benefits. In Mises's words, "neither cohabitation, nor what precedes it and follows, generates social cooperation and societal modes of life. The animals too join together in mating, but they have not developed social relations. Family life is not merely a product of sexual intercourse. It is by no means natural and necessary that parents and children live together in the way in which they do in the family. The mating relation need not result in a family organization. The human family is an outcome of thinking and acting."<sup>36</sup>

Nor is the modern ideal of monogamous marriage a creation of ecclesiastical directives. Modern marriage is a product of the evolution of contract law and its deliberate extension into matters of family life. Monogamy historically wins out over polygamy as conflict over control and disposition of the property that a woman brings to a marriage, including the identification of her proper heirs, is resolved through recourse to the idea of contract. This process is described by Mises in the following passage:

Thus monogamy has been gradually enforced by the wife who brings her husband wealth and by her relatives—a direct manifestation of the way in which capitalist thought and calculation has penetrated the family. In order to protect legally the property of wives and their children a sharp line is drawn between legitimate and illegitimate connection and succession. The relation of husband and wife is acknowledged as a contract.

As the idea of contract enters the Law of Marriage, it breaks the rule of the male, and makes the wife a partner with equal rights.

<sup>36</sup>Ibid., p. 168.



From a one-sided relationship resting on force, marriage thus becomes a mutual agreement; the servant becomes the married wife entitled to demand from the man all that he is entitled to ask from her.

This evolution of marriage has taken place by way of the law relating to the property of married persons. Woman's position in marriage was improved as the principle of violence was thrust back, and as the idea of contract advanced in other fields of the Law of Property it necessarily transformed the property relations between the married couple. The wife was freed from the power of her husband for the first time when she gained legal rights over the wealth that she brought into marriage and which she acquired during marriage.

Thus marriage, as we know it, has come into existence entirely as a result of the contractual idea penetrating into this sphere of life. All our cherished ideals of marriage have grown out of this idea. That marriage unites one man and one woman, that it can be entered into only with the free will of both parties, that it imposes a duty of mutual fidelity, that a man's violations of the marriage vows are to be judged no differently from a woman's, that the rights of husband and wife are necessarily the same—these principles develop from the contractual attitude to the problem of marital life.<sup>37</sup>

In sum, family life in its modern form, as well as the morals and rules of conduct that sustain and make it possible, are the outcome of a historical process directed by reason and fueled by the eagerness of individual human beings to establish living arrangements compatible with the fullest possible satisfaction of their desires under the evolving division of labor. Thus, as Mises concludes, modern marriage "is the result of capitalist, and not ecclesiastical, development."<sup>38</sup>

Like the morals underlying marriage, all spiritual or intellectual phenomena, including religion and culture, are powerfully conditioned by the development of the social division of labor. As

<sup>37</sup>Ibid., pp. 95–96.

<sup>38</sup>Ibid., p. 97.

Mises points out, "all inner culture requires external means for its realization, and these external means can be attained only by economic effort. When the productivity of labor decays through the retrogression of social co-operation the decay of inner culture follows."<sup>39</sup> Mises illustrates this historically by noting the decline of the Roman Empire, which "was only a result of the disintegration of ancient society which after reaching a high level of division of labor sank back into an almost moneyless economy."<sup>40</sup> The "disintegration" of the social division of labor delivered a devastating setback not only to human population, productivity, and prosperity, but also to scientific, technical, and artistic pursuits. In short, "The Classical culture died because Classical society retrogressed."<sup>41</sup>

Linguistic evolution is also intimately connected with changes occurring in the division of labor. Language is "a tool of thinking and acting" and, as such, "changes continually in conformity with changes occurring in the minds of those who use it."<sup>42</sup> When communication between members of a linguistically homogeneous group is impaired or altogether cut off, the consequence is a divergent evolution of the language among the isolated groups from that point onward. Thus Mises explains the emergence of local dialects as a "disintegration of linguistic unity" that results "When communication between the various parts of a nation's territory was infrequent on account of the paucity of the interlocal division of labor and the primitiveness of transportation facilities."<sup>43</sup>

Along with genetic endowment and natural environment, Mises identifies the social division of labor as an important factor operating to constrain the possibilities of the individual's "being and becoming" at any point in history.<sup>44</sup> The individual is born into a social environment characterized by pre-existing rules of conduct, linguistic conventions, legal and moral codes, customs,

<sup>39</sup>Ibid., p. 310.

<sup>40</sup>Ibid., p. 309.

<sup>41</sup>Ibid., p. 309.

<sup>42</sup>Mises, *Theory and History*, p. 232.

<sup>43</sup>Ibid., p. 233.

<sup>44</sup>Mises, *Socialism*, pp. 314-15.

and social institutions whose *raison d'être* is to render possible human cooperation under the division of labor. In choosing to integrate himself into society, the individual must consciously adapt himself to the division of labor both physically and spiritually: physically, by forgoing the exercise and development of his abilities and skills in a whole range of tasks designed to serve directly his own wants and by pursuing a highly specialized profession or occupation oriented to satisfying the wants of other human beings; and spiritually, by adopting behavior in accordance with social norms and institutions.

Thus, according to Mises,<sup>45</sup> "The most important effect of the division of labor is that it turns the independent individual into a dependent social being. Under the division of labor, social man changes. . . . He adapts himself to new ways of life, permits some energies and organs to atrophy and develops others. He becomes one-sided."

Moreover, as Mises points out, the very concept of an isolated human being is a fiction, a useful mental construct for the elaboration of economic theory but impossible of realization in history.<sup>46</sup> *Homo sapiens* is necessarily a creature of social cooperation under division of labor, because language, the prerequisite of conscious thought, cannot be developed by an isolated being. As Mises expresses it:

The biological passing of a species of primates above the level of a mere animal existence and their transformation into primitive men implied the development of the first rudiments of social cooperation. *Homo sapiens* appeared on the stage of earthly events neither as a solitary food-seeker nor as a member of a gregarious flock, but as a being consciously cooperating with other beings of his own kind. Only in cooperation with his fellows could he develop language, the indispensable tool of thinking. We cannot even imagine a reasonable being living in perfect isolation and not cooperating at least with members of his family, clan, or tribe. Man as man is necessarily a social animal. Some sort of cooperation is an essential characteristic of his nature.<sup>47</sup>

<sup>45</sup>Ibid., p. 304.

<sup>46</sup>Mises, *Human Action*, pp. 243–44; and Mises, *Socialism*, pp. 291–92.

<sup>47</sup>Mises, *Theory and History*, p. 252.

These considerations lead Mises to conclude that “The development of human reason and human society are one and the same process.”<sup>48</sup> Elsewhere Mises affirms “the inner and necessary connection between evolution of the mind and evolution of society.”<sup>49</sup> But if social cooperation is a necessary precondition of the origination of the human mind, the existence and evolution of the social division of labor beyond the rudimentary level depends on the ability of the human intellect to operate with cardinal numbers in order to calculate the outcome of social production processes. This is another sense in which, for Mises, society can be considered a rational phenomenon.

### Economic Calculation, Market, and Society

Mises characterizes the market as “the foremost social body.”<sup>50</sup> As such the market economy is “the product of a long evolutionary process.”<sup>51</sup> This does not imply, however, that market relations are a nonteleological or undesigned outcome of tropistic and nonrational cultural selection processes. To the contrary, Mises argues that the market economy is the product of conscious reason and teleological striving, it is “the outcome of man’s endeavors to adjust his action in the best possible way to the given conditions of his environment that he cannot alter.”<sup>52</sup> In this spirit, Mises refers to the market economy both as “a man-made mode of acting under the division of labor” and as a “strategy” for achieving social and economic progress.<sup>53</sup>

Moreover, the market originates and evolves through individual exchanges, which involve “intentional mutuality” and “conscious and purposeful cooperation.”<sup>54</sup> As Mises writes, “The recurrence of individual acts of exchange generates the market step by step with

<sup>48</sup>Mises, *Socialism*, p. 291.

<sup>49</sup>*Ibid.*, p. 300.

<sup>50</sup>Mises, *Human Action*, p. 315.

<sup>51</sup>*Ibid.*, p. 265.

<sup>52</sup>*Ibid.*

<sup>53</sup>*Ibid.*

<sup>54</sup>*Ibid.*, p. 194.

the evolution of the division of labor within a society based on private property.”<sup>55</sup> It follows then that “The exchange relation is the fundamental social relation. Interpersonal exchange of goods and services weaves the bond which unites men into society. The societal formula is: *do ut des*.”<sup>56</sup>

By virtue of the fact that it subsists in the network of exchanges continually recurring among purposeful human actors, the market and its configuration at any moment in time is to be explained by the human values and choices which give rise to these exchanges. In this sense, certainly, market society is a purposeful creation, an intended consequence of consciously chosen behavior. According to Mises:

The market is a process, actuated by the interplay of the actions of the various individuals cooperating under the division of labor. The forces determining the—continually changing—state of the market are the value judgments of these individuals and their actions as directed by these value judgments. . . . The market is entirely a resultant of human actions. Every market phenomenon can be traced back to definite choices of the members of the market society.

[T]he only factors directing the market and the determination of prices are the purposive acts of men. There is no automatism; there are only men consciously and deliberately aiming at ends chosen. There are no mysterious mechanical forces; there is only the human will to remove uneasiness.<sup>57</sup>

But while market phenomena are to be explained completely in terms of conscious human choices, the successive price structures which emerge in the course of the market process are genuinely “social” phenomena. They are social in the sense that, although every individual transactor contributes to their formation, they represent more than any particular individual’s contribution. The result is that each individual when planning his market activities takes prices into account as if they were uninfluenced by his own actions. As Mises writes:

<sup>55</sup>Ibid., p. 327.

<sup>56</sup>Ibid., p. 194.

<sup>57</sup>Mises, *Human Action*, pp. 257–58 and 315.

The market phenomena are social phenomena. They are the resultant of each individual's active contribution. But they are different from each such contribution. They appear to the individual as something given which he himself cannot alter.

[Prices] are social phenomena as they are brought about by the interplay of the valuations of all individuals participating in the operation of the market. Each individual, in buying or not buying and in selling or not selling, contributes his share to the formation of the market prices. But the larger the market is, the smaller is the weight of each individual's contribution. Thus the structure of market prices appears to the individual as a datum to which he must adjust his own conduct.<sup>58</sup>

Mises emphasizes that it is not any particular price but the momentarily prevailing complex of interrelationships among prices that constitutes the social aspect of the market:

It would be absurd to look upon a definite price as if it were an isolated object in itself. A price is expressive of the position which acting men attach to a thing under the present state of their efforts to remove uneasiness. It does not indicate a relationship to something unchanging, but merely the instantaneous position in a kaleidoscopically changing assemblage. In this collection of things considered valuable by the value judgments of acting men each particle's place is interrelated with those of all other particles. What is called a price is always a relationship within an integrated system which is the composite effect of human relations.<sup>59</sup>

In determining the price structure, the market also determines, as part of the same social process, the allocation of labor and other resources among various lines of production and the "distribution" of income among the various individuals contributing to production. Writes Mises:

The pricing process is a social process. It is consummated by an interaction of all members of society. All collaborate and cooperate, each in the particular role he has chosen for himself in the framework of the division of labor. Competing in cooperation and cooperating in

<sup>58</sup>Ibid., pp. 315 and 331.

<sup>59</sup>Ibid., p. 392.

competition all people are instrumental in bringing about the result, viz., the price structure of the market, the allocation of the factors of production to the various lines of want-satisfaction, and the determination of the share of each individual. These three events are not different matters. They are only different aspects of one indivisible phenomenon. . . . In the market process they are accomplished *uno acto*.<sup>60</sup>

It is thus that the market process gives rise to “not only the price structure but no less the social structure, the assignment of definite tasks to the various individuals.”<sup>61</sup> It is the market and the market alone which permits the development and persistence of a meaningful and purposeful social order. Under the guidance of the market, each individual chooses purposefully to integrate himself with greatest advantage to himself and to his fellows into the social division of labor. In this way, the social system “is steered by the market. . . . The market alone puts the whole social system in order and provides it with sense and meaning.”<sup>62</sup>

In Misesian social theory, therefore, the hallmark and *sine qua non* of market society and of social being itself is not its “spontaneity” (whatever that may mean) but its purposefulness. When the social steering mechanism of the market is destroyed, as it is under socialist central planning, systematic and meaningful social cooperation becomes impossible and is replaced by “a system of groping about in the dark. What is called conscious planning is precisely the elimination of *conscious purposive action*.”<sup>63</sup>

While human cooperation in the division of labor is made possible by the social resultant of market exchange relationships, i.e., the price structure, the market itself is predicated upon an intellectual operation consciously originated and performed by the individual human mind. This operation is what Mises calls “economic calculation in monetary terms” or simply “monetary calculation.” According to Mises monetary calculation is “the intellectual

<sup>60</sup>Ibid., p. 338.

<sup>61</sup>Ibid., p. 311.

<sup>62</sup>Ibid., p. 257.

<sup>63</sup>Ibid., pp. 700–01; emphasis mine.

basis of the market economy” and “the guiding star of action under the social system of division of labor.”<sup>64</sup> It is a “method of thinking” purposefully created by “acting man,” which “made it possible to calculate his actions.”<sup>65</sup>

Calculation is absolutely necessary for an actor to determine the most advantageous allocation of scarce resources in a world in which resources are neither purely nonspecific nor absolutely specific to a wide variety of possible production processes.<sup>66</sup> Under these conditions, therefore, monetary calculation:

is the compass of the man embarking upon production. He calculates in order to distinguish the remunerative lines of production from the unprofitable ones. . . . Every single step of entrepreneurial activities is subject to scrutiny by monetary calculation. The premeditation of planned action becomes commercial precalculation of expected costs and expected proceeds. The retrospective establishment of the outcome of past action becomes accounting of profit and loss.<sup>67</sup>

Capital, “the fundamental concept of economic calculation,” and the correlative concept of income enable the actor to mentally grasp the distinction between means and ends “with regard to the perpetually changing conditions of highly developed processing industries and the complicated structure of the social cooperation of hundreds of thousands of specialized jobs and performances.”<sup>68</sup> Capital accounting is thus the indispensable precondition of the expression of individual rationality and purpose within the context of the social division of labor, because, without recourse to this intellectual operation, men and women would be unable to evaluate the outcomes, whether consummated or expected, of their actions. According to Mises: “Monetary calculation reaches its full perfection in capital accounting. It establishes the money prices of the available means and confronts this total with the changes brought about by

<sup>64</sup>*Ibid.*, pp. 299 and 259.

<sup>65</sup>*Ibid.*, p. 231.

<sup>66</sup>*Ibid.*, pp. 207–08.

<sup>67</sup>*Ibid.*, p. 229.

<sup>68</sup>*Ibid.*, p. 261.



action and by the operation of other factors. This confrontation shows what changes occurred in the state of the acting man's affairs and the magnitude of those changes; it makes success and failure, profit and loss ascertainable."<sup>69</sup>

Without the possibility of economic calculation, even a human actor in perfect isolation would find his range of purposeful activities or "autistic exchanges" restricted to less than the full range of production possibilities determined by the purely external elements of his environment (including his labor capacities). In characterizing the economies of the isolated individual and of the isolated socialist society as unrealizable "imaginary constructions," Mises declares: "Robinson Crusoe, who . . . may have existed, and the general manager of a perfectly isolated socialist commonwealth that never existed would not have been in a position to plan and to act as people can only when taking recourse to economic calculation."<sup>70</sup>

Market and therefore society are impossible without calculable action. Mises is emphatic on this point: "The tasks set to acting within any system of the division of labor cannot be achieved without economic calculation. . . . That [the market] is capable of such calculation was instrumental in its evolution and conditions its present-day operation. *The market economy is real because it can calculate* [emphasis mine]." Thus logic dictates that a treatment of the problem of economic calculation precede the systematic elaboration of a theory of the market economy. Catallactics, in turn, must precede the analysis of alternative economic systems, such as socialism, that provide no scope for calculable action. These latter systems of economic organization cannot even be conceptualized without recourse to the calculational modes of thought developed within the market economy. To quote Mises:

The analysis of the problems of the market society, the only pattern of human action in which calculation can be applied in planning action, opens access to the analysis of all thinkable modes of action

<sup>69</sup>Ibid., p. 230.

<sup>70</sup>Ibid., p. 243.

and of all economic problems with which historians and ethnographers are confronted. All noncapitalistic methods of economic management can be studied only under the hypothetical assumption that in them too cardinal numbers can be used in recording past action and planning future action. This is why economists place the study of the pure market economy in the center of their investigations.<sup>71</sup>

But, as Mises points out, economic calculation involves arithmetic computation and "computation requires a common denominator to which all items entered are to be referable."<sup>72</sup> It is for this reason that economic calculation can only be calculation in terms of money prices and that the development of economic calculation as well as of the application of cardinal numbers in all areas of human life is logically and historically inseparable from the evolution of money and the market economy. As Mises writes:

Thus money becomes the vehicle of economic calculation. . . . only because money is the common medium of exchange, because most goods and services can be sold and bought on the market against money, and only as far as this is the case, can men use money prices in reckoning. The exchange ratios between money and the various goods and services as established on the market of the past and as expected to be established on the market of the future are the mental tools of economic planning. Where there are no money prices there are no such things as economic quantities. . . . There is no means for man to find out what kind of action would best serve his endeavors to remove his uneasiness as far as possible . . .<sup>73</sup>

[Monetary calculation] developed in the frame and was gradually perfected with the improvement of the market mechanism and with the expansion of the scope of things which are negotiated on markets against money. It was economic calculation that assigned to measurement, number, and reckoning the role they play in our quantitative and computing civilization. The measurements of physics and chemistry make sense for practical action only because there is economic calculation. It is monetary calculation that made arithmetic a tool for a better life. It provides the mode of using

<sup>71</sup>Ibid., pp. 266–67.

<sup>72</sup>Ibid., p. 214.

<sup>73</sup>Ibid., pp. 208–09.

achievements of laboratory experiments for the most efficacious removal of uneasiness. . . . Our civilization is inseparably linked with our methods of economic calculation. It would perish if we were to abandon this most precious intellectual tool of acting.<sup>74</sup>

### **Use of Calculation versus Use of Knowledge: The Social Function of Prices**

In Mises's view, then, human society is a profoundly rational phenomenon, a product of the capacity of the human intellect to conceive cardinal numbers and manipulate them in arithmetic operations. To assert therefore that the primary function of the market's price system is to effectuate "the use of knowledge in society" is to seriously misconceive the nature of the social problem. *The* problem of society is first and foremost one of calculating the outcome of purposive action undertaken within the framework of the division of labor. As the only possible tool of calculable action, money prices do not merely permit people to utilize their individual "knowledge of particular circumstances of time and place" to enhance the efficiency with which goods are produced in society, prices render possible the very existence of social production processes. For Mises, therefore, the market provides for far more than a "division of knowledge," it produces "the intellectual division of labor that consists in the cooperation of all entrepreneurs, landowners, and workers as producers and consumers in the formation of market prices. [W]ithout it, rationality, i.e., the possibility of economic calculation, is unthinkable."<sup>75</sup>

In fact Mises presents a penetrating critique of the Walrasian view that, in the plans of producers, prices substitute for knowledge of the economic data or, rather, for entrepreneurial understanding and appraisal of future variations of these data. Mises's critique is grounded on the incontrovertible fact that "The prices of the market are historical facts expressive of a state of affairs that

<sup>74</sup>Ibid., p. 230.

<sup>75</sup>Mises, *Theory and History*, p. 75.

prevailed at a definite instant of irreversible historical time.”<sup>76</sup> As such, realized prices can never serve as an unambiguous guide to production, which is always aimed at supplying a market of the more or less remote future involving a different configuration of the economic data. Indeed, if producers were certain that the data underlying future markets would never differ from those determining the present or immediately past state of the market, they could completely dispense with prices and calculation and simply perform the same productive activities over and over again. For, as Mises reminds us, “the main task of economic calculation is not to deal with the problems of unchanging or only slightly changing market situations and prices, but to deal with change.”<sup>77</sup> Ironically, a world in which prices (of previously consummated exchanges) convey knowledge upon which to base future-oriented production decisions is a world in which the price system is, as Mises might say, “supererogatory and otiose.”

In the real world of action and change, on the other hand, “Exchange ratios are subject to perpetual change because conditions which produce them are perpetually changing. The value that an individual attaches both to money and to various goods and services is the outcome of a moment’s choice.”<sup>78</sup> The result, according to Mises, is that “The planning businessman cannot help employing data concerning the unknown future; he deals with future prices and future costs of production.”<sup>79</sup> Moreover, since past prices are not causally linked to the emergence of future prices, they cannot embody knowledge relevant to the drafting of present production plans. This is an irrefutable conclusion of praxeological analysis, the neglected negative implication of Mises’s regression theorem.

Explains Mises:

In drafting their plans entrepreneurs look first at the prices of the immediate past which are mistakenly called *present* prices. Of

<sup>76</sup>Mises, *Human Action*, p. 223.

<sup>77</sup>*Ibid.*, p. 212.

<sup>78</sup>*Ibid.*, p. 217.

<sup>79</sup>*Ibid.*, p. 224.

course, the entrepreneurs never make these prices enter into their calculations without paying regard to anticipated changes. The prices of the immediate past are for them only the starting point of deliberations leading to forecasts of future prices. The prices of the past do not influence the determination of future prices. It is, on the contrary, the anticipation of future prices of the products that determines the state of prices of the complementary factors of production. *The determination of prices has, as far as the mutual exchange ratios between various commodities are concerned, no direct causal relationship whatever with the prices of the past.*<sup>80</sup>

In a qualifying footnote to this passage, Mises notes that, in the case of the exchange ratio between money and other economic goods, the emphasized statement does not apply. This is a reference to Mises's regression theorem, according to which the money unit's past purchasing power is a causal factor in the determination of its current purchasing power.<sup>81</sup>

It is clear therefore that in Mises's view the information yielded by the price system does not obviate entrepreneurial forecasting and interpretative understanding of the constellation of data underlying the markets of the future. What role then does the knowledge of past prices play in today's decisions about the allocation of resources? According to Mises, past prices are useful to entrepreneurs in "appraising" the future prices that will emerge in the wake of forecast data changes. Or, put another way, yesterday's prices do not "economize knowledge" but save on the mental effort expended by the entrepreneur in striving to "understand" the effects of anticipated change on tomorrow's price structure, the elements of which serve as the cardinal numbers in today's economic calculations. Recourse to their experience of past prices eliminates the need for entrepreneurs to mentally reconstruct *ab initio* the price structure and the pattern of resource allocation every time there occurs an anticipated shift in the data requiring the calculation of new production decisions. Entrepreneurial appraisalment is enormously simplified when it may proceed by estimating the effects of

<sup>80</sup>Ibid., p. 336; emphasis mine.

<sup>81</sup>Ibid., p. 336 fn.2.

anticipated variations of the data on a preexisting price structure. As Mises writes:

Numbers applied by acting man in economic calculation do not refer to quantities measured but to exchange ratios as they are expected—on the basis of understanding—to be realized on the markets of the future to which alone all acting is directed and which alone counts for acting man. . . . As acting is always directed toward influencing a future state of affairs, economic calculation always deals with the future. As far as it takes past events into consideration, it does so only for the sake of an arrangement of future action.

The prices of the past are for the entrepreneur, the shaper of future production, merely a mental tool. The entrepreneurs do not construct afresh every day a radically new structure of prices or allocate anew the factors of production to the various branches of industry. They merely transform what the past has transmitted in better adapting it to the altered conditions. How much of the previous conditions they preserve and how much they change depends on the extent to which the data have changed. . . . In order to see his way in the unknown and uncertain future man has within his reach only two aids: experience of past events and his faculty of understanding. Knowledge about past prices is a part of this experience and at the same time the starting point of understanding the future.<sup>82</sup>

As one component of experience, past prices are therefore an important, but by no means indispensable, auxiliary for entrepreneurial understanding of the future course of prices. However, since it is, in the final analysis, *future* prices which concern entrepreneurs, Mises concludes that economic calculation and rational allocation of resources could still take place even in the event of a complete obliteration of the memory of past prices:

If the memory of all prices of the past were to fade away, the pricing process would become more troublesome, but not impossible as far as the mutual exchange ratios between various commodities are concerned. It would be harder for the entrepreneurs to adjust

<sup>82</sup>Ibid., pp. 210 and 337.

production to the demand of the public, but it could be done nonetheless. It would be necessary for them to assemble anew all the data they need as the basis of their operations. They would not avoid mistakes which they now evade on account of experience at their disposal. Price fluctuations would be more violent at the beginning, factors of production would be wasted, want-satisfaction would be impaired. But finally, having paid dearly, people would again have acquired the experience needed for a smooth working of the market process.<sup>83</sup>

Let me summarize Mises's position on the social function of prices and the acquisition and use of knowledge in society. The price system is not—and praxeologically cannot be—a mechanism for economizing and communicating the knowledge relevant to production plans. The realized prices of history are an accessory of appraisal, the mental operation in which the faculty of understanding is used to assess the quantitative structure of price relationships which corresponds to an anticipated constellation of the economic data. Nor are anticipated future prices tools of knowledge; they are instruments of economic calculation. And economic calculation itself is not the means of acquiring knowledge, but the very prerequisite of rational action within the setting of the social division of labor. It provides individuals, whatever their endowment of knowledge, the indispensable tool for attaining a mental grasp and comparison of the means and ends of social action. As Mises says: "It is not the task of economic calculation to expand man's information about future conditions. Its task is to adjust his actions as well as possible to his present opinion concerning want-satisfaction in the future."<sup>84</sup>

### **The Problem of Socialism: Calculation or Knowledge?**

It is therefore clear that Mises's critique of the possibility of socialism is not about knowledge but about calculation. It proceeds

<sup>83</sup>Ibid., p. 337.

<sup>84</sup>Ibid., p. 214.

ineluctably from his insight that, although cardinal numbers and their arithmetic properties are “eternal and immutable categories of the human mind,” economic calculation is “only a category inherent in acting under special conditions” or what the German Historical School referred to as an “historical category.”<sup>85</sup> Thus “The system of economic calculation in monetary terms is conditioned by certain social institutions. It can operate only in an institutional setting of the division of labor and private ownership of the means of production, in which goods and services of all orders are bought and sold against a generally used medium of exchange, i.e., money.”<sup>86</sup> Should these preconditions of calculable action disappear in the further course of social evolution, due, for example, to the abolition of private ownership of the nonhuman means of production, rational social action will become impossible and social division of labor will literally disintegrate into its component parts, into primitive household economies.

Simply and starkly put, Mises’s position is that “Human cooperation under the system of the social division of labor is possible only in the market economy. Socialism is not a realizable system of society’s economic organization because it lacks any method of economic calculation. . . . The choice is between capitalism and chaos.”<sup>87</sup> Elsewhere Mises declares “economic calculation” to be “the essential and unique problem of socialism.”<sup>88</sup>

Nor did Mises ignore the so-called “knowledge problem” faced by central planners. In fact, in his later discussion of socialism in *Human Action*, he carefully and repeatedly distinguished between the problem of calculation and that of knowledge, by explicitly assuming that the economic planners possessed full knowledge of the relevant economic data.<sup>89</sup>

For example, Mises prefaces his chapter on the “Impossibility of Economic Calculation under Socialism” with the following list of

<sup>85</sup>Ibid., pp. 199 and 201.

<sup>86</sup>Ibid., p. 229.

<sup>87</sup>Ibid., pp. 679–80.

<sup>88</sup>Ibid., p. 703.

<sup>89</sup>Ibid., pp. 689–715.



assumptions: "We assume that the director has at his disposal all the technological knowledge of his age. Moreover, he has a complete inventory of all the material factors of production available and a roster enumerating all manpower employable. In these respects the crowd of experts and specialists which he assembles in his offices provide him with perfect information and answer correctly all questions he may ask them. We assume that the director has made up his mind with regard to the valuation of ultimate ends. . . . We may assume, for the sake of argument, that a mysterious power makes everyone agree with one another and with the director in the valuation of ultimate ends."<sup>90</sup>

The planner thus possesses "perfect information" about the general rules of technology and about the particular circumstances of time and place relating to each consumer's value scale and to the availability of each of the variety of factors. Now consider, as Mises does, the planner's decision to build a house under these conditions. Mises argues that the planner still faces the insoluble problem of which of the various known technical methods for realizing his project he should select. Each of the methods employ the given factors in different quantities, each absorbs a different period of production, and each yields a building with a different physical durability.

