

THE AUSTRIAN ECONOMICS NEWSLETTER

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Atlantic Economic Association Highlights Carl Menger

by Susan G. Cole

As further testimony to the growing interest in the Austrians among economists, the entire issue of the September 1978 *Atlantic Economic Journal* was devoted to Carl Menger and Austrian economics. Managing editor John M. Virgo credits the efforts of Laurence S. Moss with setting up a session on Menger and the Austrians at the 1977 Atlantic Economic Association meetings. This issue is the result of that session. Five major articles are offered concerning Menger's work plus a brief discussion of each by Karen Vaughn of George Mason University. The introduction and concluding remarks are by Richard E. Wagner of Virginia Polytechnic Institute.

In his opening remarks Wagner confronts some widely held but erroneous beliefs concerning the Austrians, such as that they are necessarily opposed to the use of mathematics in economics. F.A. Hayek has said on several occasions that the judicious use of algebra enables one to describe certain patterns of events without having to resort to quantifying these relationships. Austrians clearly need not be opposed to the use of such a method of reasoning in principle.

In the first major article of the collection, Samuel Bostaph of Western Maryland College considers "The Methodological Debate Between Carl Menger and

the German Historicists." In 1883 and 1884, this debate generated much heat and little light on the subject of the proper method in economics. Bostaph's intent is to reinterpret the key issues at stake in order to discredit the popular presumption resulting from the debate that all methodological disputes are either irresolvable or counterproductive. From comments by Ludwig von Mises and Joseph Schumpeter, Bostaph develops the thesis that the central disagreements between Menger and the Historical School were *epistemological* at base although neither the participants nor subsequent historians of thought recognized them as such. As a result much of the debate and most of the historical assessment of it missed the mark.

Bostaph presents an excellent review of the genesis of the debate, the polemical exchanges which characterized it, and the unfortunate consequences for economic theory due to Menger's concern with method. Bostaph restates the *Methodenstreit* in terms of these underlying epistemological issues with particular reference to three areas of concern: the theory of concepts, the concept of a

complex entity, and the nature of causal laws. For Schmoller, the discovery of general principles lay in the descriptive summation over all observations of all characteristics. Causality was interpreted to mean mere uniformity in succession as seen through the human mind and subject to change based on future observation.

In contrast, Menger's chief concern was the discovery of general defining characteristics, "essences", which made identification of a specific entity possible. Causality is derived from the laws of identity and causality must by the very nature of the entity which they describe hold true for all time. Bostaph contends that due to these incompatible epistemological foundations, the two views are diametrically opposed and cannot exist side by side as so many historians of economic thought had insisted.

Although Bostaph credits Menger with attempting to forthrightly state his assumptions in an effort to reach the root of the problem, he suggests that arguments over epistemological issues are a hopeless task for nonphilosophers and that the

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The *Austrian Economics Newsletter* is designed as a research and communications device for work in Austrian economics. As such, it is essential that we have the active support and cooperation of our readers. We need any information which would be of value to other Austrians and we welcome any suggestions for improving the *Newsletter*. The success of the *Newsletter* fundamentally depends on our ability to encourage the participation and involvement of our readers.

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Two Panels Stress Entrepreneurship

Southern Meetings

by Jack High

Israel Kirzner (NYU), Larry White (UCLA) and Jonathan Hughes (Northwestern) delivered papers at a special session of the November 9, 1978 Southern Economic Association meetings in Washington, D.C. The title of the session was Entrepreneurship and Economic Activity.

Kirzner's paper, "Entrepreneurship, Choice, and Freedom," applied his notion of the entrepreneur to give a richer meaning to the idea of economic choice, and to draw a distinction between the freedom to do something, and the power to do something. An interesting theme of the paper was that neither members of an economic system nor economists can be expected to enumerate the harms that result from loss of freedom, because no one will discover those opportunities they are not permitted to pursue. Just as the spontaneous order generates benefits that are no part of anyone's design, so the lack of a spontaneous order cuts off this source of benefits without anyone necessarily being aware of the loss.