Mises elaborates the problem confronting the planner in this situation in the following terms:

Which method should the director choose? He cannot reduce to a common denominator the items of various materials and various kinds of labor to be expended. Therefore he cannot compare them. He cannot attach either to the waiting time (period of production) or to the duration of serviceableness a definite numerical expression. In short, he cannot, in comparing costs to be expended and gains to be earned, resort to any arithmetical operation. The plans of his architects enumerate a vast multiplicity of items in kind; they refer to the physical and chemical qualities of various materials and to the physical productivity of various machines, tools, and procedures. But all their statements remain unrelated to each

<sup>90</sup>Ibid., p. 696.

other. There is no means of establishing any connection between them. . . . Eliminate economic calculation and you have no means of making a rational choice between the various alternatives.<sup>91</sup>

For Mises, therefore, “the crucial and only problem of socialism . . . is a purely economic problem, and as such refers merely to means and not to ultimate ends.”<sup>92</sup> In other words, it is the problem purely of Robbinsian maximizing, of deciding how *given* means are to be allocated in light of a *given* structure of ends.

In responding to the socialist criticism that capitalist calculation is fallible because it takes place under conditions of uncertainty, Mises leaves no doubt that inability to calculate and lack of knowledge are logically distinct problems and that the former is the rock upon which the socialist ship founders. Writes Mises:

all human action points to the future and the future is always uncertain. The most carefully elaborated plans are frustrated if expectations concerning the future are dashed to the ground. However, this is a quite different problem. Today we calculate from the point of view of our present knowledge and of our present anticipation of future conditions. We do not deal with the problem of whether or not the director will be able to anticipate future conditions. What we have in mind is that the director cannot calculate from the point of view of his own present value judgments and his own present anticipation of future conditions, whatever they may be. If he invests today in the canning industry, it may happen that a change in consumers' tastes or in hygienic opinions concerning the wholesomeness of canned food will one day turn his investment into a malinvestment. But how can he find out *today* how to build and equip a cannery most economically.<sup>93</sup>

It is because socialism lacks the means to calculate, therefore, that Mises emphatically denies that men “are free to adopt socialism without abandoning economy in the choice of means” or that “Socialism does not enjoin the renunciation of rationality in the employment of the factors of production.”<sup>94</sup>

<sup>91</sup>Ibid., pp. 698–99.

<sup>92</sup>Ibid., p. 697.

<sup>93</sup>Ibid., pp. 699–700.

<sup>94</sup>Ibid., p. 702.

Mises approaches the knowledge versus calculation issue from still another angle. He assumes that human history has, in effect, come to an end and that all further changes in the economic data have ceased. He assumes in addition that the socialist central planner is miraculously endowed with perfect knowledge relating to the full data of this final equilibrium state. Even in this situation the planner confronts a problem requiring economic calculation. The planner must decide how to utilize most economically the means of production bequeathed by the past, e.g., the existing capital structure and acquired skills and location of the labor force, which are not yet adjusted to their equilibrium configurations. For, as Mises points out,

as long as the equilibrium is not yet attained, the system is in a continuous movement which changes the data. The tendency toward the establishment of equilibrium, not interrupted by the emergence of any changes in the data coming from without, is in itself a succession of changes in the data. . . . The knowledge of conditions which will prevail under equilibrium is useless for the director whose task it is to act today under present conditions. What he must learn is how to proceed in the most economical way with the means available today which are the inheritance of an age with different valuations, a different technological knowledge, and different information about problems of location. He must know which step is the next he must take. . . . [Thus] even if . . . we assume that a miraculous inspiration has enabled the director without economic calculation to solve all problems concerning the most advantageous arrangement of all production activities and that the precise image of the final goal he must aim at is present to his mind, there remain essential problems which cannot be dealt with without economic calculation.<sup>95</sup>

There is a significant implication of our interpretation of Mises's critique of socialism. Although the market economy has perfectly solved the problem of economic calculation—its very existence attests to the veracity of this conclusion—praxeologically, at least, it is on all fours with socialism with regard to the knowledge problem. For the

<sup>95</sup>Ibid., pp. 712–13.

imperfection of knowledge deriving from uncertainty of the future is a category of all human action, which cannot be overcome by recourse to the market price system, entrepreneurial alertness, the competitive discovery process, and so on. In any event, comparisons between centrally planned and market economies on the basis of their alternative mechanisms for discovering and disseminating knowledge have little more than heuristic value, precisely because, even assuming conditions of perfect knowledge, calculable, and therefore purposeful, action is logically impossible under central planning. On the other hand, a market economy in which relatively obtuse and mentally inert entrepreneurs appraise and plan on the basis of spotty and inaccurate knowledge of future conditions could still exist and operate because it would permit the calculations necessary for the Robbinsian economizing of scarce productive factors.

On this basis, we are led to reject the revisionist "discovery-process view" of the socialist calculation debate at least as it applies to Mises's contribution (Hayek's is another matter). This view has been recently enunciated by Israel Kirzner<sup>96</sup> and Don Lavoie<sup>97</sup> and basically concludes that the Austrian position in the debate "represented a critique of socialism only because and to the extent that markets under capitalism indeed constitute such a dynamic process of entrepreneurial discovery."<sup>98</sup> But this ignores Mises's key insight that the theory of monetary calculation and calculable action does not belong to the theory of catallactics. As a logical inference from categorical uncertainty, "It is part of the general theory of praxeology"<sup>99</sup> and, as such, is a logical antecedent of catallactic theorems relating to the dynamic role of the entrepreneur-promoter in the functioning of the market process.

The Kirzner-Lavoie approach also errs in distinguishing the advantages of economic calculation from "the broader issue of the social

<sup>96</sup>Israel M. Kirzner, "The Economic Calculation Debate: Lessons for Austrians," *The Review of Austrian Economics* 2 (1988): 1-18.

<sup>97</sup>Don Lavoie, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (New York: Cambridge University Press, 1985).

<sup>98</sup>Israel Kirzner, "The Economic Calculation Debate," p. 3.

<sup>99</sup>Mises, *Human Action*, p. 398, n. 1.

advantages of the price system.”<sup>100</sup> As we have documented in great detail above, however, Mises never made this distinction, even in his most mature view of the market process as presented in *Human Action*. In fact Mises conceived *the* social advantage of the price system to be that it made practicable human society itself by providing the cardinal numbers for computing the costs and benefits of purposive action undertaken within the social division of labor. Finally, Mises, in sharp contrast to the discovery-process approach, denied that prices are directly relevant to the entrepreneurial discovery of information about future market conditions. On the one hand, according to the regression theorem, relative prices of the past are logically unrelated to relative prices which will emerge on future markets. On the other hand, future prices themselves must be appraised in light of the logically prior process of entrepreneurial discovery or, more accurately, “understanding” of yet to emerge market conditions.

### **Social Evolution as Ideological Struggle**

Mises’s recognition of the ability of human reason to grasp the benefits of social cooperation and to identify and implement its intellectual and institutional preconditions leads him to affirm that “human action itself tends toward cooperation and association.”<sup>101</sup> The progressive extension and intensification of the division of labor and the concomitant flowering of society is only a tendency in social evolution, however, subject to reinforcement, retardation, or even reversal by ideology. As Mises notes, “There is no evidence that social evolution must move steadily upwards in a straight line. Social standstill and social retrogression are historical facts which we cannot ignore. World history is the graveyard of dead civilizations.”<sup>102</sup>

<sup>100</sup>Kirzner, “The Economic Calculation Debate,” p. 12.

<sup>101</sup>Mises, *Human Action*, p. 160.

<sup>102</sup>Mises, *Socialism*, pp. 309–10.

Ideology, as defined by Mises, is the “totality of our doctrines concerning individual conduct and social relations.”<sup>103</sup> Since all social interactions and relationships involve conscious human behavior necessarily guided by specific ideas, human society itself, at any point in its history, is an ideological, which is to say rational, creation. Mises is emphatic on this point, declaring:

Society is a product of human action. Human action is directed by ideologies. Thus society and any concrete order of social affairs are an outcome of ideologies.

Any existing state of social affairs is the product of ideologies previously thought out. Within society new ideologies may emerge and supersede older ideologies and thus transform the social system. However, society is always the creation of ideologies temporally and logically anterior. Action is always directed by ideas; it realizes what previous thinking has designed.<sup>104</sup>

For Mises, then, the complex of human social relations is, in a fundamental sense, the product of rational design. Society is hardly a “spontaneous” or “undesignated” formation, because it is inevitable that each individual excogitate and compare before hand the prospective benefits and costs of his participation in exchange relations and the social division of labor. Nevertheless, as is clear from his discussion of the market’s price structure, Mises does not deny that there may be some unintended, and, at the same time, quite momentous consequences associated with deliberate yet decentralized choices to cooperate catallactically:

Any given social order was thought out and designed before it could be realized. This temporal and logical precedence of the ideological factor does not imply the proposition that people draft a complete plan of the social system as the utopians do. What is and must be thought out in advance is not the concerting of individual actions into an integrated system of social organization, but the actions of individuals with regard to their fellow men and of already formed groups of individuals with regard to other groups. . . . Before any

<sup>103</sup>Mises, *Human Action*, p. 178.

<sup>104</sup>*Ibid.*, pp. 187–88.

act of barter takes place, the idea of mutual exchange of goods and services must be conceived. It is not necessary that the individuals concerned become aware of the fact that such mutuality results in the establishment of social bonds and in the emergence of a social system. The individual does not plan and execute actions intended to construct society. His conduct and the corresponding conduct of others generate social bodies.<sup>105</sup>

As a social rationalist, however, Mises leaves no doubt that he considers such ignorance of the remoter consequences of catallactic activity not as a virtue to be hailed in the name of "spontaneity," but as a vice which may ultimately prove destructive of the social division of labor. The reason is that the failure of participants in the division of labor to correctly comprehend the links between their individual actions and social outcomes invites the adoption of ideologies based on erroneous accounts of the nature of society and of social progress. Such falsely-grounded ideologies, in turn, may lead to conduct inconsistent with the continued maintenance of social relations. For example, the struggle for neomercantilist privileges by special interest groups, based on the ideology of interventionism or the "mixed economy," constitutes, according to Mises,

antisocial conduct which shakes the very foundations of social cooperation. . . . It is the outcome of a narrow-mindedness which fails to conceive the operation of the market economy and to *anticipate the ultimate effects of one's own actions.*

It is permissible to contend that the immense majority of our contemporaries are mentally and intellectually not adjusted to life in the market society although they themselves and their fathers have *unwittingly created this society by their actions.* But this maladjustment consists in nothing else than in the failure to recognize erroneous doctrines as such.<sup>106</sup>

Social maladjustment, which is inspired by fallacious ideology, carries in its wake the possibility of social disintegration and is more likely to result the greater the degree to which the consequences of

<sup>105</sup>Ibid., p. 188.

<sup>106</sup>Ibid., p. 319; emphasis mine.

human actions are unintended, or, to use Mises's term, "unwitting." To the extent that social norms, policies, and institutions are "undesigned," are not completely and correctly thought out in advance and accounted for in a logically consistent ideology, to that extent does the continued existence of society become problematic. Following up on this insight, Mises advances a speculative theory of spontaneous social disintegration which links up unwitting consequences with ideological failure:

The liberal conception of social life has created the economic system based on the division of labor. The most obvious expression of the exchange economy is the urban settlement, which is only possible in such an economy. In the towns the liberal doctrine has been developed into a closed system and it is here that it has found most supporters. But the more and the quicker wealth grew and the more numerous therefore were the immigrants from the country into the towns, the stronger became the attacks which Liberalism suffered from the principle of violence. Immigrants soon find their place in urban life, they soon adopt, externally, town manners and opinions, but for a long time they remain foreign to civic thought. One cannot make a social philosophy one's own as easily as a new costume. It must be earned—earned with the effort of thought. Thus we find, again and again in history, that epochs of strongly progressive growth of the liberal world of thought, when wealth increases with the development of the division of labor, alternate with epochs in which the principle of violence tries to gain supremacy—in which wealth decreases because the division of labor decays. The growth of the towns and of the town life was too rapid. It was more extensive than intensive. The new inhabitants of the towns had become citizens superficially, but not in ways of thought. . . . On this rock all cultural epochs filled with the bourgeois spirit of Liberalism have gone to ruin. . . . More menacing than barbarians storming the walls from without are the seeming citizens within—those who are citizens in gesture, but not in thought.<sup>107</sup>

If social disintegration may occur "spontaneously," due to an ignorance of the remoter consequences of social action, social progress

<sup>107</sup>Mises, *Socialism*, p. 49.



can only be assured by the widespread adoption of an ideology of social life which *consciously* and correctly accounts for these consequences. This ideology is liberalism. According to Mises:

In Liberalism humanity becomes conscious of the powers which guide its development. The darkness which lay over history recedes. Man begins to understand social life and allows it to develop consciously.

History is a struggle between two principles, the peaceful principle, which advances the development of trade, and the militarist-imperialist principle, which interprets human society not as a friendly division of labor but as the forcible repression of some of its members by others. The imperialistic principle continually regains the upper hand. The liberal principle cannot maintain itself against it until the inclination for peaceful labor inherent in the masses shall have struggled through to full recognition of its own importance as a principle of social evolution.<sup>108</sup>

The insight that social progress is contingent on the formulation and acceptance of a correct ideology of social life prompts Mises to emphatically reject the social meliorism of older or Enlightenment liberals, which optimistically projected a continuous, uninterrupted improvement in social conditions into the future. To Mises, this—and not the attempt to *rationaly design and construct* the institutional framework proper to man's nature as a cooperant in the social division of labor—constitutes the supreme abuse of reason.<sup>109</sup> A similar abuse was also committed by the social evolutionists of the nineteenth century—and, one might add, latter-day social evolutionists—who “smuggled into the theory of biological transformation the idea of progress.”<sup>110</sup>

In contrast to the social meliorists and evolutionists, Mises, the social rationalist maintains that “Men are not infallible; they err very often. ... The good cause will not triumph on account of its reasonableness and expediency. Only if men are such that they will finally espouse policies reasonable and likely to attain the ultimate ends

<sup>108</sup>Ibid., pp. 48 and 302.

<sup>109</sup>Mises, *Human Action*, pp. 864–65.

<sup>110</sup>Ibid., p. 192.

aimed at will civilization improve. . . . Man is free in the sense that he must daily choose anew between policies that lead to success and those that lead to disaster, social disintegration, and barbarism."<sup>111</sup>

The rationalist view of social evolution, therefore, is not one of placid and automatic improvement insured by "unintended" consequences, "undesigned" institutions, "tacit" knowledge, and "natural selection" of rules of conduct. Social rationalism implies, instead, that human history is the outcome of a conflict between ideologies, which are consciously formulated and adopted by reasoning human beings. Whether an epoch is characterized by social progress, social retrogression, or even social disintegration depends upon which particular ideologies have become current and which individuals have attained ideological "might," defined by Mises as "the power to influence other people's choices and conduct."<sup>112</sup> Thus, according to Mises, "The power that calls into life and animates any social body is *always* ideological might, and the fact that makes an individual a member of any social compound is always his own conduct."<sup>113</sup>

The course of social evolution and the fortunes of humanity therefore are inextricably bound up with the fortunes of the ongoing ideological struggle. No social institution can or ever does evolve in a wholly spontaneous or unreflective way, unsullied, as it were, by ideological influences.

A case in point is language, generally cited by social evolutionists as the archetype of a social institution that develops in a basically unconscious fashion. But, as Mises argues, men's conscious reflections on social relationships and their deliberate attempts to redesign them according to the ideologies such reflections give rise to, have a powerful impact on linguistic development. This is so because language, "the most important medium for social cooperation," is at bottom ideological: "[I]t is a tool of thinking as it is a tool of social action."<sup>114</sup> As such, the abstract terms contained in a living language are "the precipitate of a people's ideological

<sup>111</sup>Ibid., p. 193.

<sup>112</sup>Ibid., p. 188.

<sup>113</sup>Ibid., p. 196.

<sup>114</sup>Ibid., p. 177; and Mises, *Socialism*, p. 321.

controversies, of their ideas concerning issues of pure knowledge and religion, legal institutions, political organization, and economic activities. . . . In learning their meaning the rising generation are initiated into the mental environment in which they have to live and to work. This meaning of the various words is in continual flux in response to changes in ideas and conditions.”<sup>115</sup>

In addition, many momentous linguistic changes in history are directly attributable to ideological causes such as political and military events.<sup>116</sup> Gaelic is just one example of a language that first fell into oblivion and then was partially revived as a result of ideological factors.<sup>117</sup> Even in the case in which a particular language is entirely the outcome of peaceful evolution, it would still be the product of a conscious commitment to liberalism, which is the ideological framework necessary to secure the peaceful development of the social division of labor. For, as Mises<sup>118</sup> repeatedly argues, the “oecumenical society” itself, the product of the historical unfolding of social division of labor, is essentially an ideological creation, which has been “slowly forming itself during the last two hundred years under the influence of the gradual germination of the liberal idea. . . . only when the modern liberal thought of the eighteenth century had supplied a philosophy of peace and social collaboration was the basis laid for the astonishing development of the economic civilization of that age.”

Ultimately, then, the degree and the direction of social evolution is governed wholly by ideological considerations. In Mises’s words “The flowering of human society depends on two factors: the intellectual power of outstanding men to conceive sound social and economic theories, and the ability of these or other men to make these ideologies palatable to the majority.”<sup>119</sup>

<sup>115</sup>Mises, *Theory and History*, p. 232.

<sup>116</sup>*Ibid.*, pp. 228–30.

<sup>117</sup>Ludwig von Mises, *Omnipotent Government: The Rise of the Total State and Total War* (New Haven, Conn.: Yale University Press, 1944), p. 85; and Mises, *Theory and History*, pp. 229–30.

<sup>118</sup>Mises, *Socialism*, pp. 302 and 310–11.

<sup>119</sup>Mises, *Human Action*, p. 864.

## 9

# *Who Predicted the 1929 Crash?*

Mark Skousen

Prediction is the acid test for any explanation of events and their relationships.

E. C. Harwood<sup>1</sup>

**D**etermining who did and who did not predict the stock market crash of 1929 and the subsequent depression is not just an exercise in curiosity. Rather it suggests a great deal about the strengths and weaknesses of an economist's theories on how the world works. Such a study may also be extremely useful in discriminating between financial theories in vogue today. The ability to predict an event or new trend is the acid test of any hypothesis. As Milton Friedman argues, "theory is to be judged by its predictive power . . . the only relevant test of the *validity* of a hypothesis is comparison of its predictions with experience."<sup>2</sup>

In reviewing the attitudes of economists, bankers, brokers, financial advisors, and politicians in the 1920s, I have come to the conclusion that the mainstream schools of orthodox economics almost universally miscalculated the financial events which occurred in late 1929 and the economic debacle that followed. Only

I wish to thank Milton Friedman, Richard M. Ebeling, Bettina Bien Greaves, the late William W. Bartley, III, and Murray N. Rothbard for providing helpful comments and additional sources of information. Any conclusions and opinions expressed herein are strictly my own.

<sup>1</sup>E. C. Harwood, *Cause and Control of the Business Cycle* (Great Barrington, Mass.: American Institute of Economic Research, 1957), p. 63.

<sup>2</sup>Milton Friedman, "The Methodology of Positive Economics," *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953), pp. 8-9.

a handful of economists and financial observers—many of whom were considered by the establishment to be unorthodox “cranks”—forecast the massive deflationary forces that rocked the foundation of the economic and political world.<sup>3</sup>

### The Significance of the Crisis

Without question the stock market crash in October, 1929, was a monumental event. Although most politicians, academic economists and Wall Street experts felt that the collapse in the securities markets was an isolated event at the time, today most economic historians feel differently, convinced that it was a principal turning point in pushing the world economy into a ever-deepening abyss. Galbraith notes, “This, the day of the Great Stock Market Crash, remains in the social memory after a full fifty years. And for good reason. After that day life for millions was not again the same.”<sup>4</sup> Investment writer Donald J. Hoppe concurs. “The stock market crash of October, 1929, is one of those unique dramatic landmarks,

<sup>3</sup>Curiously, three econometricians from Harvard and Yale recently absolve their academic ancestors of any grievous sin in not anticipating the Great Depression by arguing that the crash and depression were “unforecastable.” See Kathryn M. Dominguez, Ray C. Fair, and Matthew D. Shapiro, “Forecasting the Depression: Harvard versus Yale,” *American Economic Review* (September 1988). Dominguez et al. found that not only did the Harvard Economic Service as well as Yale’s Irving Fisher fail to anticipate the crash and depression, but their own modern econometric model could not predict the events of 1929–1933 either. “Our results imply that the Harvard and Yale forecasters cannot necessarily be faulted for remaining optimistic after the Crash. Their continued optimism is consistent with our conclusion based on time-series methods that the Depression was not forecastable” (p. 605). On the contrary, the correct conclusion to draw from Dominguez’s article is not that the depression was unpredictable, but that the economics establishment has been using the wrong forecasting model! Harvard and Yale did not “tie” in the forecasting game, as the apologists claim; they both lost. In short, their methodology of forecasting depressions has been and remains seriously flawed. It is a tragedy that orthodox economists have not found a reliable theory of depressions, and that sophisticated time-series models have been unable to improve on the embarrassing record of the Harvard Economic Service and Irving Fisher. There is no reason to exult over a faulty model that expresses optimism in the face of the worst economic cataclysm in modern times.

<sup>4</sup>John Kenneth Galbraith, *The Great Crash, 1929* (1954; Boston: Houghton Mifflin, 1979), p. xi; new introduction.

such as the assassination of Julius Caesar, the landing of Columbus or the Battle of Waterloo, that historians find so convenient for marking the major turning points in the destiny of man.”<sup>5</sup>

### Irving Fisher and the “New Era” Advocates

First, let us review the optimistic views of historical figures who were devastatingly wrong about the 1929 crash and ensuing economic crisis. The most famous American economist, Yale professor Irving Fisher, belongs in this category. Fisher built a reputation as the foremost monetary theorist and advocate of the “quantity theory of money.” Even today he is hailed by some to be one of America’s best economists.<sup>6</sup> Based on his contemporary theoretical works, *The Nature of Capital and Income* and *The Purchasing Power of Money*, Fisher firmly believed in the long-run neutrality of money, signifying that an increase in the money supply would result in a proportional increase in prices without causing any long-term ill-effects. While he did refer to “maladjustments” and “over-investments” that might occur in specific lines of production, Fisher regarded them as points of short-term disequilibrium, caused mostly by institutional factors (contracts, customs, legal restrictions, etc.), which would eventually work themselves out.<sup>7</sup>

<sup>5</sup>Donald J. Hoppe, *How to Invest in Gold Stocks and Avoid the Pitfalls* (New Rochelle, N.Y.: Arlington House, 1972), p. 99. Another financial writer, James Dines, argues that “the stock market ‘discounts’ the future, so that when people refer to ‘1929’ they mean not so much the market crash of that year, but the Great Depression which the barometric stock market forecasted for 1932” (James Dines, *The Invisible Crash* [New York: Random House, 1975], p. 23).

<sup>6</sup>Mark Blaug calls Fisher “One of the greatest, if not the greatest, and certainly one of the most colourful American economists” (*Who’s Who in Economics*, Mark Blaug, ed., 2nd ed. [Cambridge, Mass.: MIT Press, 1986], p. 273).

<sup>7</sup>Irving Fisher, *The Nature of Capital and Income* (1906; 1912; Augustus M. Kelley, 1965); *The Purchasing Power of Money*, 2nd ed. (1911; 1916; 1922; New York: Augustus M. Kelley, 1963), pp. 184–85, passim. Perhaps a remark by Lord Keynes might appropriately apply to Fisher’s long-run equilibrium approach to monetary phenomenon: “Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again” (John Maynard Keynes, *A Tract on Monetary Reform* [London: Macmillan, 1923], p. 80).

Fisher's emphasis on long-term monetary stability and his tragic failure to see the coming onslaught were evident throughout the 1920s. He was a principal advocate of the "New Era" optimism of the Roaring Twenties, one of the upbeat apostles of a "new and better world." In the mid-1920s, he suggested that the "so-called business cycle" no longer had any essential basis in the economic system.<sup>8</sup> He favored the inflationary expansion of credit by the Federal Reserve in the 1920s as long as prices remained relatively stable, and in fact had a great deal of faith in the Federal Reserve system, expecting that it could stabilize the economy if a crisis arose.

Price stabilization was Fisher's principal monetary goal. He became a leading advocate of the "stable money" movement, having organized in May, 1931, the Stable Money League, later to become the Stable Money Association. Other prominent members of the stabilization association were economists Alvin Hansen, Arthur C. Pigou, Ralph G. Hawtrey, Knut Wicksell, Gustav Cassel, and John Maynard Keynes.<sup>9</sup>

The idea was not so much to stabilize the growth of the money supply, but to stabilize prices, particularly wholesale and consumer prices. According to Fisher and other price-stabilization advocates, if consumer prices remained relatively stable, everything was all right. But if prices began to sag, threatening deflation, the Fed should intervene and expand credit. In fact, wholesale and consumer prices in the United States were remarkably stable, and even declined slightly during the 1920s. Thus the monetarists thought everything was fine. They were thrown off-guard by this apparent price stability of the twenties. They failed to see the mischievous effects the Fed's expansionary policy would have in the latter half of the 1920s and dismissed the warning signs of economic trouble in such areas of the Florida real estate boom and the stock market euphoria.<sup>10</sup>

<sup>8</sup>Irving Fisher, "Our Unstable Dollar and the So-Called Business Cycle," *Journal of the American Statistical Association* (June 20, 1925): 179–202.

<sup>9</sup>A short review of the price stabilization movement is found in Murray N. Rothbard, *America's Great Depression*, 4th ed. (1963; New York: Richardson & Synder, 1983), pp. 153–64.

<sup>10</sup>Milton Friedman, today's most famous monetarist, denies that the Federal Reserve was the engine of inflation in the 1920s, or that the 1920s was inflationary at

In the latter half of the 1920s, Fisher became the chief oracle of the stock market boom. His excessive optimism was personal as well as ideological, since besides being a professor he was a millionaire businessman and major investor on Wall Street.

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all. "By 1923, wholesale prices had recovered only a sixth of their 1920–21 decline. From then until 1929, they fell on the average of 1 per cent per year. . . . The stock of money, too, failed to rise and even fell slightly during most of the expansion. . . ." He concludes: "Far from being an inflationary decade, the twenties were the reverse. And the Reserve System, far from being an engine of inflation, very likely kept the money stock from rising as much as it would have if gold movements had been allowed to exert their full influence" (Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States 1867–1960* [Princeton: Princeton University Press, 1963], p. 298). Friedman calls the 1920s the "high tide" of the Federal Reserve System, and makes a sharp distinction between the general economy and the stock market and real estate bubbles (pp. 291–92). He offers no explanation for the precipitous decline in the stock market. His principal concern is the sharp decline in the money stock between 1929 and 1933. See *ibid.*, pp. 299–300.

However, Anna J. Schwartz, in a separate article, suggests a probable relationship between the restrictive monetary policy beginning in late 1928 and the stock market crash. But she still insists that Fisher was right in believing that stock prices in 1929 were not generally overvalued. "Had high employment and economic growth continued, prices in the stock market could have been maintained" (Schwartz, "Understanding 1929–1933," *Money in Historical Perspective* [Chicago: University of Chicago Press, 1987], p. 130). Originally appeared in *The Great Depression Revisited*, Karl Brunner, ed. (Boston: Martinus Nijhoff, 1981), pp. 5–48.

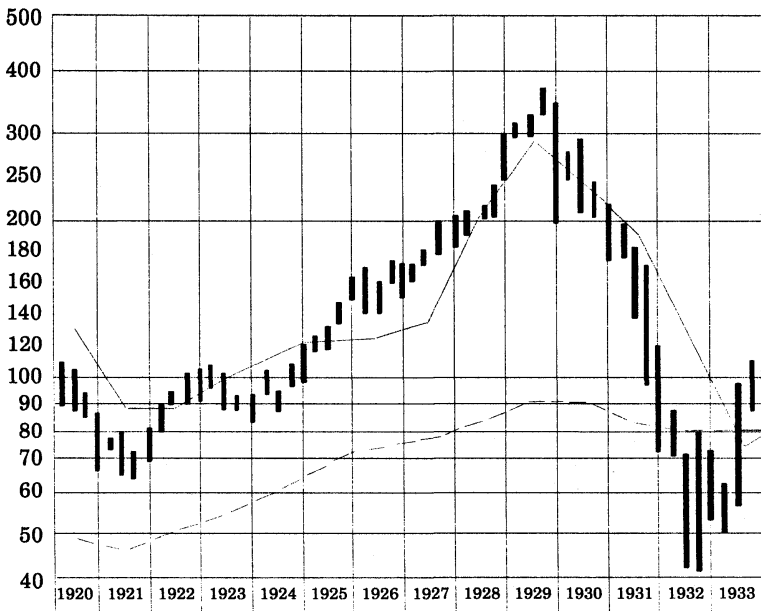
To support her thesis, Schwartz cites an article by Gerald Sirkin, professor of economics at the City University of New York. Based on seemingly reasonable price-earnings ratios for most stocks in 1929, Sirkin concludes that overall stock prices in 1929 "hardly present a picture of a 'speculative orgy'" (Sirkin, "The Stock Market of 1929 Revisited: A Note," *Business History Review* 49 no. 2 [Summer 1975]: 223–31). This is a classic example of the ivory-tower world of academia run amuck.

As any experienced security analyst knows, price-earnings ratios can be a highly misleading indicator of speculative activity. In fact, by their very nature, price-earnings ratios severely underestimate the degree of stock-market speculation because *both* prices and earnings tend to rise during a boom. Granted, *p/e* ratios rise overall in a bull market as a result of rising earnings expectations. But higher future earnings were illusory for a variety of reasons. Sirkin fails to realize, for example, that from 1926 to 1929, industrial production advanced only 8.1% and commodity prices fell 4.7%, while common stock prices rose 93%! See Schroeder Boulton, "Inflation and the Stock Market," in H. Parker Willis and John M. Chapman, *The Economics of Inflation* (New York: Columbia University Press, 1935, p. 311). According to the Standard Statistics Common Stock Average, a well-diversified holding of U. S. stocks would have more than trebled in value from 1924 to 1929. How Sirkin could consider such an increase in stock prices "not speculative" is beyond me. Whenever stock prices rise consistently faster than industrial output in general, a stock market "correction" is inevitable. Clearly, the easy-credit policies of the Fed in the 1920s went primarily into stocks, real estate and other capital-intensive markets rather than other areas of the economy, creating an imbalance that hardly reflected itself in price-earnings ratios. Thus, "speculative orgy" is a proper description of the 1929 stock market.



Fisher saw the booming stock market as a reflection of the “New Era” of permanent prosperity in America. He denied any “orgy of speculation” even though the Dow Jones Industrial Average climbed from 103 in 1922 to an all-time high of 381 on September 3, 1929, more than trebling in seven years. (See figure 1.) When, on September 5, 1929, the less-influential financial advisor Roger W. Babson warned investors of an impending crash, Fisher refuted Babson, saying, “There may be a recession in stock prices, but not anything in the nature of a crash.”<sup>11</sup>

**Figure 1**  
Dow Jones Industrial Average, 1920-1933



Source: *Value Line Investment Survey*, Quarterly price range.

<sup>11</sup>*New York Herald-Tribune*, 6 September 1929. For an account of the Babson-Fisher feud, see Robert T. Patterson, *The Great Boom and Panic, 1921-1929* (Chicago: Henry Regnery, 1965), pp. 89-90. Several weeks later, on 16 October 1929, Fisher said, “I do not feel that there will soon, if ever, be a fifty or sixty point break below present levels, such as Mr. Babson has predicted.”

For nearly two months, Fisher appeared to be right. While the market did not reach new highs, neither did it fall sharply. On October 15, less than two weeks before the crash, Fisher opined, "I expect to see the stock market a good deal higher than it is today, within a few months."<sup>12</sup> The next day, he made the soon-to-be-immortal prediction that "stock prices have reached what looks like a permanently high plateau."<sup>13</sup> On Monday, October 21, 1929, he suggested that "even in the present high market, the price of stocks have not yet caught up with their real values." Any drop in stock prices "was a shaking-out of the lunatic fringe that attempts to speculate on margin. . . ."<sup>14</sup> Finally, on October 22, two days before Black Thursday, Fisher stated, "in my opinion current predictions of heavy reaction affecting the general level of securities find little if any foundation in fact."<sup>15</sup>

But Fisher was unrepentant after the unexpected collapse of stock prices between late October and December. By mid-December he had written a new book, *The Stock Market Crash—And After*, a bold attempt to reestablish optimism in the nation. He rationalized, "I had stated my opinion in September, preceding the panic, that the market had reached its peak, as proved to be the case. I also expressed the view that the recession would not be in the nature of a serious crash, in which I was mistaken. I also predicted that the new plateau of stock prices would survive any recession. This has proven true."<sup>16</sup>

Unfortunately, Fisher was wrong again. Despite his faith in Hoover's program to stem the tide, the Dow industrials fell an additional 200 points before bottoming out in 1932 around 40! His own portfolio was practically wiped out by the extended Wall Street crash. To end the depression in the early thirties, Professor Fisher advocated reflation, devaluation, and abandoning the

<sup>12</sup>Gordon Thomas and Max Morgan-Witts, *The Day the Bubble Burst* (New York: Penguin Books, 1979), p. 324.

<sup>13</sup>Edward Angly, compiler, *Oh Yeah?* (New York: Viking Press, 1931), p. 38. *New York Times*, 16 October 1929.

<sup>14</sup>Thomas and Morgan-Witts, *The Day the Bubble Burst*, p. 343.

<sup>15</sup>Paterson, *The Great Boom and Panic*, p. 29.

<sup>16</sup>Irving Fisher, *The Stock Market Crash—And After* (New York: Macmillan, 1930). His introduction is dated 15 December 1929.

gold standard. Welcoming Franklin Delano Roosevelt's decision to act in 1933, he felt the bottom had been reached and he could finally stave off bankruptcy.<sup>17</sup>

Clearly, Fisher's monetary ideology and theory of price stabilization proved to be fatally flawed in the critical stages of a world economic crisis. His macroeconomic vision concealed basic financial facts which should have raised serious question marks about the soundness of the economic system. For instance, wasn't he concerned about the fact that the call rate on stock margin loans reached 15–20% in 1929 while the discount rate remained at 6%? Such a discrepancy should ring alarm bells to any seasoned speculator. Surely he must have sensed danger. Yet, typical of many financial advisors blinded by a pet theory, he could not see what now appears to be obvious. Monetarists such as Fisher who focus exclusively on general commodity prices as an indication of inflation instead of Federal Reserve credit policies are bound to be disappointed in their ability to predict the future of economic events.

### Mitchell and "New Era" Optimism

Fisher was not alone among members of the economic profession in his failure to predict the crash. Another representative of the "New Era" thesis was Wesley C. Mitchell, the uncontested authority on business cycles in the 1920s. Mitchell was not only an economics professor at Columbia, but director of the National Bureau of Economic Research in New York, thus embodying the spirit of academic, business and government collaboration. He was a classic example of an economist who, with all his erudite credentials and objective analysis, should have been able to foresee the impending crisis. Yet he did not.<sup>18</sup> Ironically, only several months

<sup>17</sup>For a review of Fisher's career, see Irving Norton Fisher, *My Father Irving Fisher* (New York: Comet Press, 1956), especially pp. 242–65.

<sup>18</sup>Perhaps the reason for Mitchell's failure to recognize the forthcoming crisis was that he was essentially an empiricist, not a theoretical economist. As Stoneman states, "Originally inspired by Veblen, Mitchell had soon been drawn into a purely empirical and quantitative approach to economics" (William E. Stoneman, *A History of the Economic Analysis of the Great Depression in America* [New York: Garland Publishing,

before the critical turn of events in 1929, Mitchell wrote an essay in a National Bureau report which historian William E. Stoneman calls "the definitive document of moderate New Era economics."<sup>19</sup> Mitchell's essay was a final review of the 1920s economy, prepared for the President's Conference on Unemployment, which was chaired by Herbert Hoover and included leaders in finance, labor, science and education. The Report of the Committee set the tone of the study: "Acceleration rather than structural change is the key to an understanding of our recent economic developments. . . . Our situation is fortunate, our momentum is remarkable."<sup>20</sup>

Although Mitchell's heart was with the "New Era" euphoria, he refrained from saying that the business cycle was a thing of the past, noting that "all is not well." He foresaw that "the pace will slacken presently" and the signs of prosperity were "wearing thin."<sup>21</sup> Nevertheless, while expressing some misgivings about pockets of economic and price weakness in the economy, he endorsed the high-wage, high-consumption character of the country. Since there was little evidence of an "unhealthy boom," it would be unlikely that there would be any "violent relapse." He saw few signs of overbuilding and overspeculation.<sup>22</sup>

Another case for "New Era" confidence in the U. S. economy was expressed by the Harvard Economic Society. Although not

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1979], p. 20). Without a theoretical underpinning, it is virtually impossible to reach any conclusions about the future based solely on past economic data. Cf. Milton Friedman, "Wesley C. Mitchell as an Economic Theorist," *Journal of Political Economy* (December 1950); and Arthur F. Burns, ed., *Wesley Clair Mitchell, The Economic Scientist* (New York: National Bureau of Economic Research, 1952), pp. 237-82.

<sup>19</sup>Stoneman, *A History of the Economic Analysis*, p. 20.

<sup>20</sup>"Report of the Committee," *Recent Economic Changes in the United States* (New York: McGraw-Hill, 1929), pp. ix, xxii. In the introduction, Edwin F. Gay, professor of economic history at Harvard, states: "The strength and stability of our financial structure, both governmental and commercial, is of modern growth" (p. 11).

<sup>21</sup>Wesley C. Mitchell, "A Review," *Recent Economic Changes in the United States* (New York: McGraw-Hill, 1929), pp. 909-10.

<sup>22</sup>*Ibid.*, pp. 890-94, 909-10. Another economist who had a bright outlook on the stock market and the economy was Professor Charles Dice of Ohio State, who claimed in his book, *New Levels in the Stock Market*, that stock prices were only "registering the tremendous changes that were in progress." See Robert Sobel, *Panic on Wall Street* (New York: Macmillan, 1968), p. 368.

particularly bullish, the Harvard Economic Society predicted a correction in the market, but “no business depression.” After the crash, the economic society stated that “despite its severity, we believe that the slump in stock prices will prove an intermediate movement and not the precursor of a business depression such as would entail prolonged further liquidation.”<sup>23</sup>

### The Misinterpretation of Keynes

Other well-known economists also missed the sudden decline in the markets and the economic crisis in 1929. R. G. Hawtrey, Britain’s leading monetarist and cycle analyst, was convinced by 1926 that if credit could be controlled, the “trade cycle” could be banished forever.<sup>24</sup>

British economist John Maynard Keynes shared Fisher’s optimism about America’s Federal Reserve expansionary policy. He was generally preoccupied with the British economic malaise which began several years before the depression in the United States. Keynes had correctly predicted the disastrous results of Britain’s return to the gold standard at an overvalued sterling exchange rate in 1925, but he had no such luck in prognosticating the economy across the Atlantic. He hailed the management of the dollar by the Federal Reserve Board from 1923 to 1928 as a “triumph” for central bank management.<sup>25</sup> He remained unconcerned about the huge rise in stock prices on Wall Street. In fact, in 1927, he met with Swiss banker Felix Somary and was anxious to buy stocks. When Somary

<sup>23</sup>Frederick Lewis Allen, *Only Yesterday* (New York: Harper & Row, 1931), p. 323. However, not everyone at Harvard was unconcerned. According to one report, Dean Wallace Donham and professor of investment banking Clinton P. Biddle warned students to get out of the market in early October, 1929. See Tom Shachtman, *The Day America Crashed* (New York: G. P. Putnam’s, 1979), p. 98.

<sup>24</sup>R. G. Hawtrey, “The Trade Cycle,” reprinted in *Readings in Business Cycle Theory* (Philadelphia: American Economic Association, 1944), pp. 333–49. Originally published in 1926 in a Dutch journal.

<sup>25</sup>Colleague D. H. Robertson concurred in 1929 that “a monetary policy consciously aimed at keeping the general price level approximately stable . . . has apparently been followed with some success by the Federal Reserve Board in the United States since 1922” (Robertson, “The Trade Cycle,” *Encyclopedia Britannica*, 14th ed. [1929] 22:354).

expressed pessimism about the future of securities prices, Keynes responded with the prediction, "We will not have any more crashes in our time."<sup>26</sup>

In late 1928, Oswald T. Falk, one of the members of the board of the National Mutual Life Insurance Company, of which Keynes was chairman, was alarmed at the "dangerous inflation" in the United States, suggesting that the company liquidate most of its American holdings. But Keynes wrote two papers disagreeing with Falk. In the second paper dated September 1, 1928, entitled "Is There Inflation in the United States?" he reviewed data on the cost of living and business credit and concluded that there was "nothing which can be called inflation yet in sight." Referring to both real estate and stock values in the United States, Keynes added: "I conclude that it would be premature today to assert the existence of over-investment. . . . I should be inclined, therefore, to predict that stocks would not slump severely (i.e., below the recent low level) unless the market was discounting a business depression." Such would not be probable since the Federal Reserve Board "will do all in its power to *avoid* a business depression."<sup>27</sup> By the time he had completed his *Treatise on Money* in 1930, however, he admitted he had been misled by stable price indices in the 1920s, and that a "profit inflation" had developed in 1928.<sup>28</sup>

## The Political Environment in 1929

Back in the United States, the Coolidge and Hoover administrations also failed to foresee trouble ahead. When Coolidge left

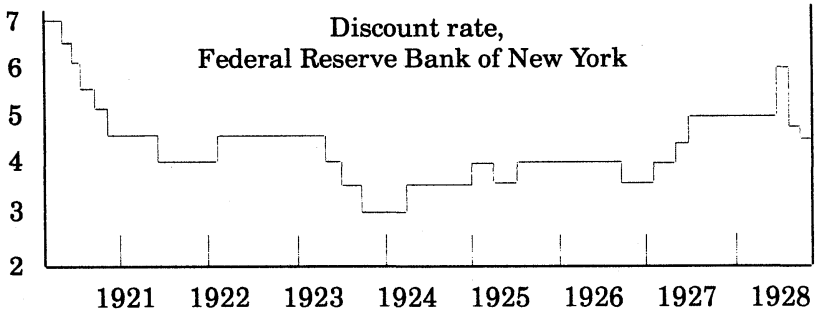
<sup>26</sup>For an account of the conversation between Keynes and Somary, see Felix Somary, *The Raven of Zürich* (1960; London: C. Hurst, 1986), pp. 146–47.

<sup>27</sup>John Maynard Keynes, *The Collected Writings of John Maynard Keynes*, vol. 13 (London: Macmillan, 1973), pp. 52–59. Also see Charles H. Hession, *John Maynard Keynes* (New York: Macmillan, 1984), pp. 238–39.

<sup>28</sup>John Maynard Keynes, *A Treatise on Money*, vol. 2 (New York: Harcourt, Brace and Co., 1930), p. 190; see pp. 190–98. Keynes lost three-fourth's of his net worth during 1929. See Donald Muggerridge, "Keynes as an Investor," in *The Collected Writings of John Maynard Keynes*, vol. 12 (London: Macmillan, 1973).

<sup>29</sup>Herbert Hoover, *Memoirs of Herbert Hoover: The Great Depression, 1929–1941* (New York: Macmillan, 1952), p. 16.

**Figure 2**  
**Discount Rate**  
**Federal Reserve Bank of New York, 1921-1929**



Source: Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, 1963), p. 304.

office in March, 1928, he continued the “New Era” optimism, calling American prosperity “absolutely sound” and stocks “cheap at current prices.”<sup>29</sup> Herbert Hoover was not as enthusiastic about the cheap credit policies of the Federal Reserve as Coolidge and Treasury Secretary Andrew Mellon were, particularly in stimulating the stock market. He opposed Benjamin Strong, Governor of the Federal Reserve of New York, who since 1924 had encouraged lower interest rates and easy credit in the United States through open-market operations in order to boost domestic prices and alleviate Britain’s overvalued exchange rate. Under the leadership of Strong and the New York Fed, the Federal Reserve Board had gradually reduced the discount rate, the interest charged to members to borrow money from the central bank, from 6 1/2% in 1921 to below 4% by August, 1927. (See figure 2.) Only in late 1928 did Strong belatedly fret about the “terrible speculation” going on in

<sup>29</sup>Herbert Hoover, *Memoirs of Herbert Hoover: The Great Depression, 1929-1941* (New York: Macmillan, 1952), p. 16.

the United States, and by then it was too late. He died and was incapable of turning the tide. By the spring of 1929, the Federal Reserve Board became alarmed over the caprices of Wall Street and the lending of funds for stock purchases. It issued a warning to member banks not to lend money for stock purchases, eventually raised the discount rate, and stopped net sales of government bonds on the open market. The full impact of this anti-inflation policy wasn't felt until October.

Despite these growing concerns, Hoover continued to make highly favorable public statements about the soundness of the economy. Years later, in his memoirs, Hoover said he was misled by members of the Federal Reserve, who told him, "We shall have no more financial panics. . . . Panics are impossible . . . unthinkable."<sup>30</sup> Soon the raging stock market became known as the "Hoover bull market," which Hoover did nothing to discourage at least publicly. Treasury Secretary Mellon continued to allay fears that the market was moving too far too fast. "There is no cause for worry. The high tide of prosperity will continue," he said in September, 1928.<sup>31</sup>

The day after Black Thursday, when the market dropped 100 points, Hoover announced to the nation. "The fundamental business of the country, that is the production and distribution of commodities, is on a sound and prosperous basis."<sup>32</sup> Several months later, in March, 1930, he spoke optimistically. "All the evidence indicates that the worst effects of the crash will have passed within sixty days."<sup>33</sup> Unfortunately, Hoover had his head in a cloud.

<sup>30</sup>Ibid., p. 7.

<sup>31</sup>Galbraith, *The Great Crash, 1929*, p. 15. Galbraith condones the phony enthusiasm of government pronouncements as a harmless "ritual which, in our society, is thought to be a great value for influencing the course of the business cycle. By affirming solemnly that prosperity will continue, it is believed, one can help insure that prosperity will in fact continue" (p. 16). On the other hand, perhaps if Hoover had spoken out earlier against the "South Sea Bubble" on Wall Street (Hoover's phrase used in his memoirs, not in 1929), perhaps the public would not have jumped in frantically as they did in late 1929, only to be massacred and financially destroyed. Perhaps the best thing that can be said about political predictions is that, in the words of de Jouvenal, "the man with the least foresight is...the man in the seat of power" (Bertrand de Jouvenal, *The Art of Conjecture* [New York: Basic Books, 1957], p. 151).

<sup>32</sup>Thomas and Morgan-Witts, *The Day the Bubble Burst*, p. 376.

<sup>33</sup>Donald J. Hoppe, *How to Invest in Gold Stocks*, p. 100.



## The Financial Bulls

There were, of course, an exceedingly large group of bankers, brokers and financial writers who saw no dangers on Wall Street even weeks before the crunch and plunged into the market with reckless abandon. Speculators included the Fisher brothers of Detroit, wheat magnet Arthur W. Cutten (known as the "Great Bull"), and Charles E. Mitchell, president of National City Bank of New York. Mitchell, as late as September 15, 1929, spoke favorably. "The markets generally are now in a healthy state."<sup>34</sup>

Financial journals such as the *Wall Street Journal* and *Barron's* were late in foreseeing the stock market decline and frequently belittled the market "bears" such as Roger Babson. William P. Hamilton, editor of the *Wall Street Journal* until late 1929, was a follower of the Dow theory, based on the technical investment approach of Charles H. Dow, the co-founder of the journal. Based on Dow's work, Hamilton wrote *The Stock Market Barometer* and argued that when two lines (the Dow industrials and the rails) broke above the equilibrium "line," it was an indication that the market was bullish. When the two lines broke below their market average, it was a bearish sign.

Throughout the 1920s, Hamilton and the *Wall Street Journal* were essentially optimistic as the trendlines moved upward. In October, 1927, in the midst of the bull market, Hamilton editorialized that, based on the Dow theory, "The stock market is saying, in so many words, that the business outlook is good and likely to continue. . . ."<sup>35</sup> The *Wall Street Journal* remained confident up to the time of the crash, a typical attitude of market technicians. Hamilton debunked Babson's September 5 warning of a collapse.

But, suddenly, on October 25—a day after Black Thursday—Hamilton flashed a warning signal in a journal editorial, "Turn of

<sup>34</sup> John Brooks, *Once in Golconda* (New York: Harper & Row, 1969), p. 112. Mitchell appears to have ignored warnings made by economists at his own bank. A report by the National City Bank of New York stated on April 18, 1929, "If the rate of credit increase rises above the rate of business growth, we have a condition of inflation which manifests itself in rising prices in some departments of the business structure, over-confidence, excessive speculation, and an eventual crash."

<sup>35</sup> Editorial, *Wall Street Journal*, 3 October 1927.

the Tide." He was 52 days and 80 points late from the top, but he recommended selling before the market dropped another 150 points. However, by early November, Hamilton had switched attitudes again, especially after John D. Rockefeller, by then an octogenarian, announced bravely, "There is nothing in the business situation to warrant the destruction of values that has taken place in the past week, and my son and I have for some days past been purchasing sound common stocks."<sup>36</sup> Hamilton editorialized in the *Wall Street Journal*: "The sun is shining again, and we will go on record as saying some good stocks are cheap. We say good stocks are cheap because John D. Rockefeller said it first. Only the foolish will combat John D.'s judgment."<sup>37</sup>

Stock-market fundamentalists, who relied on earnings and other vital statistics to predict the future of individual companies, did not necessarily fare any better in the stock market crash than the Dow theorists and other technicians did. Benjamin Graham, author of the Wall Street bible, *Security Analysis*, did not escape. "Graham's clients suffered in the Crash like everybody else. But he managed to keep them solvent, and over the next several decades he consistently compiled a creditable investment record."<sup>38</sup>

One of the biggest promoters of the stock market and easy credit was William Crapo Durant, president of General Motors. When the Fed warned member banks not to divert funds to stockbrokers for margin in February, 1929. Durant strongly opposed this measure, and in a secret meeting in Washington, tried to persuade Hoover and the Fed to return to easy money policies. When they refused, Durant clandestinely unloaded billions of dollars in GM stock and other securities. He was able to do this without causing a market panic by having former GM officer John J. Raskob, who had recently become chairman of the Democratic Party, travel around the country promoting GM and the stock market! In a well-publicized

<sup>36</sup>*New York Times*, 31 October 1929. Quoted in Thomas and Morgan-Witts, *The Day the Bubble Burst*, p. 402.

<sup>37</sup>"Broad Street Gossip," *Wall Street Journal* (1 November 1929), p. 2.

<sup>38</sup>David Dreman, *The New Contrarian Investment Strategy* (New York: Random House, 1982), p. 43.

interview in the August, 1929, issue of *Ladies Home Journal*, entitled, "Everybody Ought to be Rich," Raskob suggested that if a person invested only \$15 a week in stocks, he could accumulate \$80,000 or more in 20 years.

However, in the end, Durant's scheme failed. While he largely escaped the October crash, he got back into the market prematurely in 1930, and was wiped out. By 1936, he declared bankruptcy.<sup>39</sup>

The only other principal character in the "see no evil" play of the twenties was John Moody, president of Moody's Investor Service and publisher of *Moody's Bond Ratings*. Although his firm had suggested caution in January, 1929, by May he envisioned an America geared for a future without precedent. "The lessons taught by the crude financial errors of the speculative corporate period, extending from 1898 down into the war and through the deflation of 1920-21, had been well learned by government and financial interests all over the country."<sup>40</sup> How ironic that the man who rated the safety of the corporate and government bonds could be rated so low for accuracy, especially after having lived through the Panic of 1907! In stark contrast, the Standard Statistics Company and Poor's *Weekly Business and Investment Letter* were both extremely cautious in late 1929.<sup>41</sup>

### "Sound Money" Economists as Dissenters

The number of bearish economists, bankers, and financial writers who actually predicted a stock market crash and economic depression were few and far between in the 1920s.

Among American economists, the only group to raise serious concerns over the inflationary twenties were from the old-fashioned "sound money" banking school. Two eminent economists representing this "hard money" tradition were Benjamin M. Anderson, the chief economist at Chase National Bank, and H. Parker Willis,

<sup>39</sup>For a full account of Durant's devious maneuvers, see Dana L. Thomas, *The Plungers and The Peacocks* (New York: G. P. Putnam's, 1967), pp. 189-92, 214-15.

<sup>40</sup>*The Literary Digest*, 26 May 1928.

<sup>41</sup>Allen, *Only Yesterday*, p. 322.

professor of banking at Columbia University and editor of the *Journal of Commerce*. Both economists were highly critical of Irving Fisher and the quantity theory of money. They shared the "Austrian" microeconomic approach toward economic events and emphasized the "real" distortions caused by bank credit expansion, especially in the stock market and real estate.

As the editor of *The Chase Economic Bulletin*, Benjamin Anderson frequently attacked the Fed-induced inflation of the 1920s and the policy of commodity price stabilization, calling it "wrong and dangerous."<sup>42</sup> He blamed rising interest rates in the late 1920s on the earlier efforts by the Federal Reserve to maintain artificially low interest rates. In particular, he said that "we touched the match to the powder keg" and "turned loose the incalculable psychological force of speculative contagion" in August, 1927, when the Fed reduced the discount rate to 3 1/2%.<sup>43</sup> He attacked Swedish economist Gustav Cassel for suggesting that the United States did not release enough credit in 1925–27 because commodity prices continued to decline.<sup>44</sup> After the October, 1929, massacre, Anderson said the cause of the trouble was "excessive cheap money and unlimited bank credit available for capital uses and speculation" in 1922–28. As to where the market was headed, he stated, "I am not a prophet. . . . I do not know what the stock market is going to do." But he discounted the possibility of a depression. "A business crisis today is absolutely precluded." He called for a mild slowdown only.<sup>45</sup>

Like Anderson, Willis rejected a strict quantity theory of money. "Rising prices are by no means universally identical with inflation.

<sup>42</sup>Benjamin M. Anderson, "Commodity Price Stabilization A False Goal of Central Bank Policy," *The Chase Economic Bulletin* 9, no. 3 (8 May 1929): 4. A summary of Anderson's reflections on the 1929-1933 economic crisis is found in his excellent work, *Economics and the Public Welfare: A Financial and Economic History of the United States, 1914-1946* (1949; Indianapolis, Ind.: Liberty Press, 1979), esp. pp. 144–50, 182–230.

<sup>43</sup>*Ibid.*, and "The Financial Situation," *The Chase Economic Bulletin* 9, no. 6 (22 November 1929): 4.

<sup>44</sup>See Gustav Cassel, *Post-War Monetary Stabilization* (New York: Columbia University Press, 1928), pp. 92–93.

<sup>45</sup>Anderson, "The Financial Situation" 11, no. 6 (22 November 1929), pp. 4, 13–14.

. . . [The] mechanism of inflation is not uniform."<sup>46</sup> For Willis, inflation induces an imbalance between production and consumption. "Inflation helps speculation by creating unsettled speculative conditions."<sup>47</sup>

### Mises and Hayek as Economic Forecasters

In Europe, the only group of economists to predict a market collapse and worldwide depression were the Viennese economists, Ludwig von Mises and Friedrich A. Hayek. It was their prediction of a forthcoming economic collapse in the 1920s that created a intense interest in their economic theories in the early 1930s, especially in England.

Mises was an economic advisor to the Austrian Chamber of Commerce when he wrote his definitive *The Theory of Money and Credit* in 1912. Based on the monetary theories of Knut Wicksell, Mises argued that the forced lowering of interest rates by central banks inevitably creates an artificial boom, especially in the capital-goods industries, which cannot last. Moreover, Mises stated that the gold standard, even though weakened by the central banks, would eventually force individual nations to give up their inflationary policies and go through a bust. He was critical of Fisher's price-index stabilization scheme, which "could not in any way ameliorate the social consequences of variations in the value of money."<sup>48</sup> The bust was inevitable whether consumer prices increased or not. As Mises later explained in his magnum opus, *Human Action*, "The crash was the necessary outcome of the attempts to lower the rate of interest by credit expansion."<sup>49</sup>

<sup>46</sup>H. Parker Willis, "Some Conclusions: The Nature and Effect of Inflation," in H. Parker Willis and John M. Chapman, *The Economics of Inflation* (New York: Columbia University Press, 1935), pp. 207–08.

<sup>47</sup>*Ibid.*, p. 216.

<sup>48</sup>Ludwig von Mises, *The Theory of Money and Credit*, 2nd ed. (1934; Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1971), p. 402.

<sup>49</sup>Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, 1966), p. 853.

As early as 1924, Mises told his colleagues in Vienna that an economic collapse was coming. The depression would be worldwide because practically every country was on a gold standard with a central bank that was inflating after the great war. Fritz Machlup recalls Mises "gift of prophecy":

As his assistant in the university seminar which met every Wednesday afternoon, I usually accompanied him home. On these walks we would pass through a passage of the Kreditanstalt in Vienna. From 1924, every Wednesday afternoon as we walked through the passage for pedestrians he said: 'That will be a big smash.' Mind you, this was from 1924 onwards; yet in 1931, when the crash finally came, I still held some shares of the Kreditanstalt, which of course had become completely worthless.<sup>50</sup>

There is more to this story. In the summer of 1929, Mises was offered a high position at Credit Anstalt, which at the time was one of the largest banks in Europe. His future wife, Margit, was ecstatic, but Mises surprised her when he said he decided not to accept the offer. "Why not?" she asked. His response shocked her: "A great crash is coming," he said, "and I don't want my name in any way connected with it."<sup>51</sup> After the United States market collapsed several months later, world trade suffered and in May, 1931, Credit Anstalt went bankrupt which, more than any other event, extended the depression throughout Europe.