White's paper, "Entrepreneurial Price Adjustment," summarized and criticized a host of recent models purporting to describe price adjustments in the market. He pointed out a number of absurdities and omissions in current disequilibrium models. He was particularly effective in arguing that tools and techniques of static analysis cannot be mechanically applied to disequilibrium analysis with any hope of success. Rather than focusing their attention on stability proofs, economists should pay more attention to the incomplete knowledge that buyers and sellers possess, and give a larger role to the entrepreneurial element in decision making.

Hughes's paper, "Entrepreneurial Activity and American Economic Progress," chronicled the atmosphere of enterprise that existed in America from colonial times onwards, with results that are visible to everyone. Hughes's work is especially valuable in showing how readily the Austrian theory of entrepreneurship (both the Misesian and the Schumpeterian versions) may be applied to historical events. In fact, Hughes maintains that any history of the American economy is hopelessly incomplete if it does not take account of the Fords and Edisons—America's great entrepreneurs.

These papers leave the impression that the entrepreneur is a vital part of economic life, and that economic theory will never be satisfactory until it has come to terms with entrepreneurship. This is a message worth impressing, and one hopes these papers will serve as both stimulant and guide to further research in this area.

American Meetings

by Lawrence H. White

Members of the American Economic Association, the leading professional organization among economists, received a taste of the Austrian analysis of entrepreneurship during their August, 1978 meetings in Chicago. A panel consisting of Professors Israel Kirzner, Gerald O'Driscoll, and Mario Rizzo presented papers on uncertainty and entrepreneurship at a well-attended session of the meetings.

Kirzner's paper took up the issues of "Alertness, Luck, and Entrepreneurial Profit." He steered between the Scylla of attributing profit to optimizing use of a resource called "entrepreneurial ability," and the Charybdis of attributing it all to unfounded luckiness. He emphasized that entrepreneurial ability can be appreciated for its role in the market process, but not within an equilibrium frame of thought.

Kirzner termed "Menger's Law" the fundamental concept that "men value goods according to the value of the satisfactions dependent on possession of those goods." This law, he argued, fully holds only in equilibrium. An agent violates Menger's Law in moving toward equilibrium, in capturing pure profit by a change of plan. At the instant he first conceives of an opportunity for profit, he turns his possessions toward the achievement of an end valued more highly. For a Misesian, the conception and implementation of a new plan cannot be logically separated into fortuitous change in knowledge and subsequent allocation, but together constitute entrepreneurial decision. Particularly interesting in the paper was the new emphasis Kirzner placed on the uncertainty inherent in entrepreneurship, on the degree of confidence an agent has or lacks in the success of his newly imagined opportunity. As this confidence grows, an action becomes less an entrepreneurial undertaking and more the fulfillment of an optimization decision.

Rizzo also took up uncertainty and profit in his presentation of "Knight's Theory of Uncertainty: A Reconsideration." In Knight's view, profits arise out of uncertainty-bearing, but not in the manner of a payment to a hired factor. Rizzo discussed Knight's distinction between classes of risky events and unique cases of uncertain events. He argued that any event can be grouped into some class or other, but the *relevance* of any particular grouping remains a matter of uncertainty. It is an entrepreneurial undertaking to evaluate the relevance of statistics on any constructed class when

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Atlantic Economic Association Highlights Carl Menger

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best we could have hoped for would have been a clear statement of the problem for the specialists to work out. This, however, is an unsatisfying solution at best and a dangerous one at worst. Too sharp a division of labor often results in inadequate tools for the task at hand and it is sometimes difficult to anticipate in advance which method of cultivation will produce the choicest kernel of wisdom. A fresh perspective may raise unforeseen questions and point to unimagined solutions.

The second article, by Laurence S. Moss (Babson College) focuses on "Carl Menger's Theory of Exchange". Moss's primary concerns are two. First, he wants to show the importance Menger placed on exchange institutions such as money in the context of economic development. Second, he attempts to distinguish Menger's technical theory of exchange (specifically his views on price formation) from the neo-Walrasian theory of price determination and speculates about reasons for Menger's divergence from orthodox price theory.

Moss begins by describing the formation of exchange institutions in Menger's system. As man began to discover and implement more roundabout methods of production, he began to face what Moss terms "coordinative uncertainty", that is, the uncertainty arising from the increasingly long periods between the start of production and the final consumption of a product. Thus, for Moss's Menger, "the basic economic problem... is how the individual can minimize the 'coordinative uncertainty' having to do with the actions and/or inaction of other people" (p. 20) who can have a direct effect on his plans during this period of production. Part of the answer lies in acquiring good information upon which Moss declines to elaborate. The other part, described in some detail, lies in holding commodity stocks (money) which reduces the cost of exchange.