After the depression was in full swing, Mises commented on his prediction in an introduction to the English translation of *The Theory of Money and Credit*:

<sup>50</sup>Fritz Machlup, "Tribute to Mises" (The Mont Pelerin Society, 13 September 1974), p. 12. Machlup also said that Mises predicted as early as 1927 that the end of freedom in Central Europe was coming, and suggested that free-market economists would be forced to leave Europe. The threat of Hitler in the 1930s resulted in the fact that by 1938, according to Machlup, "most of us had acted upon the master's advice and had taken the first chance we got to leave our native country in good time" (p. 13).

<sup>51</sup>Margit von Mises, *My Years with Ludwig von Mises*, 2nd ed. (Spring Mills, Penn.: Libertarian Press, 1984), p. 23.

From 1926 to 1929 the attention of the world was chiefly focused upon the question of American prosperity. As in all previous booms brought about by expansion of credit, it was then believed that the prosperity would last forever, and the warnings of the economists were disregarded. The turn of the tide in 1929 and the subsequent severe economic crisis were not a surprise for economists; they had foreseen them, even if they had not been able to predict the exact date of their occurrence.<sup>52</sup>

Mises's student, Friedrich A. Hayek, also expected an economic crisis, specifically in the United States. His timing appeared to be a little more precise than Mises's. As director of the Austrian Institute of Economic Research, Hayek published several pessimistic articles in the institute's monthly reports in 1929. Referring to this prediction in an interview in 1975, Hayek stated:

I was one of the only ones to predict what was going to happen. In early 1929, when I made this forecast, I was living in Europe which was then going through a period of depression. I said that there [would be] no hope of a recovery in Europe until interest rates fell, and interest rates would not fall until the American boom collapses, which I said was likely to happen within the next few months.<sup>53</sup>

Hayek explained the theoretical underpinnings for his outlook in the late 1920s:

What made me expect this, of course, is one of my main theoretical beliefs that you cannot indefinitely maintain an inflationary boom. Such a boom creates all kinds of artificial jobs that might keep going for a fairly long time but sooner or later must collapse. Also, I was convinced after 1927, when the Federal Reserve made an

<sup>52</sup>Ludwig von Mises, "Preface to English Edition," *The Theory of Money and Credit*, H.E. Batson, trans. (Indianapolis, Ind.: Liberty Fund, 1980), pp. 14–15. Written in June, 1934.

<sup>53</sup>Interview with F. A. Hayek, *Gold & Silver Newsletter* (Newport Beach, Calif.: Monex International, June 1975). Hayek's report appeared in *Monatsberichte des Österreichischen Instituts für Konjunkturforschung* (1929). Lionel Robbins refers to Hayek's prediction of the depression in America in the Foreword to Hayek's *Prices and Production*, 1st ed. (London: George Routledge & Sons, 1931), p. xii.

attempt to stave off a collapse by credit expansion, the boom had become a typically inflationary one.

So in early 1929 there was every sign that the boom was going to break down. I knew by then that the Americans could not prolong this sort of expansion indefinitely, and as soon as the Federal Reserve was no longer willing to feed it by more inflation, the thing would collapse.

In addition, you must remember that at the time the Federal Reserve was not only unwilling but was *unable* to continue the expansion because the gold standard set a limit to the possible expansion. Under the gold standard, therefore, an inflationary boom could not last very long.<sup>54</sup>

The Austrian economists were able to forecast the economic debacle, particularly in the United States, because they looked beyond general price indices and stable macroeconomic phenomenon such as wage levels and consumer spending. They focused on the *micro* foundations of the economy, and how artificially low interest rates and credit expansion encouraged “a dangerous stock market and real estate boom.”<sup>55</sup> In sharp contrast to the orthodox economists in the 1920s, the Austrians did not consider real estate and the stock market as isolated factors in the economy. As Rothbard indicates, both securities and real estate are titles to capital, and are an integral reflection of the excessive expansion of the capital-goods industries in an inflationary boom.<sup>56</sup> Hence, an economic depression would necessarily include the decline in real estate and securities values.

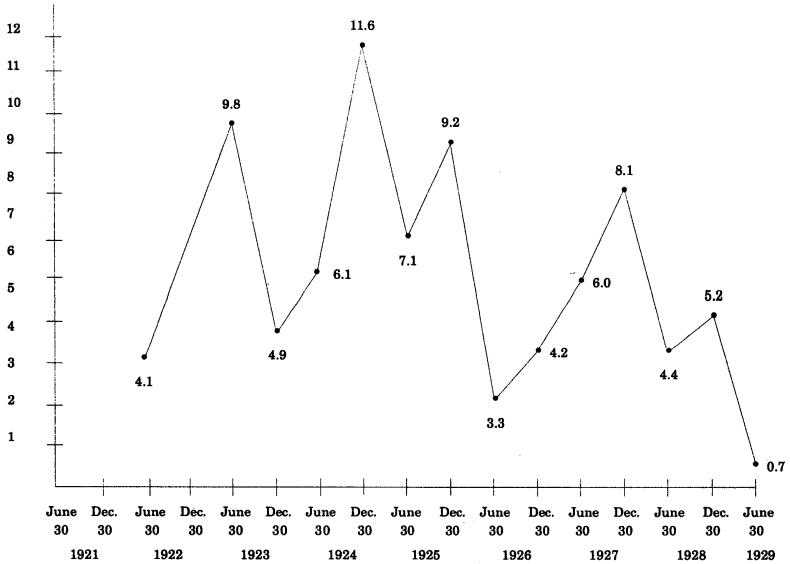
<sup>54</sup>Interview with Hayek, *Gold & Silver Newsletter*, June 1975.

<sup>55</sup>Murray N. Rothbard, “The New Deal and the International Monetary System,” in *The Great Depression and New Deal Monetary Policy* (San Francisco: Cato Institute, 1980), p. 85. Rothbard’s article originally appeared in *Watershed of Empire: Essays on New Deal Foreign Policy*, Leonard P. Liggio and James J. Martin, eds. (Colorado Springs: Ralph Myles, 1976).

<sup>56</sup>Rothbard, *America’s Great Depression*, pp. 75, 324, n. 24. Benjamin M. Anderson also emphasized the speculative mania in stocks and real estate. He pointed out that the bull market in real estate was not just in Florida, but in Manhattan and other areas of the country. Anderson, *Economics and the Public Welfare*, pp. 186–87, 204.



**Figure 3**  
**Growth Rate of Total Money Supply**  
**United States, 1921-1929**



Source: Murray N. Rothbard, *America's Great Depression* (San Francisco: Cato Institute, 1980), Table 1, p. 88.

As Hayek indicates, the Austrian economists in the 1920s were mindful of changes in the money supply figures in the United States. They knew that a financial break was not far away when the monetary engine slowed down, or stopped. (See figure 3.) As Rothbard summarizes:

The inflation of the 1920's was actually over by the end of 1928. The total money supply on December 31, 1928 was \$73 billion. On June 29, 1929, it was \$73.26 billion, a rise of only 0.7 per cent per annum. Thus, the monetary inflation was virtually completed by the end of 1928. From that time onward, the money supply remained

level, rising only negligibly. And therefore, from that time onward, a depression to adjust the economy was inevitable. Since few Americans were familiar with the "Austrian" theory of the trade cycle, few realized what was going to happen.<sup>57</sup>

### Swiss Banker Felix Somary

Another little-known Austrian economist and Swiss Banker, Felix Somary, was prophetically pessimistic prior to the depression. In fact, according to contemporaries, Somary prophesied the stock market crash, remained gloomy throughout the depression era, and foresaw the second world war as an inevitable consequence of the peace treaties after 1918.<sup>58</sup> Somary grew up in Vienna, studied economics under Böhm-Bawerk, and knew fellow students Joseph Schumpeter, Ludwig von Mises, and Otto Bauer. Like Mises, Somary was a defender of the free market and the gold standard, and a critic of socialism and government's inflationary policies. In 1901, he won the seminar prize for writing an article defending the inevitability of depressions. "How often in my later life have I again had to defend the thesis of major depressions and their inevitability, even in Socialist states, where they merely take another form."<sup>59</sup>

Somary found his brand of "hard money" economics useful as a Swiss banker, money manager, and diplomat. In September, 1926, Somary delivered a speech at the University of Vienna, predicting that the economic upswing and stock market boom that was just in its infancy "must end with the bankruptcy of governments and the destruction of banks."<sup>60</sup>

He rejected the commonly held view by mainstream economists at the time that commodity prices were stable and therefore no inflationary crisis could arise. Yet inflation was apparent in securities prices. In September, 1928, he spoke before a group of economists and stressed the large disparity between loan rates and the yield on

<sup>57</sup>Ibid., p. 147.

<sup>58</sup>Felix Somary, *The Raven of Zürich: The Memoirs of Felix Somary*, A. J. Sherman, trans. (New York: St. Martin's Press, 1986), pp. 272-92.

<sup>59</sup>Ibid., p. 14.

<sup>60</sup>Ibid., p. 281.

stocks, which he regarded as an “unmistakable symptom of a crash.”<sup>61</sup> His speech was not well-received. “Here among my acquaintance were representatives of at least a dozen economic theories, but not one of them had an inkling of the nearness of the greatest crash of our generation.”<sup>62</sup>

Somary recommended selling shares as early as 1926, thus missing out on a large part of the bull market on Wall Street. Many of his clients left him. In the summer, 1929, he noted:

For three years I had advised against share purchases, but many clients had not followed that advice; now was the time to extricate them from their shareholdings, as soon as possible. My telephone call saved many large amounts, and in several cases a client's entire fortune.<sup>63</sup>

Somary remained gloomy after the crash. In expectation of a banking panic in Europe, Britain going off the gold standard, and a worldwide depression, he withdrew in early 1931 all the assets of Blankart & Cie., the Swiss bank he managed, on deposit with banks in England, Germany, and Italy.<sup>64</sup> But in June 1932, he turned cautiously optimistic and published a small pamphlet entitled *Turning Point?*, suggesting that the worldwide depression has possibly bottomed out.<sup>65</sup> From all accounts, Somary was remarkably prescient until a few years before his death. In a lecture given at Harvard University, he warned that the government's cheap money policies would soon result in a new depression and economic catastrophe. The date was April 1956.<sup>66</sup>

## Babson and the Cassandras on Wall Street

A few notable financial figures became increasingly apprehensive about the stock market and the industrial boom in the late

<sup>61</sup>Ibid., p. 153.

<sup>62</sup>Ibid.

<sup>63</sup>Ibid., p. 157.

<sup>64</sup>Ibid., p. 162.

<sup>65</sup>Ibid., p. 166.

<sup>66</sup>Ibid., pp. 293–302.

1920s. No doubt the most famous doomsdayer was Roger W. Babson, an investment counselor from Boston who had an extensive career in politics, church work, education and science. To many, he was considered a mystical crank who tried to apply the laws of physics (Newton's Law of Action and Reaction) to economics and finance. Actually, Babson's combined use of trendlines in the "Babsoncharts" and division of business cycles into four distinct periods (improvement, prosperity, decline, depression) is not that different from those used by many respected chartists and cycle analysts today. But back in the 1920s, the use of such technical analysis was just beginning.

Nevertheless, Babson's fundamentals were basically sound. After determining which phase of the business cycle the country was in, he would review old volumes of the *Commercial and Financial Chronicle* to get a sense of what to expect. He had a healthy suspicion of market booms, which he knew could end swiftly after witnessing the 1907 panic and the Florida real estate bust in 1927-28.

Starting as early as September, 1926, he became bearish on the stock market. (The Dow Industrials only around 160, and would move another 200 points before topping out!) Babson admitted that his most serious mistake was in being premature in his pronouncements. His famous call on September 5, 1929, when he told listeners to sell stocks and buy gold, was not the first time he had predicted a crash. He stated so in his well-publicized speech before the Annual National Business Conference: "I still repeat what I said at this time last year and the year before; namely, that sooner or later a crash is coming which will take the leading stocks and cause a decline of from 60 to 80 points in the Dow-Jones Barometer."<sup>67</sup>

In his autobiography, Babson confessed:

Although I gave a very pessimistic address immediately preceding the collapse in September, 1929, yet I had been giving similar

<sup>67</sup>*New York Herald-Tribune*, 6 September 1929. Babson, known as the "Gloomy Gus of the financial soothsayer community," lost his credibility for crying wolf too often. "Babson had been wrong for such a long time that few could take him seriously, as he pontificated from a point hundreds of miles away from the nerve center of Wall Street" (Tom Shachtman, *The Day America Crashed* [New York: G. P. Putnam's, 1979], p. 99).

warnings for about eighteen months. Although a study of newspaper files shows that the Babson Organization was given almost exclusive credit for forecasting the great depression of 1929–35, yet it should be emphasized that we thought the break would come before it did. In the same way we thought the upward turn would come before it did in 1932.<sup>68</sup>

Babson expected a rapid business recovery starting in September, 1930—again years before it happened. Perhaps he was relying on the quick recovery made from the 1907 panic. History does not always repeat itself!

### Harwood: Another New England Voice in the Wilderness

Fellow New Englander E. C. Harwood was another voice in the wilderness who forecast dire consequences of unsound monetary practices. Based in Great Barrington, Massachusetts, he founded the American Institute for Economic Research, an independent investment advisory service and publisher of economic and financial studies. Harwood was a strong advocate of the gold standard, and believed that bank credit inflation was responsible for business malinvestments and financial fluctuations.

In addition to writing for his own publications, Harwood wrote regularly for *The Annalist*, a financial and economic weekly published by the *New York Times*. Noting the growing net export of gold from the United States in 1927, he concluded that the credit expansion by the Federal Reserve had to come to an end soon. In March, 1928, he compared the expanding credit to a swollen shoe:

To return to the credit “shoe,” we are in this position: the foot has swelled; there are numerous “bunions”; the Federal Reserve is

<sup>68</sup>Roger W. Babson, *Actions and Reactions: An Autobiography of Roger W. Babson*, 2nd ed. (New York: HarperCollins, 1950), p. 267. See also Earl L. Smith, *Yankee Genius: A Biography of Roger W. Babson* (New York: Harper & Brothers, 1954), pp. 262–70. According to the *Wall Street Journal* (6 September 1929), Babson had predicted a crash in the stock market as early as 11 September 1926.

tightening the “lacing”; and there is a fair probability that the “shoe” itself will shrink materially. Therefore, we should not be surprised if a pinching sensation develops in the not far distant future.<sup>69</sup>

Several years later, Harwood noted that the publication of his article was timely—bond prices reached their high in March, 1928. On January 25, 1929, he wrote in *The Annalist* that the banks were “overloaned,” and that only the Federal Reserve could forestall a collapse. In a follow-up article on February 15, he warned about the “grave dangers” in security speculation. “In the absence of any outside check, the situation is similar to the famous tulip speculation which occurred in the Netherlands, or even to the ill-fated Florida land boom. . . . [T]he current speculation in, and price inflation of, capital goods as represented by securities is far more dangerous than commodity speculation.”<sup>70</sup> Finally, on August 2, 1929, Harwood concluded that “the time may not be far distant when the country will realize, in the light of a ‘cold gray morning after,’ that it has just been on another credit-splurging spree.”<sup>71</sup> Moreover, once deflationary forces took hold in the post-1929 era, Harwood did not expect a quick return to prosperity.

## Joe Kennedy: A Lone Wolf Operator

Probably the most successful speculator in the 1929–33 period was Joe Kennedy. He seemed to have the ideal temperament for speculating—“a passion for facts, a complete lack of sentiment, a marvelous sense of timing,” said a confidante.<sup>72</sup>

<sup>69</sup>E. C. Harwood, “The Probable Consequences to Our Credit Structure of Continued Gold Exports,” *The Annalist* (23 March 1928). This and other articles by Harwood are summarized in his *Cause and Control of the Business Cycle*, 5th ed. (1932; Great Barrington, Mass.: American Institute for Economic Research, 1957), pp. 63–66.

<sup>70</sup>E. C. Harwood, “Speculation in Securities vs. Commodity Speculation,” *The Annalist* (15 February 1929).

<sup>71</sup>E. C. Harwood, “Deterioration of the American Bank Portfolio,” *The Annalist* (2 August 1929).

<sup>72</sup>Richard J. Whalen, *The Founding Father: The Story of Joseph P. Kennedy* (New York: New American Library, 1964), p. 66.

According to various accounts, Kennedy stayed in the market until late 1928, when he sold most of his RKO "A" stock and options, netting several million dollars. He spent the 1928–29 winter at his second home in Palm Beach, Florida, which he had purchased at a bargain price after the Florida real estate slump. Kennedy decided not to reinvest in 1929, but to stay in cash. "Only a fool holds out for the top dollar," he once said.<sup>73</sup> In the summer of 1929, when he saw that shoeshine boys were talking about the stock market, it reaffirmed his decision to stay out. "Then and there, so ran his recollection, he decided that a market anyone could play, and a shoeshine boy could predict, was no market for him."<sup>74</sup>

Kennedy also allegedly sold short during the long market descent in the early 1930s and made over a million dollars. Then he reentered Wall Street on the long side in early 1933, six months after the market had bottomed.<sup>75</sup>

## The Story of Jesse Livermore

What about Jesse Livermore, the speculator-king and "The Great Bear" of Wall Street? He made his name by shorting stocks in the Panic of 1907. But, despite his reputation as a perennial short-seller, he was a frequent buyer in the 1920s. He occasionally dabbled on the short side of the market in 1924, and shorted the market more frequently as the bull market matured. Knowing that Babson was going to deliver an alarmist speech on an otherwise dull market day in September, 1929, he loaded up on the short side, and profited handsomely when the "Babson Break" forced a sharp dip in the market. Quoted in the *New York Times* on October 21, he pointed out fundamental defects in the market: "What has happened . . . is the inevitable result of continuous rank manipulation of many stock issues to prices many times their actual worth based upon real earnings and yield returns. . . . If anyone will take the

<sup>73</sup>Ibid., p. 104, based on an interview with Oscar Haussermann in Boston on 10 October 1962.

<sup>74</sup>Ibid., p. 105.

<sup>75</sup>Ibid., pp. 107, 132.

trouble to analyze the prices of . . . stocks . . . They must look at them as selling at ridiculously high prices.”<sup>76</sup> Responding to Professor Fisher’s rosy outlook, Livermore exclaimed, “What can a professor know about speculation or stock markets? Did he ever trade on margin? Does he have a single cent in any of these bubbles he talks are cheap?”<sup>77</sup>

In terms of his public announcements, Livermore appeared to join the ranks of market dissenters. Unfortunately, he was of two minds during the crash, and did not follow his own advice! According to biographer Paul Sarnoff, Livermore had a habit of trading both sides of the market during the 1920s, and was both short and long in 1929–30. Sarnoff concludes, “Even though Livermore had won millions on the short side of the market, he had actually lost about six million in his long position! Incredibly enough, Livermore’s losses just about balanced any gains he may have made.”<sup>78</sup>

## The Two Faces of Bernard Baruch

The legendary Bernard Baruch said in his autobiography that he warned his friends right before the crash that he was selling out and for them to follow suit. He added, “Several times in 1928, in fact, I sold, feeling that a break was imminent, only to have the market continue upward.”<sup>79</sup> He also allegedly sold stocks short in the spring of 1930 to make up for stocks he still held, and bought some gold stocks as a hedge.

<sup>76</sup>*New York Times*, 21 October 1929. See also Tom Shachtman, *The Day America Crashed*, p. 57.

<sup>77</sup>Thomas and Morgan-Witts, *The Day the Bubble Burst*, p. 336. Of course, Irving Fisher was heavily invested in the market—he even borrowed money from the banks to buy new venture stocks and increase his position in Remington Rand, his primary stock holding. Remington declined from \$28 to \$1 during the long bear market. As one New Yorker commented, “Gosh, he’s suppose to know all the answers, and look how he got burned!” (quoted in I. N. Fisher, *My Father Irving Fisher*, pp. 262–63).

<sup>78</sup>Paul Sarnoff, *Jesse Livermore, Speculator-King* (Palisades Park, N.J.: Investors Press, 1967), p. 90. Contrary to rumor, Livermore did not kill himself after the stock market crash. He committed suicide in 1940, not 1930.

<sup>79</sup>Bernard M. Baruch, *My Own Story* (New York: Henry Holt, 1957), p. 244.



Certainly, Bernard Baruch did not suffer outwardly from the 1929–33 depression; he continued to travel abroad, support relatives, and make charitable and political contributions. But outward signs can be deceptive, and autobiographies are notoriously tainted. In actuality, while Baruch did get in on the ground floor of the stock market in 1924, he did not use the elevator to come down from its penthouse in 1929. He got caught up in the “industrial renaissance” optimism of the twenties. In June, 1929, he prophesied a new era of peace, understanding, and international cooperation.<sup>80</sup> A recent study of his brokerage records, tax returns, and other financial dealings resulted in a revisionist portrait of the Wall Street guru:

The weight of the evidence supports the conclusion that he didn't sell out in time. A thorough going industrial-renaissance optimist, he underestimated the gravity of the situation for months following the Crash and sold stocks only belatedly (so belatedly that his 1929 tax return showed a stock-trading profit: he hadn't taken his losses yet). On the other hand, he also managed to stay out of The Cleaners. He was not overextended on margin, and he resisted the temptation to buy stocks heavily before the liquidation had run its course. Before the devaluation of the dollar he had the presence of mind to buy gold and gold-mining shares. He was not the Bernard Baruch of legend, but that was the only standard by which he can be said to have failed.<sup>81</sup>

### Other Pessimistic Forecasts

A few financial editors realized early that the mad speculation on Wall Street would eventually end in a catastrophic plunge. Alexander Dana Noyes, financial editor of the *New York Times*, was highly critical of the speculative mania. In a November 21, 1928, editorial he stated that,

the stock market speculation has reached an exceedingly dangerous stage. . . . [T]he recent action of the stock market,

<sup>80</sup>James Grant, *Bernard Baruch: The Adventures of a Wall Street Legend* (New York: Simon & Schuster, 1983), pp. 243 n and 223–53.

<sup>81</sup>*Ibid.*, pp. 233–34.

supplemented by yesterday's wild extravagances, should emphasize the belief that this sort of thing cannot possibly be continued much longer. . . .<sup>82</sup>

By September, 1929, Noyes was making comparisons between the panic of 1907 and 1929, although he expressed the hope that the new Federal Reserve could stabilize the situation. After the crash hit, Noyes suggested that the general public was caught off guard because, unlike in previous panics, there were no warning signs of a major business or bank failure in 1929. "The end of the great speculation came at the moment when the whole community seemed to have convinced itself that the end would never come."<sup>83</sup>

Paul M. Warburg, prominent New York banker and a founder of the Federal Reserve System who previously encouraged an "easy money" policy, attacked the "orgies of unrestrained speculation" in the March 9, 1929, issue of *Commercial and Financial Chronicle*, pointing out that high stock prices were "quite unrelated to respective increases in plant, property, or earning power." He predicted that unless the speculative binge ended, it would "bring about a general depression involving the entire country."<sup>84</sup>

*The Commercial and Financial Chronicle* generally took a sober view of the financial situation in the late 1920s. In early 1929, president and editor Jacob Seibert editorialized that the "financial debauchery" of the late twenties was due to easy credit Fed policy.<sup>85</sup> He suggested that the Fed's warning of excessive stock speculation in February, 1929, was "altogether right" but too late to stem the tide.<sup>86</sup>

<sup>82</sup>*New York Times*, 21 November 1928. Quoted in Patterson, *The Great Boom and Panic*, pp. 57–58.

<sup>83</sup>Dana L. Thomas, *The Plungers and The Peacocks*, p. 194. *Dun's Review & Modern Industry* reflected the confident atmosphere by business in 1929: "Nothing has occurred to indicate that widespread recession is under way. . . ." (5 October 1929).

<sup>84</sup>*Commercial and Financial Chronicle* (9 March 1929), p. 1444. Quoted in Patterson, *The Great Boom and Panic*, p. 73. Regarding Warburg's critical role in promoting the Fed's policy of easy credit and low interest rates, see Rothbard, *America's Great Depression*, pp. 117–20.

<sup>85</sup>*The Commercial and Financial Chronicle*, 9 March 1929, p. 1443.

<sup>86</sup>*Ibid.*, 30 March 1929, pp. 1968–69.

However, after the crash, which he blamed on the Fed, he felt that the underlying economic conditions were now “sound.”<sup>87</sup>

### **Summary: The Uneasy Case for Forecasting**

Forecasting may be, like government, a necessary evil. To make consistent profits, whether in business or investments, one must have an accurate expectation of what the future holds. In the case of the boom-bust business cycle of the roaring twenties and the depressed thirties, making the right prediction at the right time was critical. As Bertrand de Jouvenel says, “A forecast is never so useful as when it warns men of a crisis.”<sup>88</sup> Those who failed to see the coming onslaught enjoyed the fruits of the boom while it lasted, but were destroyed financially when the unexpected bust hit. On the other hand, the handful of sober analysts who correctly prophesied the crisis avoided much of the economic pain, and may even have profited from it.

But timing is a critical element in the art of forecasting. It does little good to predict a future event if you are too early—or too late. Roger Babson is a good example. Suppose an investor had followed his advice and bought blue-chip stocks in 1924, when the Dow Jones Industrial Average was near the ground floor at 100. If the investor had responded to Babson’s warning of a slump, suppose he sold in late 1927, when the Dow Jones Averages hit 200. His investment would have doubled, not a bad 3-year return. But he would have missed the next 180 points on the upside from 1927 until late 1929. When the crash finally hit, his faith in Babson was renewed. But then, in September, 1930, upon Babson’s forecast of a “rapid business recovery,” the investor would have repurchased, thinking this would be the turning point. The Dow was then back at 200, the same price it was when Babson recommended selling in late 1927! Unfortunately, the Dow continued to

<sup>87</sup>Ibid., 26 October 1929, p. 2577.

<sup>88</sup>Bertrand de Jouvenel, *The Art of Conjecture*, p. 126.

slump another 150 points in the next two years. Such a marked decline would be sufficient to wipe out any profits earned in the 1920s. Conclusion: Babson's "too early-too late" advisory service turned out to be far more costly than expected.

## Mises and the Self-Contradiction of Forecasting

If a conservative investor followed Mises's prediction of a "big smash" as early as 1924, he would not have participated in either the boom or the bust, assuming he had the willpower not to stay out amidst the cries of optimism from others year after year.<sup>89</sup> Despite his own "gift of prophecy," Mises was undoubtedly the most outspokenly antagonist toward the virtues of forecasting among Austrian economists. Mises was well aware of the desire of businessmen and investors to know the precise time to act. While he recognized the inevitable results of inflation, price controls and other forms of government intervention, he was adamant that no one can predict a specific date when an event or crisis will occur. "The economist knows that such a boom must result in a depression. But he does not and cannot know when the crisis will appear. . . . There are no rules according to which the duration of the boom or the following depression can be computed."<sup>90</sup> Mises warned businessmen and investors that there is no such thing as "quantitative economics," and therefore "forecasts about the course of economic affairs cannot be considered as scientific." He debunked the use of "charts and curves," which refer to the past, not the future. "If the future were merely a continuation of the trends that prevailed in the past, it would not be uncertain and we would not be in need of any forecasting."<sup>91</sup>

<sup>89</sup>Mises was apparently not interested in investing. He once told his fiancé, "If you want a rich man, don't marry me. I am not interested in earning money. I am *writing* about money, but will never have much of my own" (Margit von Mises, *My Years with Ludwig von Mises*, p. 24).

<sup>90</sup>Mises, *Human Action*, pp. 870–71.

<sup>91</sup>Mises, "The Plight of Business Forecasting," *National Review* (4 April 1956), p. 18.

Mises ends his discussion by drawing the insightful conclusion that accurate forecasting by the vast majority of businessmen and investors is *a priori* impossible and self-contradictory! “The very fact that people are putting faith in the forecast of a crash results in the annulment of the prediction: it *instantly* produces the crash.” The *only* way accurate information about a future economic debacle could be helpful to the speculator is if “he *alone* has it while all other people are still *bullish*.”<sup>92</sup> Babson practically says the same thing: “The making of forecasts tends to defeat their accuracy.”<sup>93</sup> That is, *if* they are followed—and, of course, Babson’s was largely ignored until the very end.

Mises’s profound insight explains why the 1929 crash and ensuing economic contraction were unexpected by almost everyone, especially the establishment. Only the so-called monetary “cranks” and unorthodox investors—a lonely minority—could effectively predict the crash. In short, Mises’s theory of forecasting is highly subjective, based on the public’s expectations of the future. In many ways, it is remarkably akin to a contrarian style of investing—i.e., to go against the expectations of the general public—although Mises would undoubtedly reject the more extreme form of contrarianism, such as, “the majority is always wrong.”<sup>94</sup>

Humphrey B. Neill’s classic work, *The Art of Contrary Thinking*, appears to adopt a nearly complete Misesian framework. Here are some samples:

When everyone thinks alike, everyone is likely to be wrong. . . . The contrary theory is a way of thinking . . . more of an *antidote* to general forecasting than a system *for* forecasting. In a word, it is a thinking tool, not a crystal ball. . . . One can interpret charts almost any way he wishes . . . there is *no* known method of *timing* events or trends . . . it is wiser to be early than to be late . . . a contrary opinion is usually

<sup>92</sup>Ibid.