In the second section, Moss analyzes Menger's exchange theory from a technical and historical vantage point. Drawing on Marshall and Edgeworth, he attempts to enumerate the conditions under which a "true equilibrium" price would prevail in Menger's world. Menger's conviction that monopoly was more often the rule than the exception in exchange is noted by Moss who then looks into the conditions for exchange under those assumptions. Finally Moss again emphasizes the fact that in spite of his valuable contributions to price theory, Menger was really more interested in the

development and function of exchange institutions.

Aside from his curious emphasis on "coordinative uncertainty", it is often difficult to determine just what Moss wishes to show. At times his basic point is well taken but requires much energetic digging on the reader's part to unearth it. For instance, when he discusses the rise of exchange institutions as a response to uncertainty, the argument bogs down in details of Menger's theory of imputation, the formulation of marginal utility as the result of increasing population growth, other functions of commodity stocks, and other such interesting, but distracting, decorations. Here also Moss's emphasis is misplaced. Money is not the prime mechanism for reducing uncertainty; surely that is the function of the price system, a fact of which Menger was aware (implicitly, if not explicitly) but which Moss ignores.

At other times, apparent confusion on Moss's part misdirect an otherwise useful discussion. The second half of his article centers on the conditions which must exist for Menger's two traders to want to stop trading at precisely the same instant. What Moss fails to grasp is that in a bilateral monopoly situation, when one trader wants to stop, the other must since there is no one else with whom he could trade. Thus, the intent discussion of "market clearing" mechanisms loses most of its power.

Israel M. Kirzner's piece on "The Entrepreneurial Role in Menger's System" is an excellent treatment of the extent to which Menger, explicitly or implicitly, found room for the entrepreneur. Parenthetically, Kirzner notes that Menger would also receive high marks if "his system might, at the hands of his followers, be expected to lead to the clear identification and explication of this role." While their explication is not always clear, subsequent work by Austrians (notably Kirzner himself) on the economic function of the entrepreneur would pass Menger with flying colors on this point.

Kirzner concentrates his attention on drawing out the implications of Menger's statements on knowledge, error, ignorance, and competition in an effort to give form to the sketchy references to the entrepreneur which Menger left us. In those brief discussions, Menger rejected the notion of the entrepreneur as risk-bearer, apparently perceiving him as performing a special kind of labor service, much like Marshall's entrepreneur-manager. Collecting information, economic calculation, the act of will, and the

supervision of production all count as entrepreneurial activities for Menger's entrepreneur.

But, for Kirzner, a conception of the entrepreneurial role must involve much more than this. It requires an intimate knowledge of the entrepreneur in the market process as embodied in a discussion of entrepreneurial profit and the process by which it is ground down to zero. Also important would be an awareness of an entrepreneur-less equilibrium and its significance, or at the very least, an understanding of the competitive market process as it deals with the inevitable uncertainty of the future, changing knowledge and the continual discovery of error.

Kirzner examines each of Menger's statements and their implications to determine whether Menger incorporated any of these elements of entrepreneurship into his theory and finds Menger wanting on all points. On knowledge, he explores Menger's remarkable discussions of uncertainty, expectations, and that special class of professionals who deal in information, yet notes that these do not imply a systematic market adjustment process fueled by entrepreneurial discovery. On

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Rutgers to Hold Conference on Inflation

On April 28 and 29, Rutgers University at Newark will host a conference on the causes and consequences of inflation, viewed from Austrian perspectives. Thomas Taylor (Wake Forest) will discuss true cost accounting under periods of inflation with components by James Buchanan (VPI) and John Egger (Towson). Gerald O'Driscoll will give a paper on the domestic consequences of inflation with comments by Huston McCulloch (Boston College) and Axel Leijonhufvud (UCLA). Leland Yeager (U.Va.) will analyze some of the international repercussions of inflation with commentators Gottfried Haberler (AEI) and Joseph Salerno (Rutgers). "Inflation and Unemployment" will be discussed by special guest lecturer Martin Feldstein (Harvard, and President, NBER). Rounding out what should be a very productive weekend, Ludwig Lachmann will offer some comments on his subjective view of the present-day position of the Austrians. For more information, please contact Richard Fink, Economics Department, Rutgers University, North New Jersey 07102, tel: (201) 648-5259.