<sup>93</sup>Babson, *Actions and Reactions*, p. 267.

<sup>94</sup>For a critique of contrary investing and other forecasting methods from a Misesian point of view, see Harry Browne, *Why the Best-Laid Investment Plans Usually Go Wrong* (New York: William Morrow, 1987).

ahead of time. . . . If the habit of contrary thinking does no more than to teach us to develop our own resources—and *to like to be alone occasionally*—it would be worthwhile. . . . So it is that economists may see their published predictions go wrong whereas if they had kept them secret the forecasts might well have worked out with extraordinary accuracy. . . . The nonconformist . . . cares little for precise “tops” or “bottoms”—he doesn’t try to measure the exact magnitude of the ups and downs because he knows there is no reliable yardstick.<sup>95</sup>

Mises and Hayek were able to predict the 1929–33 crisis many years before it took effect. It took a long time because the public did not know of their prognostication, nor of their brand of economics. If the general public and the opinion-makers had all been followers of Mises and Hayek, the crash would have occurred sooner—or not at all (since the Federal Reserve might have stopped inflating sooner, and the stock market would never have reached its lofty levels).

But few people knew of the Austrians, or paid any attention to the doomsdayers. Hayek knew that the collapse was imminent once the Federal Reserve stopped inflating in late 1928, and said so in an *obscure* publication—it was not the front page of the *New York Times*. Nor did the gloom-and-doomers, such as Babson and Harwood, get much publicity until the near end. Once the fundamental economic factors are in place—such as the halting of monetary growth or the raising of the discount rate—the time it takes for the trend to change is often a matter of public psychology: when does the public begin to sense a change? For Mises, “it is not our task to examine this problem,” but for the speculator, it is a critical determinant.<sup>96</sup> Humphrey Neill emphasized, “It seems to me that the long history of economic forecasting clearly demonstrates that ‘psychology’ is the missing key.”<sup>97</sup> Contrary investing is a fashionable psychological tool for forecasting these days, but it is practically difficult to implement, as many professional “contrarians”

<sup>95</sup>Humphrey B. Neill, *The Art of Contrary Thinking*, 4th ed. (1954; Caldwell, Idaho: Caxton Printers, 1980).

<sup>96</sup>Mises, “The Plight of Business Forecasting,” p. 17.

<sup>97</sup>Neill, *The Art of Contrary Thinking*, p. 98.

have discovered. And of course if everyone says, "We are all contrarians now," it is plainly self-contradictory. The simple idea of "buying when everyone is selling" or vice versa is easier said than done—it only works during *extreme* overbought or oversold situations, as Neill points out. "The public is right *during* the trends but wrong at both ends!"<sup>98</sup>

Nevertheless, as long as those who understand the innerworkings of the economy remain outside the mainstream of public opinion, a rational program for accurate forecasting is possible. Hayek and Harwood demonstrated this to be the case in the late 1920s. They did not speak in generalities, but focused on specific factors in the market to indicate that a top was imminent: the net export of gold, the end of monetary expansion by late 1928, the raising of the discount rate in Summer, 1929, and the general public's frenzied interest in Wall Street in late 1929 as reflected in the high call rates on margin loans. No one, of course, was able to predict the exact date, but it became possible to say, "within the next few months" something drastic must happen. Like the birth of a child, you know the approximate time, but not the precise day or hour.

Recently, especially after the inflationary blow-off in the late 1970s, the public's perspective of monetary trends changed. "We are all monetarists now!" is the rally cry. It seems that everyone watches the money supply—it's front page news. In this sense, Mises may be right, and the markets react to monetary changes much more quickly. The forecaster must recognize when change is in the air and general expectations alter.

It used to be that the monetary view of economic events was largely ignored or unknown by the public at large. Thus, in the 1920s, it was relatively easy for an Austrian economist or "sound money" analyst to predict a catastrophic depression like the thirties. It was not difficult in the age of inflation and Keynesianism in the 1960s and 1970s for a handful of nontraditional monetary economists or hard-money writers to forecast higher gold prices and the dollar devaluation. What are the prospects of a 1929-style crash

<sup>98</sup>Ibid., p. 44.

when books making such predictions are on the *New York Times* bestseller list? Financial advisor Joseph Granville writes of the “reincarnation of Roger Babson” in our time.<sup>99</sup> But what happens when there are dozens of outspoken Roger Babson appearing on network talk shows, all predicting an economic apocalypse in the near future?

We have hardly reached the point yet where economists are saying, “We are all Austrians now!” but more and more followers of Mises and Hayek are appearing almost unexpectedly around the country. I doubt, however, if any of them will win one of Keynes’s beauty contests. The political views of the Austrians and hard-money advisors will never be popular. But that is not to say that their economic analysis will be ignored. Therefore, it may be more difficult to predict the future collapse of Western civilization. Under the circumstances, we might well be reminded of Mises’s hypothesis that events will not happen as we expect. If everyone reads Professor Batra’s alarmist tract, *The Depression of 1990*, and follows his advice, the “crash” may well come a lot sooner than 1990, if Mises is right.<sup>100</sup> Then, we may all concur with Sir Isaac Newton, who said, “I can calculate the motions of heavenly bodies, but not the madness of people.”<sup>101</sup>

<sup>99</sup>Joseph Granville, *The Warning: The Coming Great Crash in the Stock Market* (New York: Freundlich Books, 1985), pp. 304–10.

<sup>100</sup>Ravi Batra, *The Great Depression of 1990* (New York: Simon & Schuster, 1987). Batra, a pessimistic determinist, violates all the principles of forecasting—setting a specific date, relying on past cycles to predict the future (cycles which Batra admits do not always repeat themselves), etc. He recommends that to avoid the crisis, the government should impose a wealth tax and rescind the Reagan cuts on marginal tax rates. Indeed, such actions might well cause a depression. Incidentally, a stock-market crash did in fact occur on October 19, 1987, only two days after this paper was delivered at the Mises seminar in New York.

<sup>101</sup>Quoted in Richard E. Band, *Contrary Investing* (New York: McGraw Hill, 1985), p. 15.



# 10

## *The Cultural Thought of Ludwig von Mises*

Jeffrey A. Tucker  
and Llewellyn H. Rockwell, Jr.

### Introduction

**L**udwig von Mises (1881–1973), heir to the Austrian tradition founded by Carl Menger and developed by Eugen von Böhm-Bawerk, was the preeminent economic thinker of his age. His best-known insights include the impossibility of economic calculation under socialism, the monetary origins of the business cycle, and an elucidation and defense of the use of deductive reasoning in the social sciences.<sup>1</sup>

In matters of public policy, Mises was an unabashed supporter of the free market, hard money, and the rule of law. During his life in

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<sup>1</sup>For example see Murray N. Rothbard, *The Essential von Mises* (Auburn, Ala.: The Ludwig von Mises Institute, 1983).

the United States (to which he emigrated in 1940), he was considered a member of the conservative movement,<sup>2</sup> and he wrote frequently for such conservative publications as *American Opinion*, *Christian Economics*, *Intercollegiate Review*, *Modern Age*, and *National Review*.

But Mises's political conservatism must be qualified. Rothbard has shown that Mises was a "laissez-faire radical" who supported national self-determination and the right to secession (even for small groups), the French Revolution, and free immigration, and opposed war and militarism—positions not characteristic of conservatism.<sup>3</sup>

Mises's political radicalism, however, did not imply any sympathy for moral libertinism (the view that human behavior ought not be restrained by formal or informal codes of manners and morals) or cultural relativism (the view that all civilizations should be regarded as equally valid). Instead, the positions Mises held on various cultural questions are characteristic of modern American traditionalist conservatism.<sup>4</sup>

This paper seeks to present Mises's views on cultural questions as well as his belief that certain cultural institutions are buttressed by a laissez-faire social order. It also seeks to show that Mises was an opponent not only of the political agenda of the Left, but of its cultural agenda as well, which he saw as inconsistent with and indeed hostile to a laissez-faire social order.

<sup>2</sup>See George H. Nash, *The Conservative Intellectual Movement in America Since 1945* (New York: Basic Books, 1976); John P. East, *The American Conservative Movement: The Founders* (Chicago: Regnery Books, 1986); Louis Filler, *Dictionary of American Conservatism* (New York: Philosophical Library, 1987).

<sup>3</sup>Murray N. Rothbard, "The Laissez-Faire Radical: A Quest for the Historical Mises," *The Journal of Libertarian Studies* (Summer 1981).

<sup>4</sup>Mises himself repudiated the term "conservatism" in "On Equality and Inequality" (1961) in *Money, Method, and the Market Process*, Richard M. Ebeling, ed. (Norwell, Mass.: Kluwer Academic Publishers, 1990), p. 191 and *Theory and History: An Interpretation of Social and Economic Evolution* (1957; Auburn, Ala.: The Ludwig von Mises, 1985), pp. 376 and 372), but by this he meant social systems characterized by "stagnation" and "rigidity," where the purpose of government is to "prevent any innovations that could endanger its own supremacy." This definition of conservatism would apply to Eastern cultures and Bismarckian welfarism. To Mises, writing in his time and place, conservatism had more in common with socialism (and American liberalism) than laissez-faire. Our use of the term "traditionalist" is derived from its use in contemporary America, especially in the context of culture: an emphasis on family and anti-egalitarianism, and a preference for enduring ideas, art, and literature of the West as versus popular culture.

The socialists had more than political economy in mind; they also wanted a revolution in social institutions, morals, arts, manners, and relations between the sexes and the races. The socialists understood that politics and economics are inextricably linked to culture. No advocate of a particular political-economic order can overlook this, and Mises did not.

Mises believed that feminism was an assertion of equality, a revolt against nature, and therefore akin to socialism; that the family and marital fidelity were essential to civilization; that it was possible to make broad generalizations and perhaps scientific statements about races and ethnic groups; that apparent racial inequalities ought to be studied, although not used to influence State policy; that "Eurocentrism" was the proper outlook; and that one need not be sympathetic to mass culture or the counter-culture, as Mises emphatically was not, to support the free market. So conservative was Mises on cultural issues, in fact, that today he would be regarded as a reactionary.<sup>5</sup>

## Equality vs. Inequality

The central theme in Mises's cultural traditionalism was the fact of human inequality. He therefore opposed all forms of egalitarianism.

<sup>5</sup>Note the contrast between the economic and cultural thought of John Maynard Keynes and that of Mises. Keynes, like his philosophical mentor E. G. Moore, was a moral libertine. Of his years at Cambridge, Keynes stated flatly: "We repudiated entirely customary morals, conventions and traditional wisdom. We were, that is to say, in the strict sense of the term, immoralists. . . . [W]e recognized no moral obligation on us, no inner sanction, to conform or obey" (Robert Skidelsky, *John Maynard Keynes: Hopes Betrayed, 1983-1920* [New Viking, 1986], pp. 142-43). Charles Rowley argues that Keynes's moral libertinism is linked with his anti-orthodox economics: "The young Keynes was to engage his energies in a sustained attack upon the moral order of Victorian England. The maturing Keynes was to launch an attack upon the fundamental precepts of classical political economy: the gold standard, laissez-faire and the principle of budget balance." Moreover, Keynes "was an active participant in organizations that regularly indulged in criminal behavior. . . . The hostility of the criminal to the specific laws that he is infringing usually extends to the wider rules and conventions of the society in question. . . . By setting himself without the law, Keynes predisposed himself to an attack on classical political economy which culminated in the *General Theory*" (Charles K. Rowley, "John Maynard Keynes and the Attack on Classical Political Economy," in *Deficits*, James M. Buchanan, Charles K. Rowley, and Robert D. Tollison, eds. [New York: Basil Blackwell, 1986], pp. 115, 121).

“The fact that men are born unequal in regard to physical and mental capacities cannot be argued away,” he wrote. “Some surpass their fellow men in health and vigor, in brain and aptitudes, in energy and resolution and are therefore better fitted for the pursuit of earthly affairs than the rest of mankind.”<sup>6</sup> In holding this view, Mises stood apart, as he so often did, from the social science establishment of his day. He cites the *Encyclopaedia of the Social Sciences* claim that “at birth human infants, regardless of their heredity, are as equal as Fords.”<sup>7</sup>

The market makes society’s existence possible, primarily because it is the only means of social cooperation that takes into account the inherent inequality of men. If every man were identical to every other (and therefore all non-human resources would be equally available to all), there would be no question of capital formation, the division of labor, or capitalism. In fact, if the assertion of equality were true, there would be no economic or social problem to discuss. Thus when Mises seeks to support the classical economists’ idea of the division of labor, the “innate inequality of men” is the first reason he invokes. The market, through the law of association, provides the means for all men to cooperate under the social division of labor, allowing all people to pursue the tasks most in keeping with their individual talents, strengths, and dispositions, whether the tasks they perform are considered mundane or extraordinary.<sup>8</sup>

The State cannot know, apart from information generated by the market, which task is better suited to which individual. Because of the constraints that nature has placed on everyone, in varying degrees, it is futile for the State to attempt to eradicate inequalities. To do so will necessarily make social conditions worse.<sup>9</sup>

<sup>6</sup>Mises, “On Equality and Inequality,” pp. 190–91.

<sup>7</sup>Horace Kallen, “Behaviorism,” in *Encyclopaedia of the Social Sciences*, vol. 2 (New York: Macmillan, 1930), p. 498, cited in *ibid.*, p. 190.

<sup>8</sup>*Human Action: A Treatise on Economics*, 3rd. ed (1949; Chicago: Henry Regnery, 1966), pp. 157–66.

<sup>9</sup>The inequality of men is also cited as a point against universal public education. In addition to its potential for abuse by government officials (*Omnipotent Government*:

Mises believed in the doctrine of equality before the law, but opposed the attempt to derive it from the alleged equality of all men: “only deadly foes of individual liberty and self-determination” do so.<sup>10</sup> Rather, he held that equality before the law, more than any other system, promotes social cooperation and prosperity. If equality is made a social goal, then individuals must be treated unequally by the law. Equality and the rule of law are incompatible.<sup>11</sup>

Neither should democracy, nor “representative democracy,” be justified on grounds of equality; to do so is “faulty and untenable.” Those who argue for the “intellectual and moral eminence of the masses,” or that “the voice of the people is the voice of God,” are most often attempting to “substitute despotism for representative government.” For Mises, democracy has only one justification: peaceful succession in government. Majority rule is not “a metaphysical principle . . .”<sup>12</sup>

Thus Mises stood in dramatic opposition to the political and cultural egalitarianism that has long been the operating principle of the modern State.<sup>13</sup>

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*The Rise of Total State and Total War* [1944; New Rochelle, N.Y.: Arlington House, 1969], pp. 82–83, 276), the goals of public education are unrealistic and socialistic. The U. S. “embarked upon the noble experiment” of “making every boy and girl an educated person” by making them “spend the years from six to eighteen in school.” The goal of every American graduating from high school—has been achieved only by “destroy[ing]” the scholarly and scientific value” of high school. “If one lowers the scholastic standard of high schools and colleges in order to make it possible for the majority of less gifted and less industrious youths to get diplomas, one merely hurts the minority of those who have the capacity to make use of the teaching. The experience of the last decades in American education bears out the fact that there are inborn differences in man’s intellectual capacities that cannot be eradicated by any effort of education” (“On Equality and Inequality,” pp. 195–96).

<sup>10</sup>Ibid., p. 190.

<sup>11</sup>Mises, *Human Action*, pp. 840–42.

<sup>12</sup>Mises (“On Equality and Inequality,” pp. 196–97) advocated democracy as a procedural matter, because he thought it the system best suited to social cooperation, a position growing out of Mises’s rule-based utilitarianism. Every individual preference is to be considered equally valid for the social order, but every individual choice is not equally valid in a moral and aesthetic sense. On Mises and utilitarianism, see Leland B. Yeager, “Mises as Utilitarian,” in this volume, pp. 300–319.

<sup>13</sup>See for example Gonzalo Fernandez de la Mora, *Egalitarian Envy: The Political Foundations of Social Justice* (New York: Paragon House, 1987) and Helmut Schoeck, *Envy: A Theory of Social Behavior* (1966; Indianapolis: Liberty Fund, 1987).

## Sex, Family, and Feminism

A poignant illustration of Mises's anti-egalitarianism can be found in his writings on sexuality, the family, free love, and feminism. Though Mises did not derive his views from a deference to tradition, he reasoned that traditional rules and institutions clearly flow from the natural interaction of men and women in freedom, and that these rules and institutions are formed by the biological necessity of the sexual division of labor in combination with the law of contract, which had such a civilizing effect on sexual relations.

### *The Sexual Instinct*

In *Socialism: An Economic and Sociological Analysis*, Mises sought to refute the arguments of those who would overthrow the "natural order" of capitalism for unnatural collectivism. In doing so, he attacked the entire agenda of the socialists, which he saw as internally consistent, yet consistently destructive. Thus Mises observed, "proposals to transform the relations between the sexes have long gone hand in hand with plans for the socialization of the means of production." "Marriage is to disappear along with private property. . . . When man is liberated from the yoke of economic labor, love is to be liberated from all the economic trammels which have profaned it. Socialism promises not only welfare—wealth for all—but universal happiness in love as well."<sup>14</sup>

Mises saw nothing degrading about sexual relations; he condemned the view that sex should be seen as a necessary evil. To Mises, sexual relations were bound up with a human inclination toward sensuality. To achieve its highest expression, however, sensuality must be brought under the discipline that only humans, and not animals, have the capacity to achieve.<sup>15</sup>

In fact, the process of becoming a man is ultimately linked with the struggle for sexual discipline and fidelity in monogamous

<sup>14</sup>Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (1922; 1936; 1951; Indianapolis: Liberty Fund, 1981), p. 74.

<sup>15</sup>*Ibid.*, p. 88.

family life. "There is a process which every individual must pass through in his own life if his sexual energies are to cast off the diffuse form they have in childhood and take their final mature shape," Mises wrote. "He must develop the inner psychic strength which impedes the flow of undifferentiated sexual energy and like a dam alters its direction." Citing Freud, he said that the necessity for undertaking the process of controlling "sexual energy" is a difficult one, and that "not everyone escapes unscathed from the stress and struggle of this change. Many succumb, many become neurotic or insane."<sup>16</sup>

In this struggle to rein in sexual urges, most men overcome their instincts and learn to control their sexual energy, an essential component of a peaceful and fulfilled life. In doing so, some men "turn to religion, others to philosophy, and still others become satisfied with everyday life." Yet one group never adjusts: "men who do not know where or how to find peace." "At any price they want to win and hold happiness. With all their might they strain at the bars which imprison their instincts." With these men, marriages are often "wrecked," not by the capitalist social order—as the socialists claimed—but by a "disease" that "germinates not without, but within; it grows out of the natural disposition of the parties concerned."<sup>17</sup>

Mises held that the neurosis caused by the struggle for fidelity was exploited by socialists and Utopians to advance their political agenda. Moreover, "this was the more to be expected since many of them were themselves neurotics suffering from an unhappy development of the sexual instinct." Mises went so far as to offer a research program: speaking of the socialist François Marie Charles Fourier (1772–1837), Mises observed that sexual "disorder" is "evident in every line of his writings": "it is a pity that nobody has undertaken to examine his life history by the psycho-analytic method."<sup>18</sup>

<sup>16</sup>Ibid., p. 74.

<sup>17</sup>Ibid., p. 84.

<sup>18</sup>Ibid., p. 75.

In discussing the role of sex, Mises drew a sharp distinction between men and women. "It is clear," he writes, "that sex is less important in the life of man than of woman. Satisfaction brings him relaxation and mental peace. But for the woman the burden of motherhood begins here. Her destiny is completely circumscribed by sex; in man's life it is but an incident. However fervently and wholeheartedly he loves, however much he takes upon himself for the woman's sake, he remains always above the sexual. Even women are finally contemptuous of the man who is utterly engrossed by sex. But woman must exhaust herself as lover and as mother in the service of the sexual instinct. Man may often find it difficult, in the face of all the worries of his profession, to preserve his inner freedom and so to develop his individuality, but it will not be his sexual life which distracts him the most. For woman, however, sex is the greatest obstacle."<sup>19</sup>

Mises saw the fate of whole civilizations hinging on their attitude towards relations between the sexes. The proper attitude establishes cooperation between the sexes, so that men are not "dragged by women" into the "low spheres of psychic bondage" (by being fixated on sexual urges and sensual satisfaction) and so that women may preserve the "freedom of inner life" (by entering sexual relations on consensual grounds). To arrive at this ideal is "part of the cultural problem of humanity."

The failure to achieve sexual cooperation "destroyed the Orient." "Every progressive movement which began with the development of personality was prematurely frustrated by the women, who dragged men down again into the miasma of the harem." Mises disagreed with those who held that the Orientals "understood the ultimate questions of existence more profoundly than all the philosophy of Europe." In fact, "they have never been able to free themselves in sexual matters" and that has "sealed the fate of their culture." Similarly, the Greeks erred, said Mises, by excluding the married woman from culture. The Greek man's "love was for the *hetaera* alone. Eventually he was not satisfied even here, and

<sup>19</sup>Ibid., p. 88.



turned to homosexual love. Plato sees the love of boys transfigured by the spiritual union of the lovers. . . . To him the love of woman was merely gross sensual satisfaction."<sup>20</sup>

The temptation toward "gross sensual satisfaction" had to be overcome so that men and women could reach a civilized understanding of their respective sexual roles.

Prostitution contradicts this cooperative spirit. The socialists had long claimed that prostitution was a product of capitalism, with women driven to sell their bodies to exploitative men. Mises comments that "prostitution is an extremely ancient institution, unknown to hardly any people that has ever existed."<sup>21</sup> It is a "remnant" of the pre-capitalistic age, "not a symptom of the decay of higher culture [Western capitalism]." It was the "ideal of capitalism" that contributed to producing the "demand for man's abstinence outside marriage" by insisting on "equal moral rights for man and woman." Thus capitalism, argues Mises, discourages prostitution.

Here Mises applies his model that whatever is in accord with man's nature—such as sexual fidelity within marriage—is fostered by the only economic system, capitalism, that is also in accord with man's nature.

By equalizing all incomes and eliminating all avenues for gaining wealth, socialism might be able to remove the "economic temptation to prostitution", but that would not solve the problems associated with the sexual instinct. Instead, the socialist's complaints about disordered sex lives under capitalism would reach their fulfillment under socialism. "By returning to the principle of violence," and creating unbalanced conditions contrary to social cooperation, socialism "must finally demand promiscuity in sexual life."<sup>22</sup>

### *Marriage vs. Free Love*

Mises viewed marriage as an inescapable social institution, part of "an adjustment of the individual to the social order by which

<sup>20</sup>Ibid., p. 89.

<sup>21</sup>Ibid., p. 92.

<sup>22</sup>Ibid., p. 91.

a certain field of activity, with all its tasks and requirements is assigned to him."<sup>23</sup> Marriage, said Mises, reins in the sexual instincts of man and allows woman to achieve what nature and biology tell us is her primary occupation, bearing children and caring for the family.

The socialists wage war against this. "Marxism indeed seeks to combat marriage just as it seeks to justify the abolition of private property."<sup>24</sup> Marxists claim that marriage was never part of natural society, and capitalism created "every imaginable evil," including marriage and the domination of women by men.<sup>25</sup>

In setting out to refute the Marxist version of history, Mises sees two historical phases in relations between the sexes: the age of violence and the age of capitalism. During the age of violence, "male aggressiveness, which is implicit in the very nature of sexual relations, is here carried to the extreme. The man seizes possession of the woman and holds this sexual object in the same sense in which he *has* other goods of the outer world. Here woman becomes completely a thing. She is stolen and bought; she is given away, sold away, ordered away; in short, she is like a slave in the house." Moreover, "where the principle of violence dominates, polygamy is universal. Each man has as many wives as he can defend. Wives are a form of property, of which it is always better to have more than few."<sup>26</sup>

This situation could not endure any more than socialism can endure. "[I]t is against nature that man should take woman as a will-less thing." Mises explains that the "sexual act is a mutual give and take, and a merely suffering attitude in the woman diminishes man's pleasure. To satisfy himself he must awaken her response." Once that is recognized, it is clear that "the victor who has dragged the slave into his marriage bed, the buyer who has traded the

<sup>23</sup>Ibid., p. 85.

<sup>24</sup>Ibid., p. 75.

<sup>25</sup>See for example, Igor Shafarevich, "Socialism in Our Past and Future," in *From Under the Rubble*, Alexander Solzhenitsyn, et al., eds. (1974; Boston: Little, Brown, 1975), pp. 26-66.

<sup>26</sup>Mises, *Socialism*, pp. 76 and 81.

daughter from her father must court for that which the violation of the resisting woman cannot give. The man who outwardly appears the unlimited master of his woman is not so powerful in the house as he thinks; he must concede a part of his rule to the woman, even though he ashamedly conceals this from the world."<sup>27</sup>

The age of violence was also "against nature" because "the characteristic of love, the overvaluation of the object, cannot exist when women occupy the position of contempt. . . . For under this system she is merely a slave, but it is the nature of love to conceive her as a queen." Under violence, the sex act will become "an extraordinary psychic effort which succeeds only with the assistance of special stimuli. This becomes more and more so in proportion as the individual is compelled by the principle of violence" and thus makes sexual intercourse more and more difficult.<sup>28</sup>

The onset of capitalism, however, corrected this, by bringing relations between the sexes more into line with nature. Society began to see marital relations as a contract, which makes the "wife a partner with equal rights. From a one-sided relationship resting on force, marriage thus becomes a mutual agreement. . . . Step by step she wins the position in the home which she holds today."<sup>29</sup>

All modern ideals of marriage grow out of contract: "that marriage unites one man and one woman, that it can be entered into only with the free will of both parties, that it imposes a duty of mutual fidelity, that a man's violations of the marriage vows are to be judged no differently from a woman's, that the rights of husband and wife are essentially the same."<sup>30</sup>

This change is reflected in the ancient and capitalist attitudes toward divorce. Under the "modern law," no longer does a man have a "right to cast off his wife which man once possessed." Mises notes that "the Church takes the lead in the struggle against divorce," but says it should "remember that the existence of the modern marriage ideal of monogamy—of husband and wife with equal

<sup>27</sup>Ibid., p. 78.

<sup>28</sup>Ibid.

<sup>29</sup>Ibid., p. 82.

<sup>30</sup>Ibid.

rights—in the defense of which the Church wishes to intervene, is the result of capitalist, and not ecclesiastical, development.”<sup>31</sup>

Mises also replies to the socialist and libertine claim that, because some geniuses have rejected marriage, the validity of the institution should be cast into doubt. It is true, he says, that “genius does not allow itself to be hindered by any consideration for the comfort of its fellows—even those closest to it. The ties of marriage become intolerable bonds which the genius tries to cast off or at least to loosen so as to be able to move freely. . . . Rarely indeed is he granted the happiness of finding a woman willing and able to go with him on his solitary path.” This was “recognized long ago,” says Mises. “The masses had accepted it so completely that anyone who betrayed his wife felt himself entitled to justify his action in these terms.” But the true genius “is rare and a social institution does not become impossible merely because one or two exceptional men are unable to adjust themselves to it.”<sup>32</sup>

Socialists also used the unhappiness of some marriages to question the institution itself. Mises agreed that it is unrealistic if “the wedded couple demand that their union shall satisfy desire permanently,” but only marriage has, to its credit, set up such an ideal. But this carries a danger. “We know for certain that desire gratified, cools sooner or later and that endeavors to make permanent the fugitive hours of romance would be vain.” He tells the socialists that “we cannot blame marriage because it is unable to change our earthly life into an infinite series of ecstatic moments, all radiant with the pleasures of love.”<sup>33</sup>

Most marriages, said Mises, do not fit the socialist caricature—bitter, pathological, abusive—especially not those “blessed with children.” In these “married love fades slowly and unnoticeably; in its place develops a friendly affection which for a long time is interrupted ever and again by a brief flickering of the old love; living together becomes habitual, and in the children, in whose development they relive their youth, the parents find consolation

<sup>31</sup>Ibid., p. 83.

<sup>32</sup>Ibid., pp. 85–86.