Symposium on Theory and Method in the Social Sciences Held in Milwaukee

By Robert Bradley, Jr.

Since the Austrian method importantly and unfashionably departs from mathematical expression and statistical evaluation of economic theory, much scholarly activity has gone into examining and popularizing such a position. The most recent example of this was the "Symposium on Theory and Method in the Social Sciences" held in Milwaukee last November, a conference devoted in part to the Austrian methodology. Funded by the Liberty Fund and held under the auspices of the Institute for Humane Studies, the conference brought together some thirty scholars from various disciplines within the social sciences to discuss seven previously published essays of seminal reputation. Chaired by Professors Arthur Shenfield (Law: The University of San Diego) and Ben Rogge (Economics: Washash College), the session papers were "The Science of Human Action" by Ludwig von Mises with I. M. Kirzner (Economics: New York University) as the author representative, "Common-Sense and Scientific Interpretation of Human Action" by Alfred Schutz with M. N. Natanson (Philosophy: Yale University) as the author representative, "Ideal Types and Historical Explanation" by J.W.N. Watkins (Philosophy: The London School of Economics), "The Theory of Complex Phenomena" by F. A. Hayek (Economics: Albert-Ludwigs-Universität of Freiburg), "Cosmos and Taxis" also by Hayek, "Developmentalism: A Critical Analysis" by Robert Nisbet (Sociology: Columbia University), and "Social Science and the Problem of Value" by W. H. Werkmeister (Philosophy: Florida State University). Though all the above essays and their respective sessions deserve serious attention, only those with direct interest for Austrian economics will be reviewed below.

"The Science of Human Action" a 1933 essay that was Mises' first elaborate presentation of his methodological views, was discussed at the opening session of the conference. Commentator Samuel Bostaph (Economics: Western Maryland College) set the tenor of the session by addressing his opening remarks to Mises' most controversial position—the *a priori* nature of economic science. Taking issue with Mises' Kantian perspective, Bostaph suggested reanchoring the first principles of economics along Aristotelian lines to encompass knowledge gained from simple experience. In response to this, Kirzner admitted that indeed Mises' terse belief in a *priorism* was the most "troublesome" and "esoteric" of his contributions, but

that the suggested formulation still led to the same first principles that Mises saw as *a priori*. Thus, the exact epistemological status of the postulates of economics is not critical for Austrians (much like the unresolved issue concerning free will and determinism), the conclusions remain the same.

In the ensuing discussion, it was pointed out that Mises in the article did distinguish between simple experience and the formalized experience of the laboratory and statistics. Thus it seems Mises paved the way for what his followers have recognized as a needed correction of his significant ideas.

The phenomenologist Alfred Schutz's essay "Common-Sense and Scientific Interpretation of Human Action," called the "central document" of his thought by Maurice Natanson, developed some central ideas implicit in much of the Austrian methodological writings. In fact, the point was made by Hayek that Schutz's influence in the Mises Vienna seminar was much greater than commonly realized.

In the social sciences, Schutz explains, not only are we what we study, but more importantly, we comprehend the meaning of our actions on a level shared by each one of us ("the general thesis of reciprocal perspectives," p. 24). This knowledge is conceptual rather than observational since we can imagine situations and employ anonymization to enjoy a level of understanding not otherwise possible, and it is here that the common-sense interpretation achieves universality.

Professor Natanson neatly divided the defining characteristics of the common-sense method of interpretation into four parts: (1) consistency of logic, (2) adherence of first principles, (3) applicability and (4) adequacy. Natanson associated the first two tenets with Mises and the last two with Schutz, confirming the complementarity of the two men's ideas. Perhaps in the future Schutz will be remembered as a pioneer of praxeology as well as phenomenology.

Professor Hayek's rich essay, "The Theory of Complex Phenomena," inspired a lively session which began with commentator Roger Garrison (Economics: Auburn University) delivering a systematic critique of the use of mathematics and econometrics in economics. As Garrison insightfully pointed out, Hayek's conclusions regarding the dichotomy of social and natural science rest on the theme of *complexity* rather than, as with Mises, *purpose*.

The natural sciences, Hayek points out

in the essay, are characterized by formulas containing only a handful of variables. On the other hand, complexity in the social sciences enters almost without limit since "any event in the course of a man's life may have some effects on almost any of his future actions" (p. 34). This contrast leads Hayek to conclude that "the price we pay for an advance" in the latter area requires "the degree of falsifiability [to] necessarily decrease." (p. 29).

The discussion continued in this vein. The use of statistics which artificially abstracts from complexity by transforming key microeconomic relationships into homogeneous aggregates was strongly criticized. Similarly, mathematical usage was criticized for its ambiguous treatment of causality. In all, the session offered in capsule form the many Austrian objections to commonly accepted procedures of contemporary economics.

When asked near the end of the conference if he thought a reconciliation of the Austrian methodology with the positivist method (as presented in Milton Friedman's influential 1956 essay) was possible, Hayek answered in the negative. And no doubt Friedman would agree. Unfortunately, the great majority of economists today do not adequately understand the reasons for this gulf, to the detriment of both sound scholarship and unambiguous progress in economics.

Austrian Lecture Program at Rutgers

As part of a growing program in Austrian Economics at Rutgers University at Newark, a series of speakers has been arranged. Already featured in this program have been Israel Kirzner (NYU) on "Austrian Economics, an Alternative Paradigm," Dominic Armentano (U. of Hartford) on "Monopoly in the Oil Industry" and Leland Yeager (UVA) on "The International Monetary Muddle." Ludwig Lachmann (NYU) will discuss the "Prospects for Austrian Economics" on March 7 and Mario Rizzo (NYU) will lecture on "The Economic Aspects of Law" on April 18 this year. Those interested should contact Joseph Salerno, Austrian Guest Lecturer Program, Economics Dept., Rutgers University, North New Jersey 07102.

Menger Society Holds Conference on Hayek

The London-based Carl Menger Society ran a one-day conference on Saturday, October 28 to mark the publication of F.A. Hayek's *New Studies in Philosophy, Politics, Economics and the History of Ideas*. The Society was formed in 1975 to promote the study of the Austrian tradition in economics. Following a highly successful two-day conference in December, 1975, funded by the Koch Foundation and attended by F.A. Hayek, Lionel Robbins, G.L.S. Shackle, David Myddleton, S.C. Littlechild, Jean-Pierre Hamilius and S.H. Frankel, the Society has organized a series of seminars, two receptions for Professor Hayek and a variety of other activities.

In early 1978, however, it became apparent that people were not prepared to travel from outside London to attend the monthly seminar at which only one paper would be presented and discussed. Consequently, the Society's Committee decided to run two or three one-day conferences a year at which four or five papers would be presented around a central theme, the first being Professor Hayek's latest book. The speakers arranged for October 28th were: John Gray (Fellow and Tutor in Politics, Jesus College, Oxford), "Freedom, Reason and Tradition in Hayek's Social Philosophy"; Thomas Torrance (Department of Logic, University of Aberdeen), "Hayek's Critique of Social Justice"; Hillel Steiner (Department of Government, University of Manchester), "Hayek and Liberty"; S.H. Frankel (Professor Emeritus, Oxford University), "Hayek on Money"; Jeremy Shearmur (Research Officer, Department of Philosophy, London School of Economics), "Hayek, Smith (and Hume)."

Because of illness, John Gray was unfortunately unable to attend. Despite this setback, an audience of 70 academics and students gathered at University College, London, to listen to and discuss the papers. Notable participants included Professor Myddleton (Cranfield), Professors Minkes and Ferns (Birmingham), Professor O'Mahony, Walter Grinder and Mark Brady (Cork), Malcolm Greenhill (Oxford), David Ramsay Steele (Hull), Dr. B. Smith (Sheffield), and Dr. Eammon Butler and Dr. Stuart Butler (Adam Smith Institute).

Hillel Steiner began the Conference by contrasting two approaches to liberty that he discerned in Hayek's work: the first, the reduction of arbitrary coercion, was judged by him to be unsatisfactory; the other, which he favored, relating to a sphere of freedom, was more radical, but raised difficult and interesting problems

concerning the rights of generations as yet unborn.