<sup>33</sup>Ibid., p. 85.

for the renunciation they have been forced to make as old age deprives them of their strength.”<sup>34</sup>

Mises notes that “no other German socialist book was more widely read or more effective as propaganda than August Bebel’s *Woman and Socialism*, which is dedicated above all to the message of free love.” This is because “free love is the socialist’s radical solution for sexual problems.” Under free love, “choice in love becomes completely free” so men and women “unite and separate just as their desires urge.” All children are nurtured, maintained, and educated by the State. And “relations between the sexes are no longer influenced by social and economic conditions.”<sup>35</sup>

The response of the moral theologian, however, is “entirely inadequate.” To Mises, radical sexual freedom is not in the interest of men or women. Free love debases sexuality, and reduces beauty and sensuality to promiscuity and force. It is only marriage that unites a man and a woman “as equal, freeborn companions and comrades.” The contract allows the woman to “deny herself to anyone” and to “demand fidelity and constancy from the man to whom she gives herself.”<sup>36</sup>

Free love wars against nature, as do all “pseudo-democratic” efforts to “efface natural and socially conditioned inequalities.” In their campaign for absolute equality, the socialists pursue a consistent pattern. They work to “make women the equal of men,” a goal which nature will not allow, just as it will not sustain the socialist attempt to “make the strong equal to the weak, the talented to the untalented, and the healthy to the sick.”<sup>37</sup>

With regard to the State child care that free-love advocates demand, Mises wrote that “to take away a woman’s children and put them in an institution is to take away part of her life; and children are deprived of the most far-reaching influences when they are torn

<sup>34</sup>Ibid., pp. 83–84.

<sup>35</sup>Ibid., pp. 74 and 87.

<sup>36</sup>Ibid., p. 87 and 91.

<sup>37</sup>Ibid., p. 90. At this point in Mises’s exposition, he adds a footnote: “To examine how far the radical demands of feminism were created by men and women whose sexual character was not normally developed would go beyond the limits set to these expositions.”

from the bosom of the family." For a person to grow up as a "healthy human being," the parents must teach the child to love. That is why State child care leads to "neurosis and homosexuality."<sup>38</sup>

"[I]t is no accident," says Mises, that Plato, who "saw only the satisfaction of a physical craving in the relations between the sexes," also proposed to "treat men and women as radically equal, to regulate sexual intercourse by the State," and "to put infants into public nursing homes at birth."<sup>39</sup>

### *Feminism as a Revolt Against Nature*

Mises makes a sharp distinction between two kinds of equality. The first demands that the law treat everyone impartially. The second wages war on nature by demanding that all natural and social inequalities be eliminated. Mises thought that the pursuit of the second would always result in the elimination of the first. That is to say, the pursuit of absolute equality means that people will be treated unequally—and unjustly—through State coercion.

Mises writes in *Liberalism* disapprovingly of the early liberals who thought "God created all men equal, endowing them with fundamentally the same capabilities and talents, breathing into all of them the breath of His spirit. All distinctions between men" were thought to be the "product of social, human—that is to say, transitory, institutions." The socialists advocate a different kind of equality, but based on the same presupposition. Of these views, Mises wrote that "nothing" is as "ill-founded as the assertion of the alleged equality of all members of the human race. . . . Men are not equal, and the demand for equality under the law can by no means be grounded in the contention that equal treatment is due to equals."<sup>40</sup> It is because Mises praised equality before the law, and rejected "radical equality," that he had no sympathies for the feminists.

The "Feminism of the Nineteenth Century," which Mises rejected, held that marriage forced personal sacrifice on women and

<sup>38</sup>Ibid., p. 91.

<sup>39</sup>Ibid.

<sup>40</sup>Ludwig von Mises, *Liberalism: A Socio-Economic Exposition* (1927; Kansas City: Sheed Andrews and McMeel, 1978), p. 28.

denied them all freedom, while it “gave man space enough to develop his abilities.” This was the “unchangeable nature of marriage, which harnesses husband and wife together and thus debases the weaker woman to be the servant of the man.” To the nineteenth century feminists, no reform of marriage was possible: only “the abolition of the whole institution alone could remedy the evil.” What should replace it is “loose relations which g[i]ve freedom to both parties.”<sup>41</sup>

Neither did Mises sympathize with twentieth-century feminism. Both overlook “the fact that the expansion of woman’s powers and abilities is inhibited not by marriage, not by being bound to man, children, and household, but by the more absorbing form in which the sexual function affects the female body.”<sup>42</sup>

Of the demand for radical equality, Mises says: “the difference between sexual character and sexual destiny can no more be decreed away than other inequalities of mankind. It is not marriage which keeps woman inwardly unfree, but the fact that her sexual character demands surrender to a man and that her love for husband and children consumes her best energies. There is no human law to prevent the woman who looks for happiness in a career from renouncing love and marriage. But those who do not renounce them are not left with sufficient strength to master life as a man may master it. It is the fact that sex possesses her whole personality, and not the facts of marriage and family, which enchains a woman. By ‘abolishing’ marriage one would not make woman any freer and happier; one would merely take from her the essential content of her life, and one could offer nothing to replace it.”<sup>43</sup>

To Mises, these unalterable facts influence the division of labor between men and women. He explored what he regarded as women’s natural limitations in the division of labor, and their ability to achieve genius and greatness on the level of men:

“Pregnancy and the nursing of children claim the best years of a woman’s life, the years in which a man may spend his energies in

<sup>41</sup>Mises, *Socialism*, p. 86.

<sup>42</sup>Ibid.

<sup>43</sup>Ibid., p. 90.

great achievements. One may believe that the unequal distribution of the burden of reproduction is an injustice of nature, or that it is unworthy of woman to be child-bearer and nurse, but to believe this does not alter the fact. It may be that a woman is able to choose between renouncing either the most profound womanly joy, the joy of motherhood, or the more masculine development of her personality in action and endeavor. It may be that she has no such choice. It may be that in suppressing her urge towards motherhood she does herself an injury that reacts through all other functions of her being. But whatever the truth about this, the fact remains that when she becomes a mother, with or without marriage, she is prevented from leading her life as freely and independently as man. Extraordinarily gifted women may achieve fine things in spite of motherhood; but because the functions of sex have the first claim upon woman, genius and the greatest achievements have been denied her."<sup>44</sup>

Mises sums up his position on feminism by distinguishing between the claim that women be granted an equal legal position with that of a man—a desire fully in accord with capitalism and nature—and the more radical claim of absolute equality, which is akin to socialism.

He writes: "So far as Feminism seeks to adjust the legal position of woman to that of man, so far as it seeks to offer her legal and economic freedom to develop and act in accordance with her inclinations, desires, and economic circumstances—so far it is nothing more than a branch of the great liberal movement, which advocates peaceful and free evolution. When, going beyond this, it attacks the institutions of social life under the impression that it will thus be able to remove the natural barriers, it is a spiritual child of Socialism. For it is a characteristic of Socialism to discover in social institutions the origin of unalterable facts of nature, and to endeavor, by reforming these institutions, to reform nature."<sup>45</sup>

Efforts to enlist feminism on the side of liberty would be doomed to failure, in Mises's view, since the two ideologies are in fundamental

<sup>44</sup>*Ibid.*, p. 86.

<sup>45</sup>*Ibid.*, p. 87.



disagreement regarding the limitations that nature has placed on human possibilities.<sup>46</sup>

It is for this reason that Mises saw public policy on the relationship between the sexes as having reached the ideal by the early twentieth century. "Nowadays the position of the woman differs from the position of the man only in so far as their peculiar ways of earning a living differ." What was left of the old order did not concern him: "The remnants of man's privileges have little importance. They are privileges of honor. The wife, for instance, still bears her husband's name."<sup>47</sup>

Neither was Mises concerned about laws regulating private life. "Now man and woman are equal before the law," Mises writes. "The small differences that still exist in private law are of no practical significance. Whether, for example, the law obliges the wife to obey her husband is not particularly important; as long as marriage survives one party will have to follow the other and whether husband or wife is stronger is certainly not a matter which paragraphs of the legal code can decide."<sup>48</sup>

Mises reserved his harshest criticism for the political ends of feminism. He regarded the laws against women's suffrage and their election to public office as largely expressing what is inherent in nature.

Mises writes: "Nor is it any longer of great significance that the political rights of women are restricted, that women are denied the vote and the right to hold public office. For by granting the vote to women the proportional political strength of the political parties is not on the whole much altered; the women of these parties which must suffer from the changes to be expected (not in any case important ones) ought in their own interests to become opponents of women's suffrage rather than supporters. The right to occupy public office is denied women less by the legal limitations of their rights than by the peculiarities of their sexual character. Without

<sup>46</sup>Wendy McElroy, *Freedom, Feminism, and the State* (Washington, D.C.: Cato Institute, 1982), pp. 3-26.

<sup>47</sup>Mises, *Socialism*, p. 82.

<sup>48</sup>*Ibid.*, p. 89.

underestimating the value of the feminists' fight to extend woman's civil rights, one can safely risk the assertion that neither women nor the community are deeply injured by the slights to women's legal position which still remain in the legislation of civilized states."<sup>49</sup>

## Race and Ethnicity

The cultural traditionalism of Mises also led him to oppose egalitarianism as regards the traits distinctive to particular racial and ethnic groups.

Mises believed that all human beings are inherently unequal, and that these inequalities can be generalized according to the social patterns that develop in terms of race and ethnicity. He viewed scholarship that seeks to study such racial and ethnic differences, within the proper scientific context, as legitimate. However, he condemned State-imposed distinctions among various groups and wanted all of them, regardless of what might be their intellectual and social capacities, incorporated into the division of labor.

From the outset, Mises condemned the theory of racial determinism, and rigid racial categorization, especially when it was defended by pseudo-science. He expressed frustration and even disgust at some of the attempts to differentiate between racial groups. In *Nation, State, and Economy* (1919), among Mises's earliest writings, he writes: "What has so far been discovered in [racial] sciences is quite scanty, of course, and is overgrown with a thicket of error, fantasy, and mysticism."<sup>50</sup> He objected to the racialists' unscientific procedures, which he found "impossible to condemn too emphatically." They focused on race "in an entirely uncritical spirit." "More anxious to coin catchwords than to advance knowledge, they scoff at all the standards demanded by scientific

<sup>49</sup>Ibid., pp. 89–90.

<sup>50</sup>Ludwig von Mises, *Nation, State, and Economy* (1919; New York: New York University Press, 1983), p. 11.

thought." As a result of such blunders "scientific knowledge" of the innate qualities of man "is still in its infancy."<sup>51</sup>

As an example of bad science, he writes of the "cranial index" of Georges Vacher de Lapouge, which was based on postulating firm relationships between the physical and the mental that "do not exist." "More recent measurements have shown that long-headed men are not always blond, good, noble, and cultured, and that the short-headed are not always black, evil, common, and uncultured," he writes.<sup>52</sup>

Moreover, he ruled out the idea that races can be measured against a "pure" standard since "all peoples have arisen from a mixture of races." It can even be shown that often the people at the "lower strata" of society are of purer "blood" than those of the upper orders, where "foreign ancestors" are common.<sup>53</sup> Thus the source of perceived racial advantages cannot relate purely to biology: "The undisputed outcome of . . . scientific investigations is that the peoples of white skin, Europeans and non-European descendants of emigrated European ancestors, represent a mixture of various bodily characteristics." Nor has science successfully related body size to mental and moral characteristics: "All these endeavors have also failed."<sup>54</sup>

As a determinant in the course of world events, people's association with a "nation," defined in terms of language, is of "great importance" when compared to the "slight significance" that race plays in shaping cultural and political movements. And the apriori argument to the contrary, to the effect that race is the most important factor in world events, Mises regarded as sheer diletantism.<sup>55</sup>

Yet Mises thought that racial factors were important in social and cultural development and that the possibility of legitimate scientific investigation into these factors should not be ruled out. We should not be misled "into skipping lightly over the race problem

<sup>51</sup>Mises, *Socialism*, pp. 289 and 288.

<sup>52</sup>Ibid., p. 289.

<sup>53</sup>Mises, *Nation, State, and Economy*, p. 10.

<sup>54</sup>Mises, *Omnipotent Government*, p. 182.

<sup>55</sup>Mises, *Nation, State, and Economy*, p. 11.

itself. Surely there is hardly any other problem whose clarification could contribute more to deepening our historical understanding. It may be that the way to ultimate knowledge in the field of historical ebb and flow leads through anthropology and race theory." "There exists true science in this field. . . ." "It may be that we shall never solve" the scientific problems associated with race studies, "but that should not make us deny the significance of the race factor in history."<sup>56</sup> Mises would not renounce racial studies, since "there still remains a germ of the race theory which is independent of the specific differentiation between noble and ignoble races."<sup>57</sup>

One can say that "some men are more gifted by birth than others"; that men differ in their physical and psychic qualities; that "certain families, breeds, and groups of breeds reveal similar traits"; and that "we are justified in differentiating between races and in speaking of the different racial qualities of individuals."<sup>58</sup> There are even "considerable bodily differences between the members of various races; there are also remarkable although less momentous differences between members of the same race, subrace, tribe, or family, even between brothers and sisters, even between nonidentical twins." And "it is a historical fact that the civilizations developed by various races are different," for example. It is "unassailable" that "some races have been more successful than others in their efforts to develop a civilization."<sup>59</sup> All this is possible to observe scientifically and sociologically, even though attempts to find "somatic characteristics of racial relationships have had no result."<sup>60</sup>

The kind of racial study he thought most important from the standpoint of classical liberalism would posit the following thesis: "certain influences, operating over a long period, have bred one race or several, with specially favorable qualities, and that the members

<sup>56</sup>Ibid.

<sup>57</sup>Mises, *Socialism*, p. 289.

<sup>58</sup>Ibid.

<sup>59</sup>Mises, *Theory and History*, pp. 326–27, 322, and 334.

<sup>60</sup>Mises, *Socialism*, p. 288.

of these races had by means of these advantages obtained so long a lead that members of other races could not overtake them within a limited period of time." While Mises was not willing to say whether this statement contains absolute scientific truth, he thought it was most compatible with the methods of science. We must ask "how it stands in relation to the theory of social cooperation."<sup>61</sup>

Even granting that certain races have "specially favorable qualities" does not necessarily mean these qualities are entirely biological; they could be predominantly environmental and cultural.<sup>62</sup> Sometimes environmental and cultural conditions can manifest themselves in physical, intellectual, and moral qualities: "Men living under certain conditions often acquire in the second, sometimes even in the first generation, a special physical or mental conformation. . . . Very often poverty or wealth, urban or rural environment, indoor or outdoor life, mountain peaks or lowlands, sedentary habits or hard physical labor stamp their peculiar mark on a man's body."<sup>63</sup>

Environment alone, however, cannot account for all group differences. If that were true, as the Marxists claim, it would be possible to adjust environment in a successful effort to equalize all human differences. It is in the context that Mises reminds that "there is a degree of correlation between bodily structure and mental traits. An individual inherits from his parents and indirectly from his parents' ancestors not only the specific biological characteristics of his body but also a constitution of mental powers that circumscribes the potentialities of his mental achievements and his personality." The attempt to change this is at odds with the doctrine of equality under the law.<sup>64</sup>

Most important from a methodological standpoint, whatever the racialists say, and "no matter how great . . . differences may be, they do not affect the logical structure of the human mind. There

<sup>61</sup>Ibid., pp. 289–90.

<sup>62</sup>Ibid.

<sup>63</sup>Mises, *Omnipotent Government*, pp. 170–71.

<sup>64</sup>Mises, *Theory and History*, pp. 327, 328.

is not the slightest evidence for the thesis developed by various schools of thought that the logic and thinking of different races are categorically different.”<sup>65</sup> This point is crucial, since Mises’s system of deducing economics from human action relies on the universal validity of logic.

As a cautionary note, he wrote in one of his last books, *Theory and History*, that there is no justification for one group feeling “racial self conceit.” What may be true for the past is not necessarily true for the future. For this reason, historians should not adopt a “racial interpretation of history.” Asserting racial superiority can also have pernicious consequences on one’s personal ethics: “innocuous vanity” can “easily” turn to “scorn of those who do not belong to the same distinguished group and into an attempt to humiliate and to insult them.” This kind of behavior has “poisoned the relations between the races for ages to come.”<sup>66</sup> Moreover, Mises vociferously opposed any talk of eugenics, arguing that “It is vain for the champions of eugenics to protest that they did not mean what the Nazis executed. Eugenics aims at placing some men, backed by the police power, in complete control of human reproduction. It suggests that the methods applied to domestic animals be applied to men.”<sup>67</sup>

Whatever the results of the studies of racial differences, Mises said they would in no way affect his view that the free society and the division of labor are the best ways to deal with group differences. Race theory “cannot in any way refute” the case for liberalism<sup>68</sup> since race theory and the liberal society “are quite compatible. “It may be assumed that races do differ in intelligence and will power, and that, this being so, they are very unequal in their ability to form society, and further that the better races distinguish themselves precisely by their special aptitude for strengthening social cooperation.”<sup>69</sup>

<sup>65</sup>Ibid., p. 327.

<sup>66</sup>Ibid., p. 334.

<sup>67</sup>Ibid., p. 531.

<sup>68</sup>Ludwig von Mises, *Planned Chaos* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1947), p. 78.

<sup>69</sup>Mises, *Socialism*, p. 290.

It is the free market, and the law of comparative advantage, that makes cooperation between the races possible. Classical liberalism argues that free labor is more productive than unfree labor, and that is a sufficient reason for favoring liberalism, said Mises. Liberalism in no way depends on the “natural law postulate of the equality or equal rights of all men.” “It may be admitted that the races differ in talent and character and that there is no hope of ever seeing those differences resolved. Still, free trade theory shows that even the more capable races derive an advantage from associating with the less capable and that social cooperation brings them the advantage of higher productivity in the total labor process.”<sup>70</sup>

It is when race theory begins to conflict with the classical liberal order that Mises objects most strongly—especially in his *Omnipotent Government*, which focused on Nazi ideology. When race war is advocated at the expense of social cooperation, race theory becomes a force for evil. Mises pointed out that race war is not to be desired from any point of view. “Lapouge has pointed out that only in the case of primitive peoples does war lead to the selection of the stronger and more gifted”; “among civilized peoples it leads to a deterioration of the race by unfavorable selection” since “the fit are more likely to be killed than the unfit.” And those “who survive the war find their power to produce healthy children impaired by the various injuries they have received in the fight.”<sup>71</sup>

The emergence of Hitler led Mises to discuss race and ethnicity in light of recent history. As Mises had warned, State enforcement of racial purity had led to conflict and war. Those race theorists whose unscientific studies Mises found “impossible to condemn too emphatically” achieved power under Nazism. In opposition to them, Mises writes in 1944 that the “Aryan hypothesis was scientifically disproved long ago. The Aryan race is an illusion.” It was bound to be, like all theories that posit a “pure stock” among white people.

Mises condemned the Nazi campaign against the Jews. It was morally wrong as well as scientifically incorrect, since there is no

<sup>70</sup>Ibid, p. 290.

<sup>71</sup>Ibid.

“alleged Jewish or Semitic race.” “It has proved impossible to differentiate the Jewish Germans anthropologically from the non-Jewish ones.” “Negroes and whites differ in racial—i.e., bodily—features; but it is impossible to tell a Jewish German from a non-Jewish one by any racial characteristic.”<sup>72</sup>

With regard to private discrimination based on preferences for one race or ethnic group or another, Mises thought such activity was permissible and natural, but that the market would tend to make it costly. “In an unhampered market society there is no legal discrimination against anybody. Everyone has the right to obtain the place within the social system in which he can successfully work and make a living. The consumer is free to discriminate, provided that he is ready to pay the cost.” “In a world in which people have grasped the meaning of a market society, and therefore advocate a consumer’s policy, there is no legal discrimination against Jews. Whoever dislikes the Jews may in such a world avoid patronizing Jewish shopkeepers, doctors, and lawyers.”<sup>73</sup>

Mises wanted to broaden the usual condemnation of unequal treatment under the law by pointing to economic interventionism as “compulsory discrimination, which furthers the interests of a minority of citizens at the expense of the majority.” Under interventionism, various groups strive to form a political alliance to obtain privileges. The farmers attempt to enforce discrimination against foreign products, and this intervention burdens the rest of the community. Moreover this legal discrimination “need have nothing to do with hatred or repugnance toward those against whom it is applied.” As an example, “the Swiss and Italians do not hate the Americans or Swedes; nevertheless, they discriminate against American and Swedish products. People always dislike competitors.”<sup>74</sup>

Economic interventionism must by necessity lead to wider and wider legal discrimination, until it ends in cruelties toward ethnic

<sup>72</sup>Ibid., pp. 290, 291.

<sup>73</sup>Mises, *Omnipotent Government*, p. 182.

<sup>74</sup>Ibid., pp. 182 and 184.



minorities, especially Jews. "In a world of interventionism only a miracle can in the long run hinder legal discrimination against Jews," said Mises. "The policy of protecting the less efficient domestic producer against the more efficient foreign producer, the artisan against the manufacturer, and the small shop against the department store and the chain stores would be incomplete if it did not protect the 'Aryan' against the Jew."<sup>75</sup>

It was not hatred of other racial or ethnic groups, however, that Mises blamed for racial conflict. It was their reflection in State policy that treated different groups in different ways. Whether these groups were organized along economic or racial lines, to the extent that the State bestowed privileges on minority interests—whether farmers or racial and ethnic minorities—at the expense of the majority (or on the majority at the expense of a minority), it created social conflict and contradicted the principles of a free society.

Thus Mises treats the issue of race and ethnicity as an anti-egalitarian scientist who deferred to the natural patterns of group interaction, even if it meant a pattern of systematic discrimination by one group against another. As a justification for such action, he rejected the theoretical grounding of most of the race theorists of his time. But he did not shrink from the conclusion that certain groups might seek advantages over other groups in particular areas, and even saw justification in speaking of superior group traits. Thus he rejected all attempts to equalize groups, and all attempts to treat them differently by law. Group differences were best harmonized in the liberal market order.

### **"Multiculturalism"**

Mises was emphatically pro-Western, for he valued freedom above all, and saw the West as responsible for the idea of freedom. The idea can be traced to the Greeks, since they "were the first to grasp the meaning and significance of institutions warranting liberty."

<sup>75</sup>Ibid., p. 184.

Despite the oligarchies of Greece, the “essential tenor of Greek ideology was the pursuit of liberty.”<sup>76</sup> Their ideas were transmitted to the Romans and later to Europe, and through the Europeans to America.

The Western idea of liberty led to representative government, the rule of law, independent courts, habeas corpus, judicial examination, freedom of speech, and separation of church and state. The West “transformed the subjects of tyranny into free citizens.”<sup>77</sup>

This contrasts with the East. The “ancient works of oriental philosophy and poetry can compare with the most valuable works of the West.” But the West overtook the East because of the Western emphasis on freedom. As a result, “for many centuries the East has not generated any book of importance. The intellectual and literary history of modern ages hardly records any name of an oriental author. The East has no longer contributed anything to the intellectual effort of mankind. The problems and controversies that agitated the West remained unknown to the East. In Europe there was commotion; in the East there was stagnation, indolence and indifference.”<sup>78</sup>

The West, unlike the East, thought that the power of despots ought to be questioned, that the individual should be independent of the State, and therefore it was necessary to create a “legal framework that would protect the private citizens’ wealth against confiscation on the part of the tyrants.”

Since in the East no wealth was protected except that of the rulers, “big-scale capital accumulation was prevented.” No middle class developed and thus there “was no public to encourage and to patronize authors, artists and inventors.” The children of the East “know nothing else than to follow the routine of their environment”: advancement through the State.<sup>79</sup>

<sup>76</sup>Ludwig von Mises, “The Idea of Liberty is Western” (1950), in *Money, Method, and the Market Process*, Richard M. Ebeling, ed. (Norwell, Mass.: Kluwer Academic Publishers, 1990), pp. 303 and 305.

<sup>77</sup>*Ibid.*, p. 304.

<sup>78</sup>*Ibid.*, p. 311.

<sup>79</sup>*Ibid.*

In contrast, “the alert youth of the West looks upon the world as a field of action in which he can win fame, eminence, honors, and wealth; nothing appears too difficult for his ambition.” “The noble self-reliance of Western man found triumphant expression in such dithyrambs as Sophocles’ choreic *Antigone*-hymn upon man and his enterprising effort and Beethoven’s *Ninth Symphony*. Nothing of the kind has been ever heard in the Orient.”<sup>80</sup>

The idea of liberty made possible the wealth of the West. Other civilizations reject Western ideas, while longing for the material benefits of capitalism. “The non-Caucasians may hate and despise the white man,” says Mises; “they may plot his destruction and take pleasure in extravagant praise of their own civilizations. But they yearn for the tangible achievements of the West, for its science, technology, therapeutics, its methods of administration and of industrial management.” “Whatever people may say about Western civilization, the fact remains that all peoples look with envy upon its achievements, want to reproduce them, and thereby implicitly admit its superiority.” But other cultures will fail to achieve the West’s prosperity so long as they insist on “preserving their traditional rites and taboos and their customary style of life.”<sup>81</sup>

But was not communism also a product of the West? Mises replies that no one advocating absolutism would get a hearing in the West, and that communism had to be disguised as “superliberalism, as the fulfillment and consummation of the very ideas of freedom and liberty.”<sup>82</sup> Moreover, the communists were free to write and publish in the West, whereas ideas contrary to the rulers of the East were not to be aired.

To Mises, however, the superiority of the West is not necessarily permanent. It would inevitably decline if “the scions of the builders of the white man’s civilization should renounce their freedom and voluntarily surrender to the suzerainty of omnipotent government.”<sup>82</sup>

<sup>80</sup>Ibid., p. 311–12.

<sup>81</sup>Mises, *Theory and History*, p. 332 and 333.

<sup>82</sup>Mises, “The Idea of Liberty is Western,” p. 306.

Nor can the West's superiority, no matter how relevant to the past, be used to predict the future.<sup>83</sup>

## Literature and the Arts

On sex, the family, and feminism, Mises held that the capitalist order reinforces the natural order, while believing that it was futile to work against man's nature and the institutions it produced. With regard to social patterns that express themselves along racial or ethnic lines, Mises thought the capitalist order would eliminate conflict by integrating everyone into the division of labor, so long as the legal order did not discriminate among groups.

The situation was different with regard to literature and the arts. Here, Mises heartily disapproves of what the market tends to reward and champions an older tradition, explaining that his disapproval of popular culture and counter-cultural ideology did not affect his defense of the market. The critics of capitalism often argued that the market rewards inferior work in literature and the arts. Mises shared the preferences of many of these critics, but believed that mass culture is the "ransom mankind must pay" so that genius will have the freedom to work.<sup>84</sup>

Great literature, Mises thought, is not likely to be successful in the marketplace. "Literature is not conformism, but dissent. Those authors who merely repeat what everybody approves and wants to hear are of no importance. What counts is the innovator, the dissenter, the harbinger of things unheard of. . . . He is precisely the author whose books the greater part of the public does not buy." "The dissenter and innovator has little to expect from the sale of his books on the regular market."<sup>85</sup>

The book tycoon caters to the public, which does not always "prefer bad books to good books"; the "buyers lack discrimination and are, therefore, ready to absorb sometimes even good books."

<sup>83</sup>Mises, *Theory and History*, p. 335.

<sup>84</sup>Ludwig von, *The Anti-Capitalistic Mentality* (1956; Spring Mills, Penn.: Libertarian Press, 1972), p. 108.

<sup>85</sup>*Ibid.*, p. 51.

Nonetheless, “it is true that most of the novels and plays published today are mere trash.” This is largely due to the amount produced, and that—under capitalism—the public, not just the intelligentsia, has for the first time the opportunity to influence what books are written and sold.

“It is not the fault of capitalism that the common man does not appreciate uncommon books.” “What characterizes capitalism is not the bad taste of the crowds, but the fact that these crowds, made prosperous by capitalism, became ‘consumers’ of literature—of course, of trashy literature. The book market is flooded by a down-pour of trivial fiction for the semibarbarians. But this does not prevent great authors from creating imperishable works.”<sup>86</sup>

Even if only one out of a thousand books published each year were “equal to the great books of the past” then “our age could still some day be called an age of the flowering of literature.”<sup>87</sup> Mises suggested that critics who attack the market for its literature “inculcate their own inability to sift the chaff from the wheat.”

“Everybody is free to abstain from reading books, magazines, and newspapers he dislikes and to recommend to other people to shun these books, magazines, and newspapers.”<sup>88</sup> And Mises did so. He attacked the popular literature of his day, especially what he saw as promoting socialism. Chief among his targets were detective stories where the villain was a member of the “successful bourgeois,” apparently respectable and widely considered incapable of wrongdoing. He is caught by a sleuth suspicious that all successful people are corrupt underneath. Mises also attacked “proletarian” novels as “nothing but trash.” His aesthetic elitism never took the form of advocating legal discrimination, however; indeed he argued against it. But he never shrank from personal discrimination, or denouncing books he did not like.

So it is with architecture. Mises says that “modern architecture has not attained the distinction of that of past centuries,” not even the “New York skyline” despite its “peculiar grandeur.” He cites

<sup>86</sup>Ibid., pp. 51 and 79.