Tom Torrance presented a clear and powerful account of Hayek's critique of the idea of social justice (as in *Law, Legislation and Liberty* Vol. 2). His paper led to a particularly lively discussion because of his championing of Hayek's idea of the State's role as a non-market welfare safety net—a view not favored by some members of the audience.

The highlight of the day for many people came with Professor Frankel's paper "Hayek on Money." Frankel saw the seeds of Hayek's denationalization policy in his work at the L.S.E. in the early 1930's. He proceeded to contrast Hayek's position with that of Menger, Keynes and Friedman. He thought Hayek's policy to be impractical given the political conditions in the U.K. today and said that people either wanted stable money or they actually preferred the short-term benefits of inflation. If stable money is wanted, then a strict monetary policy can guarantee it. However, the fact that they have rejected a strict monetary policy indicated to him that they did not want reliable currency. Thus he almost came to the view that denationalization was a redundant idea.

Jeremy Shearmur discussed Hayek on the History of Ideas. He emphasized the particular significance of Hayek's work on the distinctive ideas of the Scottish historical school and urged liberals to revive Adam Smith's theory of history.

Commenting on the conference, the Society's Chairman, John Blundell, and Vice Chairman, Jeremy Shearmur, said that the attendance, the papers, the discussion and the comments they had received from the participants all led them to believe that it had been a great success.

The Carl Menger Society is now planning to capitalize on this success and a second one-day conference is planned for this spring around the theme of "Contemporary Economic Problems—Austrian Alternatives."

Also under consideration is the possibility of publishing the October 28th papers along with the transcript of the final session of the December, 1975 Conference—a discussion between Hayek and Robbins.

The officers of the Carl Menger Society are: Chairman, John Blundell; Vice Chairmen, Jeremy Shearmur and Sudha Shenoy; Secretary, Cathleen Mainds. For information contact John Blundell, 52 Shaftesbury Avenue, London W.1.

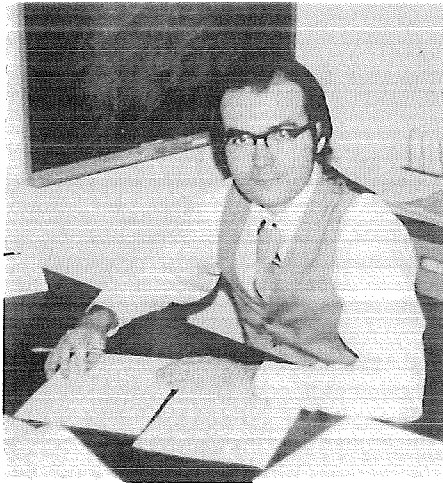
The Seminar for Austro-German Philosophy

This seminar, a forum for discussion of German language philosophy, especially the "cognitive philosophy of the type developed by Brentano, Husserl, and their followers," is holding a number of sessions that should be of particular interest to Austrian economists. Austrians can already trace an influence of this "phenomenology" and its relationship to economics in the works of Alfred Schütz (see Bradley's review on page 4). Last November the seminar had a weekend session entitled *Phenomenology and Value Theory* that included papers on Munich phenomenology and on the Austrian and Marxian theories of value. Two future sessions of interest to Austrians will be the May 5, 1979 meeting in London on *Phenomenology and Social Rules* discussing the issue of the primacy of mental acts vs. social rules, and the June 1-2, 1979 meeting at Sheffield entitled *On Austrian Methodology*, a symposium on methodological individualism organized in conjunction with the Carl Menger Society. The Seminar will be involved in a number of publishing ventures planned by Philosophia Verlag, München, an established German philosophical publishing house which plans to develop a specialist list in the area of Austrian thought with a marked leaning toward market-oriented works in both German and English. The Seminar for Austro-German Philosophy also acts as a general clearing house for scholars in England who are interested in these areas. Interested students may contact the Seminar by writing to Dr. B. Smith, Department of Philosophy, The University, Sheffield, S10 2TN, England, tel. (0742) 78555.

American Entrepreneurship Panel (Continued)

confronting an individual event. Non-transformable uncertainty—scope for entrepreneurship—is thus ever-present.

O'Driscoll brought the theory of entrepreneurship to bear on a very different area in his paper on "Rational Expectations and Entrepreneurship." He found



Gerald P. O'Driscoll, Jr.

that while the rational expectations literature holds truths valuable for the theory of entrepreneurship, the reverse holds with even greater strength. O'Driscoll presented the rational expectations critique of standard macro models as an insistence that a model not postulate persistent unexploited profit opportunities. Rational expectations models themselves, however, lack a theory of entrepreneurship and so do not explain the adjustment process by which profit opportunities come to be exploited. He pointed out that "only the existence of entrepreneurship could insure that transactors' expectations would tend to *become* rational," and went on to explicate the role of the entrepreneur in coordinating a monetary economy. Unless they incorporate the entrepreneurial function, macroeconomists of whatever camp are unlikely to achieve much of substance in their analysis of disequilibria.

The Austrian School and Spontaneous Order: Comment on O'Driscoll

By Lawrence H. White

In the penultimate section of his paper on "Spontaneous Order and the Coordination of Economic Activities,"¹ Gerald O'Driscoll performs a valuable service in bringing into the open a controversy, sparked by Professor Lachmann's thought, which has arisen in Austrian circles over the question of general equilibration. It is evident (especially within these same circles) that further clarification of the issues involved is required before a satisfactory avenue for resolution of this dispute can be found.

The basic question which has been raised regarding general equilibration is: to what extent does there exist a tendency toward an overall equilibrium of an economy of interconnected markets? To formulate an acceptable answer to this question we must clearly specify at least three items: (1) the meaning given to "tendency" in this context; (2) the temporal perspective (*ex ante* or *ex post*) from which market processes are viewed, and (3) the particular conception of general equilibrium employed. There has been misunderstanding among the disputants on all three items. I shall briefly—undoubtedly too briefly—deal with each of these items in turn.

(1) The notion of a "tendency toward an overall equilibrium" has been infelicitously interpreted (by me no less than by others) as a process of movement which would, under specified conditions, eventually allow an economy to reach general equilibrium. Hayek noted years ago that "tendency" in this context is better interpreted as the *likelihood* that the configuration of an economy (particularly its array of prices) will be *near* to a general equilibrium configuration.² Under this interpretation no contradiction exists between the denial that general equilibrium (or complex *ex ante* coordination of plans) could ever be brought about in a real-world competitive economy and the affirmation that such an economy harbors a strong tendency toward an overall equilibrium. "Equilibrating forces" which possess the capability of maintaining an economic system at a high level of coordination may yet inherently lack the capability of bringing about perfect coordination.

The problem of specifying market conditions and forces sufficient to usher in the reign of perfect and final equilibrium seems ultimately insoluble, for there is a simultaneity problem involved with having each market participant finally adjust his own activities to accord with the market signals to be generated by the activities of all others. The market signals by which

he orients himself must already embody the decisions taken by all others before any one agent can act in a sufficiently informed manner. Perfect foresight would allow agents to overcome the simultaneity problem, but only because perfect foresight would place them already in Hayekian general equilibrium. It would not allow a *process* by which they might reach that state. Imperfection of foresight forms an impassable moat around the kingdom of perfect harmony. We may nonetheless attempt to specify the essential characteristics of an overall equilibrium, as Hayek had best begun to do,³ and to use that kingdom as an analytical point of reference in assessing the likelihood (tendency) for an economic system to be in its general vicinity (i.e. for the variables of the system to be approximately at equilibrium values) under specified circumstances.

(2) Austrian economists are in general agreement with the proposition that market forces must be traced back to the plans of market participants, particularly the plans of entrepreneurs. Analytical differences arise over whether emphasis is to be placed on the expectations and decisions in which plans originate (an *ex ante* perspective) or on the experience the testing of plans provides (an *ex post* perspective). It seems to me that both perspectives are necessary for the analysis of dynamic economic processes, and that neither should be allowed to eclipse the other permanently.