<sup>87</sup>Ibid., p. 51.

<sup>88</sup>Ibid., p. 56.

several reasons for this. With regard to religious buildings, the “accentuated conservatism” of the churches shuns innovation. There are no more palaces because “the wealth of the entrepreneurs and capitalists is . . . so much inferior to that of kings and princes that they cannot indulge in such luxurious construction. No one is today rich enough to plan such palaces as that of Versailles or the Escorial.” And government buildings are dull because “committees and councils are not likely to adopt the ideas of bold pioneers.”

Such grand projects may never return, but in the modern era, architectural genius is expressed on a smaller level. “Only in apartment houses, office buildings and private homes have we seen something develop that may be qualified as an architectural style of our age.”<sup>89</sup>

As far as arts and architecture are concerned, genius must have the freedom to breathe. When freedom creates base culture, it is the fault of the masses. Says Mises: “It is not the fault of capitalism that the masses prefer a boxing match to a performance of Sophocles’ *Antigone*, jazz music to Beethoven symphonies, and comics to poetry.”<sup>90</sup>

Mises writes: “The moral corruption, the licentiousness and the intellectual sterility of a class of lewd would-be authors and artists is the ransom mankind must pay lest the creative pioneers be prevented from accomplishing their work. Freedom must be granted to all, even to base people, lest the few who can use it for the benefit of mankind be hindered.”<sup>91</sup>

How could Mises deliver such harsh judgments on aesthetic issues? Does not liberalism mean tolerance? Indeed, in *Liberalism* Mises wrote that “Liberalism demands tolerance as a matter of principle, not from opportunism. It demands tolerance even of obviously nonsensical teachings, absurd forms of heterodoxy, and childish silly superstitions. It demands toleration for doctrines and opinions that it deems detrimental and ruinous to society and

<sup>89</sup>Ibid., p. 78.

<sup>90</sup>Ludwig von Mises, *Liberty and Property* (1958; Auburn, Ala.: The Ludwig von Mises Institute, 1988), p. 27.

<sup>91</sup>Ibid., p. 108.

even for movements that it indefatigably combats. For what impels liberalism to demand and accord toleration is not consideration for the content of the doctrine to be tolerated, but the knowledge that only tolerance can create and preserve the condition of social peace without which humanity must relapse into the barbarism and penury of centuries long past."<sup>92</sup>

By toleration, however, Mises meant that coercion ought not to be used to prevent the public from being exposed to these ideas, not that the public should grant even passive approval to them. In fact, it is the job of the liberal to discourage that approval. "Against what is stupid, nonsensical, erroneous, and evil, liberalism fights with the weapons of the mind . . ."<sup>93</sup>

## Summary

In sum, we see that Ludwig von Mises held many cultural positions central to modern American traditionalist conservatism, all of which are centered on his anti-egalitarianism. He favored traditional families organized on the principle of patriarchy and viewed the accompanying obligation of fidelity as binding; he thought that such institutions as the family and marital fidelity were natural, exclusively civilized, and highly desirable; he thought it was possible to make generalizations about races and ethnic groups when they exhibit distinctive traits, to study these differences, and even to use racial and ethnic generalizations as principles of action, while opposing any legal discrimination among groups; he praised Western civilization as superior to all others because it was the fount of liberty and capitalism; and he criticized mass culture and counter-culturalism while favoring Western literature and arts that had stood the test of time.

<sup>92</sup>Mises, *Theory and History*, pp. 56–57.

<sup>93</sup>*Ibid.*, p. 57. The very discussion of tolerance presupposes the legitimacy of disapproval; if it were possible and desirable for everyone to be equally approving of all doctrines, cultures, and practices, there would be no reason to raise the question of toleration.

## Some Points of Analysis

What follows are the authors' thoughts on some points in Mises's analysis that we see as particularly interesting:

1. The cultural thought of Ludwig von Mises has received virtually no attention among Misesian scholars, though it is clear that his framework is rich in analytical possibilities. Besides its consistency, the most distinctive mark is his cultural traditionalism, which bears strong resemblance to orthodox religious ethics on matters of sexuality, marriage, free love, and promiscuity.

Yet it is important to view Mises as he was: a value-free scientist, a rationalist, and a utilitarian. A brief perusal through the writings of modern American conservative thought<sup>94</sup> shows sharp differences with the Misesian approach. Mises took great care to arrive at his cultural views (excluding here his purely aesthetic preferences) through deductive means.

His thinking on the institution of the family and fidelity demonstrates this most clearly. Nowhere does he defer to tradition or theism. Instead, for Mises, the family and fidelity are natural outgrowths of the division of labor (supported by pervasive inequality), and the need for sexual relations to be governed by contract.

This is not to suggest that religion did not have a tacit influence on the non-religious Mises, although his Jewish parents were also non-religious. The culture of Mises's Austria, and the University of Vienna where he studied, was heavily Catholic. Even Mises's own tradition of the Austrian school of economics had as its founder Carl Menger, a disciple of the Thomist philosopher Franz Brentano.<sup>95</sup> Menger's economic ideas, in turn, have much in common with those of the late scholastics.<sup>96</sup>

<sup>94</sup>William F. Buckley, Jr., *American Conservative Thought in the Twentieth Century* (Indianapolis: Bobbs-Merrill, 1970).

<sup>95</sup>Wolfgang Grassl and Barry Smith, *Austrian Economics: Historical and Philosophical Background* (New York: New York University Press, 1986).

<sup>96</sup>Alejandro Chaufen, *Christians for Freedom: Late-Scholastic Economics* (San Francisco: Ignatius Press, 1986).



This cannot be taken too far, however, for Mises credited capitalism and the industrial revolution for advances in liberty, contract, and voluntarism—not Christianity. He sought to set capitalism and Christianity against each other in terms of their respective historical contributions.<sup>97</sup>

This did not mean he was hostile to religion as such, however. “It would be a serious mistake to conclude that the sciences of human action and the policy derived from their teachings, liberalism, are antitheistic and hostile to religion.”<sup>98</sup> The problem was anti-capitalism. “The churches of all denominations,” Mises complained, are promoting economic fallacies instead of teaching “Christian doctrine.”<sup>99</sup>

Christianity’s doctrinal steadiness, says Mises, is the source of the Catholic Church’s institutional and organizational strength. He congratulated the Catholic Church as a bureaucracy that actually worked, even in absence of the price system necessary for organizing society and the economy at large. The Church is not unlike Plato’s ideal: a “perfect state” ruled “by unselfish philosophers” where the judges are “unbribeable” and “impartial administrators” abide “by the eternal immutable laws of justice.”<sup>100</sup>

The Catholic Church distinguishes itself for having “successfully solved the most delicate problem of every non-democratic government, the selection of the top executives. To every boy access to the highest dignities of the Church is virtually open. The local priest is anxious to smooth the way to education of the most intelligent youths of his parish; they are trained in the Bishop’s seminary; once ordained, their further career depends entirely upon their character, their zeal, and their intellect.”<sup>101</sup>

It is for this reason that “the princes of the Catholic Church, the abbots and the teachers of the theological universities, are a

<sup>97</sup>Mises, *Socialism*.

<sup>98</sup>Mises, *Human Action*, p. 155.

<sup>99</sup>Ludwig von Mises, *Economic Freedom and Interventionism: An Anthology of Articles and Essays*, Bettina Bien Greaves, ed. (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1990), p. 231.

<sup>100</sup>Ludwig von Mises, *Bureaucracy* (1944; Spring Mills, Penn.: Libertarian Press, 1983), p. 101.

<sup>101</sup>*Ibid.*, pp. 102–03.

body of eminent men. Even in the most advanced countries they are worthy rivals of the most brilliant scholars, philosophers, scientists, and statesmen." Mises concedes that "there are among the prelates many scions of noble and wealthy families. But they do not owe their office to their ancestry. They have to compete, on almost equal terms, with the sons of poor peasants, workers, and serfs."<sup>102</sup>

Yet those who would order the economy to mirror this ideal in absence of a price system can find no solace in the experience of the Catholic Church. Whereas the economy must constantly take account of changing resources, technology, and tastes, the Church "is built upon a perennial and immutable doctrine." It is for this reason that "no precedent of a perfect hierarchy could be found other than that presented by Catholicism."<sup>103</sup>

2. For Mises, cultural and sociological analysis that subverts "social institutions" that are the product of the "unalterable fact of nature" is highly dangerous. It is in this sense that Mises can be most comfortably called a conservative: what is, should be preserved, with the proviso that its origins are consistent with social cooperation. For him, only socialists argued against those institutions, whether in disputing the results of economic cooperation (e.g., price formation and income distribution), or patterns in sexual relations. Only to the extent that social conditions are the result of exogenous aggression (State or private), are they to be argued against and rebuilt on a foundation of private property, contract, and the rule of law.

3. Mises can be seen as typical of twentieth-century *laissez-faire* economics<sup>104</sup>: the advocates of free markets have largely been associated with cultural traditionalism. Conversely, the advocates of socialism have been associated with cultural libertinism.<sup>105</sup> Libertarians who regard themselves as "neither left nor right," and who therefore mix free markets with libertinism, dismiss this pattern as an accident, or as the result of Christian conservatives intent on promoting their

<sup>102</sup>Mises, *Bureaucracy*, pp. 102–03.

<sup>103</sup>*Ibid.*

<sup>104</sup>Nash, *The Conservative Intellectual Movement in America Since 1945*.

<sup>105</sup>Robert Nisbet, "Uneasy Cousins," in *Freedom and Virtue: The Conservative/Libertarian Debate*, George W. Carey, ed. (Boston: University Press of America, 1984), pp. 13–24.

religious agenda.<sup>106</sup> But if there is coherence to Mises's position, it may assist in the development a deeper understanding of the relationship between a free economic order and a traditionalist perspective on cultural matters.

In Mises, the connection between laissez-faire and traditionalism can be seen in two ways. First, Mises—and most other economic libertarians—are vehemently anti-egalitarian, as was shown above, and most cultural leftists support some sort of social and cultural leveling. Second, Mises and other economic libertarians regarded the free market and traditional social institutions as in keeping with the natural order, whereas socialism and interventionism, as well as cultural libertinism, seek to upset this natural order and to impose designs on society that are alien to the social patterns of freedom. How this relates to Mises's apparent use of natural law-type constructs, in spite of his explicit rejection of natural law, ought to be the subject of further scholarly reflection.

4. Mises is often credited with having provided the best analytical framework for understanding the inevitability of socialism's failure: its inability to calculate the relative usefulness of the collectively owned and thus non-traded means of production. Do his cultural and sociological criticisms of socialism have similar predictive power? Nineteenth-century socialists advocated free love, but it was not until the 1960s that it was openly practiced by the Left, creating what has been called the "destructive generation." Mises regarded this and other aspects of the sociological and cultural agenda of the Left as being as much socialist as the desire to collectivize the means of production.

5. If we can think about welfarism as a half-way house to socialism, can we say that Mises correctly correlated the growth of

<sup>106</sup>Paul Kurtz, "Libertarianism as the Philosophy of Moral Freedom," in *Freedom and Virtue: The Conservative / Libertarian Debate*, George W. Carey, ed. (Boston: University Press of America, 1984), pp. 135–46. As to a possible connection between libertinism and statism, Kurtz's role in the drafting of the "Humanist Manifesto II" (1973) is instructive. The document calls for "a socialized and cooperative economic order, autonomous and situational ethics, . . . many varieties of sexual exploration, . . . and the development of a system of world law and order based on a transnational federal government" (cf. Malachi Martin, *The Keys of This Blood* [New York: Simon & Schuster, 1990], p. 295).

interventionism with the breakup of the family and increased promiscuity?<sup>107</sup> If natural differences between the sexes, and the requirements of the division of labor, yielded the family, then the attempt to equalize the sexes will break down the division of labor and *mutatis mutandis* the family as a fundamental unit of society. Scholars and policy groups concerned with family issues might do well to consider this.

It is also noteworthy that Mises claimed that capitalism saved humanity from sexual neurosis. The idea of contractual sexual relations freed both men and women from the psychological oppression of the disordered sexual lives that result from broken marriages and the socialist desire to abolish the institution altogether. Has the level of sexual neurosis and misconduct risen in conjunction with the level of economic interventionism?

6. Mises said that economic intervention, by definition, must favor some groups over others, so that intervention necessarily translates into unequal treatment of groups defined by their race and ethnicity. Could the plethora of race-based programs established by the U.S. government be directly correlated with its economic interventionism? Might working to reestablish a free economy also lay the intellectual groundwork for repealing laws that mandate racially and ethically unequal treatment?

Mises saw great danger in attempting to ground legitimate equality under law in a false notion of inborn equality. If the State imposed an equality that ignored possible patterns of different strengths and weaknesses among different groups, the rule of law would be undermined. Can it be argued that this has occurred in American society since at least the early 1960s?<sup>108</sup>

7. Mises leaves open the question of why it might be in the interests of women in traditional roles to oppose women's suffrage. Logical speculation could produce the following deduction. Feminists are the ones most likely to exercise the vote once it is granted. Given their socialist intellectual framework, feminists would also

<sup>107</sup>Charles Murray, *Losing Ground: American Social Policy, 1950-1980* (New York: Basic Books, 1984).

<sup>108</sup>Walter E. Williams, *The State Against Blacks* (New York: McGraw-Hill, 1982).

support heightened State intervention, which is likely to make the lives of women who are full-time wives and mothers more difficult (state child care, fewer tax breaks for motherhood, and cultural opposition to the family). Greater State intervention, by making most people poorer, also makes the maintenance of the traditional one-earner family more difficult.

Moreover, non-feminist wives and mothers will have less interest in being politically active. Thus, by default, women's suffrage leads to political power being exercised against non-feminists. Far better for the non-feminists, Mises might have argued, to oppose women's suffrage than to live under feminist domination that would by logic follow the passage of women's suffrage.<sup>109</sup>

8. Mises denied the cultural worth of many goods and services produced under capitalism, especially those associated with mass culture. For him, capitalism was not to be blamed, for the market reflects the moral character of the public. What is unclear is whether he thought a growing baseness of mass culture could undermined the intellectual foundations of the free market. He certainly thought that popular literature laden with leftist ideology (Mises gives the example of detective stories) had bad consequences. But did he see similar dangers in base but non-ideological mass culture?

<sup>109</sup>Possibly instructive in this regard is George Gilder, *Sexual Suicide* (New York: Quadrangle, 1973).

## *Mises and His Critics on Ethics, Rights, and Law*

Leland B. Yeager

### **Mises's Utilitarianism**

**L**udwig von Mises was a utilitarian and has been criticized for being one. Utilitarianism is a particular approach to ethics in personal life and public affairs. It compares alternative sets of institutions, laws, traditions, patterns and maxims and rules of behavior, and traits of personal character. It approves of those that support and disapproves of those that subvert the kind of society that affords people relatively good opportunities to make satisfying lives for themselves. Institutions and practices and attitudes that facilitate fruitful cooperation among individuals as they pursue their own diverse specific ends score ahead of ones that make for destructive clashes. "Social cooperation" (so called by Mises and many other thinkers in the utilitarian and libertarian traditions) is so nearly essential to individuals' success in their own diverse pursuits that it is a nearly ultimate criterion of institutions, ethical precepts, character traits, and so forth. On this criterion, truth-telling and promise-keeping command approval. So does respect for justice, property rights, and other human rights.

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These words are mine, not Mises's; but his stance on economic policy does rest on an ethical underpinning like the one just sketched out. Mises wrote bluntly. The theory of social cooperation elaborated by British political economy from Hume to Ricardo, he says,

consummated the spiritual, moral and intellectual emancipation of mankind inaugurated by the philosophy of Epicureanism. It substituted an autonomous rational morality for the heteronomous and intuitionist ethics of older days. Law and legality, the moral code and social institutions are no longer revered as unfathomable decrees of Heaven. They are of human origin, and the only yardstick that must be applied to them is that of expediency with regard to human welfare. The utilitarian economist does not say: *Fiat justitia, pereat mundus*. He says: *Fiat justitia, ne pereat mundus*. He does not ask a man to renounce his well-being for the benefit of society. He advises him to recognize what his rightly understood interests are. In his eyes God's magnificence does not manifest itself in busy interference with sundry affairs of princes and politicians, but in endowing his creatures with reason and the urge toward the pursuit of happiness.<sup>1</sup>

"The ultimate yardstick of justice is conduciveness to the preservation of social cooperation . . . [,] for almost every man the great means for the attainment of all ends. An eminently human common interest, the preservation and intensification of social bonds, is substituted for pitiless biological competition, the significant mark of animal and plant life. Man becomes a social being. . . . Other people become his fellows. . . . As social cooperation is . . . a means and not an end, no unanimity with regard to value judgments is required to make it work. . . . [S]ocial cooperation is for man a means for the attainment of all his ends. . . . The characteristic feature of a free society is that it can function in spite of the fact that its members disagree in many judgments of value."<sup>2</sup>

<sup>1</sup>Ludwig von Mises, *Human Action*, 2nd ed. (New Haven: Yale University Press, 1963), p. 147.

<sup>2</sup>Ludwig von Mises, *Theory and History* (1979; Auburn, Ala.: The Ludwig von Mises Institute, 1985), pp. 54–61.

“By its recognition that social cooperation is for the immense majority a means for attaining all their ends, [utilitarianism] dispels the notion that society, the state, the nation, or any other social entity is an ultimate end and that individual men are the slaves of that entity. It rejects the philosophies of universalism, collectivism, and totalitarianism. In this sense it is meaningful to call utilitarianism a philosophy of individualism.”<sup>3</sup>

As Murray Rothbard has correctly pointed out,<sup>4</sup> no one can ever advocate any policy whatsoever on a *purely* scientific, value-free basis. Mises would agree. No one can approve or disapprove of a particular policy or of anything at all without holding at least one ultimate or fundamental value judgment. A judgment is ultimate in the sense that its holder, in expressing it, has come to the end of being able to give factual and logical reasons for his attitudes.<sup>5</sup> For Mises and other utilitarians, the fundamental value judgment is approval of happiness and disapproval of misery. (One can argue for or against particular policies, lifestyles, and so forth by trying to show that they tend toward happiness or misery; but I cannot imagine how one could argue for happiness and against misery themselves. But if one could so argue, the argument would necessarily invoke some further, deeper, value judgment, which would then be the fundamental one.)

Mises hastens to disavow hedonism in the narrow sense: despite superficial critics, “happiness” does not mean mere material, bodily pleasures. Advanced utilitarians, he says, interpret pleasure and pain, utility and disutility, in the “purely formal” senses of those words, emptying them of all specific content. They refer to whatever individuals in fact try to achieve or avoid.<sup>6</sup> Mises recognizes that

<sup>3</sup>Ibid., p. 58.

<sup>4</sup>Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, N.J.: Humanities Press, 1982), p. 212.

<sup>5</sup>On fundamental value judgments, see Paul Edwards, *The Logic of Moral Discourse* (New York: Free Press, 1965); Sidney S. Alexander, “Human Values and Economists’ Values,” in *Human Values and Economic Policy*, Sidney Hook, ed. (New York: New York University Press, 1967), esp. pp. 105–07 and 114–15; and Amartya K. Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, 1970), esp. pp. 62–64.

<sup>6</sup>Ludwig von Mises, *Epistemological Problems of Economics*, George Reisman, trans. (1933 in German; Princeton: Van Nostrand, 1960), pp. 52, 151; Mises, *Theory and History*, pp. 12–13; and Mises, *Human Action*, p. 21.



many people, especially creative workers, are not driven by material desires or narrow self-interest alone. They may also be expressing competence and strength and even heroism.<sup>7</sup> "There are people whose only aim is to improve the condition of their own ego. There are other people with whom awareness of the troubles of their fellow men causes as much uneasiness as or even more uneasiness than their own wants."<sup>8</sup>

Mises's remarks about the merely formal content of "happiness" hardly settle all questions about fundamental value judgments. Room remains for discussing whether the utilitarian criterion should be the true happiness of individuals or instead, if there is a difference, the satisfaction of whatever desires individuals suppose they have. Still, Mises is on the right track. "Happiness," before being unpacked, is an inadequate term for the ultimate utilitarian value judgment. I can only take stabs at labeling what is ultimately desirable: it is individuals' success in making good lives for themselves, or fulfillment, or satisfaction, or life appropriate to human potentiality. No single word is an adequate label; but when a single word is required as shorthand, "happiness" is the traditional choice.

This formulation might be criticized as being all-encompassing to the point of vacuousness. Yet it is not vacuous: alternative criteria are conceivable. They include conformity to the supposed will of God; or performance of duty for duty's sake alone, with no analysis of consequences entering into the identification of duties; or conformity to intuited ethical precepts for conformity's sake alone; or respect for individual rights that have simply been postulated rather than argued for on utilitarian or any other grounds, and again regardless of consequences; or conduciveness to the flourishing of the highest or noblest specimens of the human race, however ordinary people might then fare (a view sometimes, rightly or wrongly, attributed to Nietzsche). Or instead of taking the "happiness" of people in general as the criterion of institutions and

<sup>7</sup>Ludwig von Mises, *Nation, State, and Economy*, Leland B. Yeager, trans. (1919 in German; New York: New York University Press, 1983), pp. 193 and 213.

<sup>8</sup>Mises, *Human Action*, p. 14.

precepts and so forth, one might conceivably urge the happiness of oneself or some other specific person.

That these alternatives are conceivable shows that the utilitarian criterion is not vacuous, while their implausibility strengthens its own appeal. As a practical matter, furthermore, utilitarianism does not hinge on any *exact* spelling out of its fundamental value judgment. Its fulfillment is served by social cooperation—a well-functioning network of beneficial relations among individuals. Institutions, precepts, and so forth may be appraised according to how they support or subvert this crucial means to happiness, without constant appeal to any precise interpretation of “happiness” itself.

With characteristic bluntness, Mises denies that utilitarian philosophy has anything to do with the doctrine of natural rights. He has a point: respect for rights is ill served by a faulty defense. Rights are not merely conferred by government; rather, they derive from ethical precepts, which in turn have a rational underpinning. Utilitarianism, Mises says, recommends “popular government, private property, tolerance, and freedom not because they are natural and just, but because they are beneficial. . . . [S]ocial cooperation and division of labor . . . is beneficial. . . .”<sup>9</sup> With apparent approval, Mises quotes Bentham: “*Natural rights* is simple nonsense: natural and imprescriptible rights, rhetorical nonsense.” In investigating what ought to be right, Bentham “does not care about preconceived ideas concerning God’s or nature’s plans and intentions, forever hidden to mortal men; he is intent upon discovering what best serves the promotion of human welfare and happiness.”<sup>10</sup>

Mises occasionally slipped into repeating slogans about “the greatest happiness for the greatest number.”<sup>11</sup> Such a formulation, taken literally, has no precise meaning, of course. All that Mises presumably meant by it is that the happiness to be furthered by social institutions and practices is the happiness of people in

<sup>9</sup>Mises, *Human Action*, p. 174.

<sup>10</sup>*Ibid.*

<sup>11</sup>Mises, *Nation, State, and Economy*, p. 183.

general—of the member of society chosen at random, in F. A. Hayek’s formulation<sup>12</sup>—rather than the differential happiness of specific persons or classes. Mises specifically repudiated any numerical utilitarianism such as critics enjoy attacking. He denied that “it is the task of economics to establish how in the whole of society the greatest possible satisfaction of all people or of the greatest number could be attained . . . [T]here is no method which would allow us to measure the state of satisfaction attained by various individuals” and make “comparison[s] between various people’s happiness.”<sup>13</sup>

### Criticism

Mises’s utilitarianism has drawn criticism even from students and others inspired by his work. I do not maintain that Mises expounded the subtlest versions of utilitarianism, complete with distinctions between act utilitarianism and the various “rule” or “indirect” versions. He was writing before most philosophical treatments of these subtleties were published. Furthermore, the subtleties were not essential to his main concerns, theoretical and applied economics. Still, his basic philosophical stance is worth defending.<sup>14</sup>

In defending it, I’ll try to write in the same spirit as Mises’s critics—not in a negativistic spirit of finding fault and placing blame but as a contribution to an ongoing discussion from which, we hope, a closer approach to the truth will emerge, a truth that the critics may turn out to have been closer to than I am.

According to one of them, Karen Vaughn,

Mises, unfortunately, attempted to refute the collectivists and authoritarians by accepting the terms of their argument and arguing for the superior ability of the free market to provide for the economic

<sup>12</sup>Friedrich A. Hayek, *Studies in Philosophy, Politics and Economics* (Chicago: University of Chicago Press, 1967), p. 163; and Friedrich A. Hayek, *The Mirage of Social Justice* (Chicago: University of Chicago Press, 1976), pp. 129–30.

<sup>13</sup>Mises, *Human Action*, p. 242.

<sup>14</sup>For an admirably detailed defense of Mises’s utilitarianism, see Henry Hazlitt, *The Foundations of Morality* (Princeton: Van Nostrand, 1964).

well-being of the populace. . . . Such an attempt to defend freedom is dangerous on two counts. First, it is open to empirical refutation.<sup>15</sup>

Secondly<sup>16</sup>, such a defense is dangerous because of “nonmaterial items in individual utility functions.” Bureaucrats may enjoy controlling and regulating. If their utilities should be taken into account and if interpersonal comparisons are not possible, how can we be sure that a nonliberal system will not provide “maximum social welfare”?

Vaughn seems to approve of the reported intellectual outlook in seventeenth-century England, when liberalism was emerging. Then, she says, “freedom was considered . . . desirable for its own sake [as] a natural condition of human beings. . . . It was a moral value that, as a bonus, also happened to lead to the well-being of society.” The utilitarian argument simply provided “additional fire power.” “By the time of John Stuart Mill, however, the argument became reversed, and freedom was espoused, not because it was a good in itself, but because it led to ‘the greatest good for the greatest number’”<sup>17</sup>

Possibly I have misunderstood her, but Vaughn does seem to say that Mises was wrong to develop arguments for freedom because they might conceivably be refuted and the case for freedom thereby embarrassed. To forestall embarrassment, it is better not to argue any case but simply to postulate freedom as a supreme value. Admittedly, someone who mounts no arguments need fear no refutations; but why, then, should he expect anyone to pay attention? As for freedom’s supposedly just happening, as a bonus, to promote “the well-being of society,” Mises might well ask what could constitute that well-being except the well-being of individuals. And how, apart from entering into or contributing to their well-being, could freedom be a supreme value?

Murray Rothbard repeatedly criticizes utilitarianism, including Mises’s formulations. One of his criticisms is similar to Vaughn’s. The utilitarian

<sup>15</sup>Karen I. Vaughn, “Critical Discussion of the Four Papers,” in *The Economics of Ludwig von Mises*, Laurence S. Moss, ed. (Kansas City, Kans.: Sheed and Ward, 1976), p. 109.

<sup>16</sup>Ibid.

<sup>17</sup>Ibid., p. 108.

will rarely adopt a principle as an absolute and consistent yardstick to apply to the varied concrete situations of the real world. He will only use a principle, at best, as a vague guideline or aspiration, as a *tendency* which he may choose to override at any time. . . . [N]ineteenth-century laissez-faire liberals came to use laissez-faire as a vague tendency rather than as an unblemished yardstick, and therefore increasingly and fatally compromised the libertarian creed. To say that a utilitarian cannot be “trusted” to maintain libertarian principle in every specific application may sound harsh, but it puts the case fairly. A notable contemporary example is . . . Professor Milton Friedman who . . . holds to freedom as against state intervention as a general tendency, but in practice allows a myriad of damaging exceptions, exceptions which serve to vitiate the principle almost completely. . . .<sup>18</sup>

This charge is first, and rather inconsistently, utilitarian itself: utilitarianism tempts its adherents into considering and sometimes even recommending unwise, nonlibertarian, policies. Second, the charge suggests that an alternative philosophical stance can guard its adherents from falling into error. Unfortunately, no doctrine can provide such built-in protection against its being misunderstood or misused or improperly set aside. It is an illegitimate test of a doctrine to expect it to do what no doctrine can do. Nothing can substitute for the constant discipline of fact and logic.

Rothbard called Mises “an opponent of objective ethics.”<sup>19</sup> I wonder if this is a fair description. Certainly Mises was not an ethical relativist or nihilist, scornful of all judgments of right and wrong and complacent about however individuals might behave, even violating the rights of others, in pursuit of narrow and short-run self-interest. On the contrary, Mises was concerned with whether behavior and precepts of behavior tended to serve or subvert social cooperation and so serve or subvert happiness. Much scope exists for positive—objective—investigation into the likely consequences of various kinds and precepts of behavior, and the

<sup>18</sup>Murray N. Rothbard, *For a New Liberty* (New York: Macmillan, 1973), p. 24.

<sup>19</sup>Murray N. Rothbard, “Praxeology, Value Judgments, and Public Policy,” in *The Foundations of Modern Austrian Economics*, Edwin G. Dolan, ed. (Kansas City, Kans.: Sheed and Ward, 1976), p. 105.

scope for purely subjective ethical judgments is correspondingly narrow.

Mises, says Rothbard, was willing to make only one value judgment: "he joined the majority of the people in favoring their common peace, prosperity, and abundance"; he endorsed "the desirability of fulfilling the subjectively desired goals of the bulk of the populace."<sup>20</sup> Actually, Mises's fundamental value judgment, instead of simply favoring whatever a majority wanted or thought it wanted, favored the actual happiness of people in general. Nevertheless, Rothbard poses a case in which the great majority wants to murder the red-heads. "How could Mises rebut this proposed policy either as a praxeologist or as a utilitarian liberal? I submit that he could not do so."<sup>21</sup> Or someone might "desire to see an innocent person suffer. . . . Yet a utilitarian must hold that [such preferences], fully as much as the most innocuous or altruistic preferences, must be included in the quantitative reckoning."<sup>22</sup>

Who says so? Mises supposedly "cannot quarrel with the ethical nature of [people's] chosen goals, for, as a utilitarian, he must confine himself to the *one* value-judgment that he favors the majority achieving their chosen goals."<sup>23</sup> (Rothbard makes sweeping references to Mises; but instead of dealing with his actual statements, he criticizes what Mises, as a utilitarian, supposedly must believe.) Now, what even half-way sophisticated utilitarian maintains that preferences and attitudes and character traits must be immune from appraisal? Mises, to my knowledge, never said any such thing.

A rules or indirect utilitarianism is indeed concerned with how attitudes and even character traits, so far as they are amenable to encouragement or discouragement, tend to affect the health of a society and so the happiness of its members.<sup>24</sup> For fear of adverse

<sup>20</sup>Ibid.

<sup>21</sup>Ibid., p. 108. This example of the redheads turns up repeatedly, by the way, in Rothbard's writings against utilitarianism.

<sup>22</sup>Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, N.J.: Humanities Press, 1982), p. 213, n. 5.

<sup>23</sup>Ibid., p. 210.

<sup>24</sup>See John Gray, *Mill on Liberty: A Defence* (London and Boston: Routledge & Kegan Paul, 1983) on John Stuart Mill's indirect utilitarianism.

side-effects and for other reasons, a utilitarian does not want to enlist the state's coercive powers in suppressing all unfortunate preferences and attitudes and traits; but this in no way means that he considers all of them equally worthy of respect and equally entitled to influence public policy. Neither as a utilitarian nor as a libertarian must I myself, for example, deplore psychological and sociological and other positive inquiry into what sorts of preferences and attitudes and lifestyles tend in fact to serve or to undercut social cooperation and happiness. But saying so in no way commits me to wanting the state to implement the supposed findings of such inquiries.

The utilitarian, says Rothbard, "has *no conception* let alone theory of justice."<sup>25</sup> With regard to property rights in particular, the utilitarian "must fall back on the pragmatic, *ad hoc* view that all titles to private property currently existing at any time or place must be treated as valid and accepted as worthy of defense against violation."<sup>26</sup> "[U]tilitarians . . . plac[e] an arbitrary and indiscriminate ethical blessing upon every current property title."<sup>27</sup> If the tyrannical king of Ruritania dissolves his rule but first divides up the whole country into the private property of himself and his relatives, "consistent utilitarians . . . must bow to this subterfuge."<sup>29</sup>

But where does Rothbard get this notion that utilitarianism requires respect for even patently spurious titles?<sup>29</sup> Mises's discussion in *Socialism* is quite sophisticated and hardly bears out the suspicion that he would defend even the ethically shabbiest status quo.

To make the case for laissez-faire and the free-market economy, says Rothbard,

<sup>25</sup>Rothbard, *The Ethics of Liberty*, p. 52—but what about John Stuart Mill's *Utilitarianism*, chap 5? First published in 1863, reprinted in *Selected Writings of John Stuart Mill*, Maurice Cowling, ed. (New York: New American Library, 1968).

<sup>26</sup>Rothbard, *The Ethics of Liberty*, p. 52

<sup>27</sup>*Ibid.*, pp. 58–59.

<sup>28</sup>*Ibid.*, p. 54.

<sup>29</sup>Rothbard, p. 60, n. 2, does cite Mises's *Socialism*, (translated by J. Kahane from the second German edition of 1932, new enl. ed. [New Haven: Yale University Press, 1951], pp. 45–47).

one must go beyond economics and utilitarianism to establish an objective ethics that affirms the overriding value of liberty and morally condemns all forms of statism, from egalitarianism to the murder of redheads, as well as such goals as the lust for power and the satisfaction of envy. To make the full case for liberty, one cannot be a methodological slave to every goal that the majority of the public might happen to cherish.<sup>30</sup>

But why would anyone *want* to make a case for liberty, the free market, and laissez-faire and against statism, envy, and the lust for power except out of concern for the character of society and, more fundamentally, for the happiness of its members? And *how could* anyone go about making such a case except in some broadly utilitarian way? It seems backwards to desire a foundation for a particular policy stance before having some idea of its consequences. But Rothbard does think he has another way.

### Rothbard's Axioms about Rights

Rothbard identifies three broad types of philosophical basis for libertarianism. First is utilitarianism. Second is emotivism: it adopts liberty, or the libertarian nonaggression axiom, as its premise on purely subjective, emotional grounds. As Rothbard suggests, such a stance abandons the realm of rational discourse.<sup>31</sup>

Third is Rothbard's own approach, emphasizing natural rights embedded in natural law. Each entity, including the species man, has its own distinct nature.

Since men can think, feel, evaluate, and act only as individuals, it becomes vitally necessary for each man's survival and prosperity that he be free to learn, choose, develop his faculties, and act upon his knowledge and values. This is the necessary path of human nature; to interfere with and cripple this process by using violence goes profoundly against what is necessary by man's nature for his life and prosperity.<sup>32</sup>

<sup>30</sup>Rothbard, "Praxeology, Value Judgments, and Public Policy," p. 109.

<sup>31</sup>Rothbard, *For a New Liberty*, pp. 23–24.

<sup>32</sup>*Ibid.*, pp. 25–26.



To appeal to what is necessary for man's life and prosperity, given his nature, sounds like a utilitarian argument. Anyway, Rothbard begins with the right to self-ownership, with the axiom that each man (or woman, as we hardly need to repeat) owns his (or her) own body. Alternatives are conceivable, though barely. One caste of persons might belong to another, an arrangement hardly compatible with an objective, impartial ethics. Or each person might own a tiny equal share of himself and all other persons. Trying to manage people's lives on such a basis, however, would quickly bring inefficiency and starvation. (Here is another tacitly utilitarian argument.) With these alternatives ruled out, self-ownership remains<sup>33</sup>

Rothbard's second axiom concerns ownership of products and land. Everyone has a right to the goods he has produced and to hitherto unowned land that he has transformed by his labor. A person does not acquire this "homesteading" right in all the unowned land that he may *claim*; his right is limited to the amount of land he actually puts into use. But once is enough. Here Rothbard avowedly follows the doctrine of John Locke, but with modifications; for example, he rejects the "Lockean proviso" that homesteading leave "enough and as good" land available for latecomers.<sup>34</sup> People may of course acquire and dispose of ownership rights in goods and land through honest trading.

These principles of property rights, especially of homesteading, look detailed or specific enough to raise doubts about whether they are truly axioms. Don't they have some utilitarian underpinning after all? Rothbard does make comments about ownership of land similar to his comments about ownership of human beings.

[I]f the land is to be used at all as a resource in any sort of efficient manner, it must be owned or controlled by *someone* or some group, and we are again faced with our three alternatives: either the land belongs to the first user, the man who first brings it into production; or it belongs to a group of others; or it belongs to the world as a

<sup>33</sup>Ibid., pp. 26–28; and Rothbard, *The Ethics of Liberty*, pp. 45–46.

<sup>34</sup>Rothbard, *For a New Liberty*, pp. 28–37; and Rothbard, *The Ethics of Liberty*, pp. 46–50, 63–65, 240.

whole, with every individual owning a quotal part of every acre of land. . . . In practice, again, it is obviously impossible for every person in the world to exercise effective ownership of his four-billionth portion (if the world population is, say, four billion) of every piece of the world's land surface.<sup>35</sup>

Notice Rothbard's references—utilitarian references—to efficiency, practicality, and effectiveness.

Nevertheless, Rothbard maintains that his "two axioms, the right of self-ownership and the right to 'homestead,' establish the complete set of principles of the libertarian system. The entire libertarian doctrine then becomes the spinning out and the application of all the implications of this central doctrine."<sup>36</sup>

### Peculiarities of the Axiomatic Approach

One peculiarity of this approach appears at the beginning, in the supposed axiom that each person *owns* himself, his body. An argument phrased in such a peculiar way is suspect for that very reason. A utilitarian argument can readily show the importance of property rights; but to put property rights at the very beginning, even ahead of considerations of human personality, seems odd indeed. Someone not intent on a particular chain of deductive reasoning would describe human nature and the human condition more straightforwardly. He would probably speak not of each person's *owning* himself but of each person's *being* his own self and having his own consciousness and purposes and capacity to feel pleasure and pain, satisfaction and frustration. He would probably assert or argue for each person's right to personal freedom. Property rights would come into the argument, but not as its very foundation.

A more pervasive peculiarity is the attempt, openly avowed,<sup>37</sup> to spin out positions on all sorts of specific issues from the two

<sup>35</sup>Rothbard, *For a New Liberty*, pp. 33–34.

<sup>36</sup>*Ibid.*, p. 40.

<sup>37</sup>Recall the quotation above from Rothbard, *ibid.*

axioms about ownership of selves and other property. (Although utilitarian points occasionally creep into Rothbard's arguments, they do not characterize his approach.) Rothbard's positions on crime, extortion, blackmail, contracts, and bankruptcy provide striking examples, calling his whole approach into question, as I shall try to show. For brevity, I'll forgo commenting on how self-confidently he spins out firm positions on abortion, boycotts, children's rights, animal rights, and other issues. Again, by the way, I emphasize that my purpose is not to attack Rothbard but to defend Mises.

Meanwhile, let us note, a utilitarian would not try to derive all sorts of specific judgments by deducing them in one direction only from a very few initial axioms. Instead, he would check his tentative specific judgments and his tentative generalizations (rules) against one another. In a way, judgments about specific cases would serve as data—tentative, corrigible data—for reaching generalizations. The utilitarian would stand ready to modify any or all of his specific and general judgments until he had achieved consistency among them, as well as consistency with his fundamental value judgment about happiness and misery. He would seek consistency between his judgment about some specific provision of the bankruptcy laws, for example, and his generalizations about honesty, promises, and property rights. At each stage, facts of reality, including the principles of psychology and economics and other disciplines, would be eligible to enter into his reasoning.<sup>38</sup>

Crime provides my first example of the peculiar positions that Rothbard deduces. He regards crime as, in effect, a private transaction between culprit and victim.<sup>39</sup> Suppose someone mugs me. By his aggression, the mugger has violated my property right in my own person and, if he has taken any valuables, my property right in them also. I am entitled to restitution or compensation. If,

<sup>38</sup>This method of seeking consistency between specific judgments and general rules is what John Rawls, not himself an avowed utilitarian, has called the method of reflective equilibrium; John Rawls, *A Theory of Justice* (Cambridge: The Belknap Press of Harvard University Press, 1971), esp. pp. 20–21, 48–51.

<sup>39</sup>Rothbard, *The Ethics of Liberty*, chap. 13. In the interest not of finding fault but of constructive discussion, I hope it is legitimate to draw, furthermore, on personal correspondence with Rothbard.

however, I waive this right and forgive the mugger, then I have made him a gift of the use (or abuse) he has made of my body and also, if I so choose, of the property he has taken. Because these were mine to give away, the situation becomes the same as if no crime had occurred. No authority has any right to prosecute him, on Rothbard's view—not if I object (and if the mugger happened to kill me, it is my heirs who have the option of forgiving him, subject to any applicable provisions of my will).

But let's face reality. In all probability the mugger did not intend to make his "transaction" with me in particular. It just happened to be I who was in the wrong place at the wrong time. By his actions and attitudes, the mugger is a threat to society, to people in general; he contributes to undermining the peace and security and social cooperation on which practically everyone's well-being depends. Because of the menace he constitutes, and for other reasons, he deserves to be restrained and punished. The accident that I rather than someone else was his victim does not entitle me to forgive him and thereby contribute to perpetuating the general menace that he and people like him pose. In fact—though this is not the main point—I probably do not want the option of forgiving him. Particularly in cases involving criminal organizations, the option to forgive would expose the victim to unwanted pressure. (It is not always true that a wider range of options is preferable to a narrow one. When I was teaching at the University of Virginia, I welcomed the rule that forbade me to change a grade, once reported, except to correct an actual error. That rule sheltered me from appeals to my compassion by students "needing" a higher grade.)

Now for extortion.<sup>40</sup> Suppose a scoundrel pressures me to pay him \$100,000 or to sell him my business firm for a token price; otherwise he will beat me up—or perhaps he just threatens to kick me in the shins or trample my tomato plants. In any case, he is violating my rights in my person or property (for the threat, like the threatened act, is itself a violation). He is properly subject to

<sup>40</sup>On this and the closely related topic of blackmail, see *ibid.*, chap. 16; here too I also draw on personal correspondence.

restraint or punishment. But suppose he makes a different threat, which I find more ominous: he will spread vicious lies to ruin my business and my personal life. He may add, rightly or wrongly, that his credibility with a wide circle of influential contacts will make his lies especially effective. Yet in this case he is not properly subject to legal restraint, for he is violating no property right of mine. I have no right to an unsullied reputation, no matter how much I may have in some sense earned it; for it is other people, not I, who have property rights in the contents of their own minds, even including their opinions of me.

It seems strange that a member of the "Austrian" school of economists, who put such emphasis on the radically subjective nature of benefits and costs, goods and bads,<sup>41</sup> should make such a momentous distinction between threats according to whether they do or do not involve *physical* harm to persons or objects. But that is what Rothbard deduces from his two axioms.

Rothbard takes a similar position on blackmail, defined as obtaining or trying to obtain money or goods in exchange for silence on some matter.<sup>42</sup> Again, the supposedly decisive question is who has a property right to the contents of the minds of the blackmailer and other people with whom he might share his information (or misinformation). Not the victim—so runs Rothbard's answer. It is irrelevant to Rothbard's judgment that the victim might be better off if the blackmailer had never been born. Rothbard brushes aside the contention that the blackmailer's activity might be judged unproductive in some sense. Rights, not assessments of productivity, must prevail. A utilitarian side point enters in: the victim may be better off with than without the opportunity to give the possessor of information an incentive not to blab. The presumption still holds that voluntary transactions—in this case, an exchange of money for

<sup>41</sup>Leland B. Yeager, "Why Subjectivism?" *Review of Austrian Economics* 1 (1987): 5–31.

<sup>42</sup>Rothbard, *The Ethics of Liberty*, chap. 16 and pp. 241–43; similar arguments also appear in Walter Block and David Gordon, "Blackmail, Extortion and Free Speech," *Loyola of Los Angeles Law Review* 19 (November 1985): 37–54 and Walter Block, "Trading Money for Silence," *University of Hawaii Law Review* 8 (Spring 1986): 57–73.

silence—benefits all concerned. I would reply (not taking space here to develop the argument) that such a proposition about gains from trade is no more universally valid than the proposition about more options always being preferable to fewer.

Rothbard's particular conception of property rights also determines his position on what contracts are properly enforceable at law.<sup>43</sup> Suppose a performer agrees with an impresario to take part in a concert tour for a specified compensation, and the impresario proceeds with costly arrangements. Or suppose a retailing chain agrees to buy 100,000 tables over the following two years at a specified price, thereby inducing the manufacturer to construct a new factory to be able to deliver. Now, for no extenuating reason (whatever one might be), the performer or the retailer defaults on his part of the bargain, leaving the impresario or the manufacturer with heavy expenses that he can hardly recoup. In neither case, we stipulate, has any money or other property yet changed hands between the contracting parties. Tough luck, Rothbard says in effect; the aggrieved party should have drawn up the contract more warily in the first place. As matters stand, the law cannot properly require the defaulter to keep his promise or pay compensation. The reason is that the default does not constitute stealing property (remember, no money has been paid); the defaulter has violated no property right. If, however, the contract had read in such a way that default did count as taking property by force or fraud, then Rothbard's judgment would be entirely different.

A utilitarian must wonder. Why, especially with "subjectivist" Austrian economists, should so great a difference hinge on the relatively materialistic issue of whether and when property had actually changed hands? The opportunity for people to make enforceable contracts in which promises serve as consideration for each other serves social cooperation, just as it undermines it to urge peculiar axioms as reasons for tolerating default on such contracts.

Rothbard condemns bankruptcy laws. They "compel the discharge of a debtor's voluntarily contracted debts, and thereby

<sup>43</sup>Rothbard, *The Ethics of Liberty*, chap. 19.

invade the property rights of creditors. The debtor who refuses to pay his debt has stolen the property of his creditor." Fraudulent concealment of assets makes the offense even worse. "But even if the defaulting debtor is not able to pay, he has *still* stolen the property of the creditor. . . ." Bankruptcy laws "virtually confer a license to steal upon the debtor." Instead, the legal system should enforce payment through, for example, attachment of the debtor's future income.<sup>44</sup>

Of course default is regrettable. So is resort to bankruptcy; so are the poor planning or the bad luck that result in its appearing necessary. But regrettable things do happen. Instead of just condemning them with simplistic axioms, the utilitarian considers how best to forestall them and how best to deal with them if they do happen anyway. He asks how the world would work and how social cooperation would flourish or would suffer if no legal means were available for distributing the assets of a hopelessly indebted debtor in an orderly way and for clearing away obstacles to his future productive activity.

## Morality and Law

Murray Rothbard and Walter Block try to ward off outrage over their positions on crime and blackmail and other issues by distinguishing between rights and the morality of exercising them and between law and morality.<sup>45</sup> To say that I have a right to exempt a mugger from prosecution is not at all to say that I should do so. To say that it should not be illegal for a scoundrel to extort money from me by threatening to spread scurrilous stories, whether false or true, is not to deny that he is indeed a scoundrel. On the view of Rothbard and Block, apparently, two categories coincide—the violation of rights and what should be illegal. Immorality is a separate question. Rothbard and Block apparently believe they can hold to their distinctive theories of rights and law while holding fairly

<sup>44</sup>*Ibid.*, p. 142.

<sup>45</sup>*Ibid.*, pp. 23–24; Walter Block and David Gordon, "Blackmail, Extortion and Free Speech," pp. 47, 53; Walter Block, "Trading Money for Silence," p. 73.

standard ethical views and waxing just as indignant as any of the rest of us over the forgiving of muggers, extortion accomplished by threats of verbal as well as physical action, blackmail, and default on contractual promises.

I wonder if their theories can be rescued so easily. The trouble is too deep-seated: it stems from trying to deduce all sorts of specific policy positions from the two axioms about property, with no more than incidental attention to the consequences of alternative rules and policies.

I see a closer relation between ethics and law than Rothbard and Block do.<sup>46</sup> A long process of evolution and selection has yielded ethical precepts that, by and large, praise or condemn kinds of behavior and traits of character according as they tend to serve or subvert human survival, social cooperation, and happiness. By a similar process of evolution, which in some cultures involves the accretion of precedents set in court decisions, law has come to reinforce the observance and penalize the violation of ethical precepts in the relatively most clear-cut cases. This evolved law has been codified and modified by legislatures. Ideally, these strands of law proscribe acts that are “wrong in themselves.” Other strands establish acts that are “wrong because they are prohibited.” Ideally, their purpose is to improve each person’s opportunities to predict other people’s actions and so to mesh his own actions with theirs. Traffic laws are the standard example (driving on the left side of the road is wrong not intrinsically but because the law prohibits it and because the violation would now infringe the warranted expectations and the rights of other people and endanger their lives). Technicalities of real-estate and inheritance law also provide examples of law intended to improve coordination.

Here, though, we are emphasizing the relation between law and ethics. Why shouldn’t reinforcement be total, with the law prohibiting and punishing absolutely all immoral behavior? Imagining such a state of affairs—a utilitarian exercise—provides the answer.

<sup>46</sup>Ludwig von Mises, *Socialism*, pp. 397–99, makes sensible comments on this relation, as does Henry Hazlitt, *The Foundations of Morality*, chap. 9.



Legally prohibiting all sorts of undesirable actions, including inappropriate sulkiness, and legally requiring all sorts of desirable actions, including kind words when appropriate, would be downright impossible. The very attempt to make law completely coincide with ethics, though doomed to failure, would bring an oppressive totalitarianism and would give the rulers vast opportunities to prosecute individuals selectively and arbitrarily. We should be chary about applying and threatening violence, on which enforcement of the law ultimately rests. Use and threat of force is tolerable only when—but not whenever—the cases in which it is applied are clearly specified and when individuals can know how they must behave to avoid having force applied to them. The law must content itself, therefore, with proscribing and punishing acts that can be defined fairly definitely and detected fairly straightforwardly, without unacceptable side effects.

The greatest range of human behavior must remain outside the direct purview of the law—kind words and charitable actions on the one hand, perverted ambition, careless gossip, and even malicious lies on the other hand. Encouragement and discouragement of most actions and attitudes must be left to the flexible, informal, and decentralized application of ethical precepts. Ethics, by its very logic, must be flexible in its application to particular cases and capable of evolving as knowledge grows and conditions change.<sup>47</sup> Whether the law should forbid certain unethical actions, such as blackmail and default on contractual promises, cannot sensibly be decided directly from first principles alone. Utilitarian considerations must carry weight, including the importance of keeping the law definite and concentrated power constrained.

Why don't we want to go to the other extreme, with law so divorced from ethics as not to exist at all? Not even actual anarchists like Rothbard would go that far.<sup>48</sup> Allowing even murder and theft to go legally unpunished would put relatively ethical people at the mercy of the unethical, and a Hobbesian war of all against all would rage.

<sup>47</sup>Hazlitt, *The Foundations of Morality*, pp. 184–85.

<sup>48</sup>Rothbard expects law to persist even in the absence of government; private enterprises would ascertain and enforce it; *For a New Liberty*, chap. 11.

When it can be framed and applied fairly definitely, furthermore, the law has educative value: it can help teach ethically rather dense people that certain acts are wrong, or at least that committing them puts themselves at risk.

On one point I emphatically agree with what I think is Rothbard's and Block's position: the law does not and should not be expected or thought to *determine* morality. It is not true that whatever the law permits is morally right and whatever it forbids morally wrong. Ethics is prior to law, logically and probably also historically. Ideally, law serves a good society by reinforcing the precepts of morality in certain clear-cut cases, doing so through the duly restricted exercise and threat of governmental coercion.

Unfortunately, actual law is not ideal law. Particular laws can be unwise in their conception and wicked in their consequences and even in their intent. Laws should always be subject to appraisal on ethical grounds. For reasons I won't take space to develop here,<sup>49</sup> a strong presumption runs in favor of obeying the law, even laws one thinks should be changed. In cases of exceptionally wicked laws, however (a particular U.S. law of 1850 comes to mind), ethical considerations may call for disobedience. In some such cases, furthermore, it may even be the lesser evil for judges to render decisions contrary to the actual law; at least I can sympathize with arguments to that effect.

The foregoing is what sense I can make of the concepts of "natural law" or a "higher law." So interpreted, I do not disparage those concepts; they are legitimate and important—enough so to deserve a sensible grounding. Actual laws, merely by being actual, do not acquire ethical force beyond what their content warrants and beyond the force of the general presumption in favor of obeying them. Laws are always properly subject to appraisal not only in view of their purposes, consequences, and side effects but also on broader ethical grounds. They should ordinarily be changed only by regular legislative and judicial processes; but in exceptional and

<sup>49</sup>See Leland B. Yeager, "Rights, Contract, and Utility in Policy Espousal," in *Cato Journal* 5 (Spring/Summer 1985): 280–83.

extreme cases, to repeat, ethical considerations may properly lead ordinary citizens and perhaps even judges to disobey them.

These truths should not be perverted into supposing that actual common law or statutory law is not actual law after all if it is deemed contrary to some natural or higher law. For the sake of clear thinking, we should maintain the distinctions between actual and ideal law and between law and ethics.

Although, then, I accept and insist on a distinction between law and ethics, mine is not the one that Rothbard and Block make. They invoke theirs, it seems to me, in an unsuccessful attempt to confer plausibility on their highly questionable positions concerning crime, blackmail, and other topics mentioned above. Their errors are not so easily plastered over, since they stem from trying to deduce all sorts of detailed positions from two supposed axioms; and their errors threaten to spread from their legal theory to their ethical theory.<sup>50</sup>

I am tempted to deliver a sermon, particularly to Walter Block, author of *Defending the Undefendable*, who portrayed the pimp, the drug pusher, the litterbug, and other unsavory types as heroes<sup>51</sup> (but not even he could make a hero out of the itchy-fingered copyeditor). Much speaks in support of a society's prevailing ethical norms, the norms that support social cooperation. A certain "squarishness" is admirable. To recognize this is not to want to dictate people's lifestyles. Still, honesty and civility, including a decent respect for other people's rights and even their feelings, do deserve encouragement. The more generally people behave decently out of respect for ingrained ethical precepts, the less is the need or apparent need for applying the coercive force of law. For these reasons, someone who wishes well for mankind should avoid writing in a style that appears to disparage traditional ethical values.

<sup>50</sup>Rothbard's *The Ethics of Liberty*, by the way, is not really a book on ethics; it is a book advocating a particular type of libertarian political philosophy.

<sup>51</sup>Walter Block, *Defending the Undefendable* (New York: Fleet, 1976); "Trading Money for Silence," *University of Hawaii Law Review* 8 (Spring 1986): 57-73; and written with David Gordon, "Blackmail, Extortion and Free Speech," *Loyola of Los Angeles Law Review* 19 (November 1985): 37-54.

## Utilitarianism Again

I have reviewed Rothbard's "natural rights" approach because it seems to be the main alternative to utilitarianism as a philosophical basis for policy espousal. (I do not regard the "contractarianism" of James Buchanan and his school as a genuine alternative, for it seems to me to be a version of utilitarianism disguised by fictions.<sup>52</sup>) In rejecting Rothbard's approach, I do not at all ridicule or dismiss the concept of rights. It is vital to a healthy society and thus to happiness that rights (very roughly, the ones mentioned in the U. S. Declaration of Independence and Bill of Rights) be respected in public policy and private life. Conducting public policy or living one's own life according to what seems narrowly expedient in each particular case would be disastrous.

The question that separates utilitarians from other theorists of rights is how to ground them philosophically. Rothbard<sup>53</sup> observes that Robert Nozick<sup>54</sup> does not give rights any grounding; he simply intuites them. Rothbard does attempt a grounding, which, however, fails, as suggested by the peculiar policy positions that his approach grinds out. The utilitarian, in contrast, compares alternative institutions; he investigates what conceptions of rights and justice, what rules, what restraints on government, and what other institutions are most conducive to a good society and so to happiness.

Obviously I am referring to so-called "rules" or "indirect" utilitarianism. The supposed utilitarian who goes around looking for opportunities to frame and execute innocent men to pacify raging mobs, or to torture redheads for the amusement and greater net satisfaction of the multitude, or to approve of rape when the rapist's pleasure outweighs the victim's distress, is an invention of superficial critics. The shallow, act-oriented versions of utilitarianism occasionally encountered may once have offered critics a target, but one must wonder why anyone still pursues worthless triumphs over doctrines that are hardly better than straw men.

<sup>52</sup>See my "Rights, Contract, and Utility in Policy Espousal."

<sup>53</sup>Rothbard, *The Ethics of Liberty*, p. 246.

<sup>54</sup>Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974).

Nevertheless, cheap shots at utilitarianism continue. Years ago, already, Mises noted the phenomenon.

Hedonism, eudaemonism, and utilitarianism were condemned and outlawed, and whoever did not wish to run the risk of making the whole world his enemy had to be scrupulously intent on avoiding the suspicion that he inclined toward those heretical doctrines. This must be kept in mind if one wants to understand why many economists went to great pains to deny the connections between their teachings and those of utilitarianism.<sup>55</sup>

Mises was forthright, even courageous, in his utilitarianism. For this his reputation continues to suffer even among eminent economists and social philosophers who in other respects are carrying on his work. I urge them to reconsider. I am not saying that Mises developed the distinction between the act and rules or indirect versions of utilitarianism and fully articulated the latter version. I am not saying that he examined and demolished the axiomatic rights approach offered as an alternative by some of his disciples. Doing all this was not necessary for his work in economics. However, a sophisticated utilitarianism does fit within and extend the philosophical framework that Mises adopted. Hazlitt, for one, extended it. Mises was on the right track.

<sup>55</sup>Mises, *Epistemological Problems of Economics*, p. 151.

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