Lachmann has taken primarily an *ex ante* perspective, stressing the role of expectations and the pervasiveness of uncertainty in future-oriented decision-making. Yet he has also noted that expectations are "largely the result of the experience of economic processes."⁴

In serial expectational processes learning is possible, provided the sequence of decision, action, result, and interpretation takes place with speed sufficient to outrun significant changes in the objective circumstances. Learning can play an important role in providing accurate foresight and coordination of the decision-maker's (amended) plan with the plans of other market participants. Only in autonomous or *unique* expectation, where the decision made is unprecedented and can or will never be repeated under similar circumstances (this is the case where the taking of the decision itself significantly and irretrievably alters the circumstances), can learning play no equilibrating role. Only with regard to unique ex-

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The Austrian School and Spontaneous Order: Comment on O'Driscoll

(Continued)

pectation can the *ex post* perspective be neglected.

Kirzner's focus on the pure arbitrage aspect of successful entrepreneurship amounts to the adoption of an exclusively *ex post* perspective, as success can be ascertained only *ex post*. This perspective obscures the uncertainty (surrounding future prices) faced by producer-entrepreneurs.⁵ To say that intertemporal opportunities for pure profit "tend to become discovered" by "alert" entrepreneurs⁶ is to slur over the fact of uncertainty, suggesting by the choice of terminology that entrepreneurs can see clearly into some aspect of the future. It is to suggest that the adoption of entrepreneurial plans depends upon knowledge of their *actual* outcomes (knowledge which in fact can only be gained in the future) rather than on *expectations* about their outcomes. Profit is then seen as the reward not for superior *foresight*, as Mises viewed it,⁷ but for the discovery of a piece of knowledge which others lack.

(3) Kirzner's readiness to accord opportunities for profit a seemingly objective status conforms with his use of an equilibrium concept embodying Pareto-optimality.⁸ The Hayekian conception of dynamic equilibrium is more appropriately subjectivist in carrying no requirement that every would-be useful fact be known to each market participant and thus carrying no requirement that optimality from the viewpoint of an omniscient observer be achieved.⁹ Lachmann has framed his discussion exclusively with reference to neo-Walrasian models of temporary general equilibrium. That he (rightly enough) finds the world of these models inconceivable says little by itself about the analytical fruitfulness of the Hayekian dynamic equilibrium or the Misesian evenly-rotating economy, and says even less about the possible tendency (properly understood) of a market economy to approximate the Hayekian sort of overall equilibrium.

One final comment: O'Driscoll expresses concern that Lachmannian skepticism toward general equilibrium involves a weakening of the case for the market system. With regard to a case based on Paretian welfare considerations this may well be true, but defenders of the market system should already be wary of arguments which claim too much. The "failure" of the market system to conform to a neo-Walrasian model which strips it of essential attributes may be regarded as reflecting poorly on the model rather than on the market system, and this is the attitude which I believe

Lachmann to be taking. In a world of ignorance and uncertainty, the virtue of spontaneous order lies not only in promoting uniformity in the coordination of plans, as the neo-Walrasian complete-knowledge model of the state "perfect competition" would suggest, but also in encouraging diversity in the exploration of possible new opportunities.¹⁰

- (1) Gerald P. O'Driscoll, Jr., "Spontaneous Order and the Coordination of Economic Activities," in Louis M. Spadaro, ed., *New Directions in Austrian Economics* (Kansas City: Sheed, Andrews and McMeel, 1978), pp. 128-134.
- (2) Friedrich A. Hayek, *The Pure Theory of Capital* (Chicago: University of Chicago Press, 1941; Midway Reprint 1975), p. 27 n. 2.
- (3) Hayek, "Price Expectations, Monetary Disturbances and Malinvestments" in *Profits, Interest and Investment* (London: George Routledge & Sons, 1939; Augustus M. Kelley Reprint, 1975), pp. 137-141; "Economics and Knowledge" in *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948; Gateway Edition 1972), pp. 33-56; *The Pure Theory of Capital*, pp. 14-28.
- (4) Ludwig M. Lachmann, "The Role of Expectations in Economics as a Social Science," in *Capital, Expectations, and the Market Process* (Kansas City: Sheed, Andrews and McMeel, 1977), p. 66.
- (5) White, "Entrepreneurship, Imagination and the Question of Equilibration," unpublished ms. presented at the Austrian Economics Seminar at New York University (March, 1976), p. 3. For Kirzner's account of entrepreneurship see Israel M. Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973), esp. pp. 1-19 and 37-43.
- (6) Kirzner, "Hayek, Knowledge, and Market Processes," unpublished ms. delivered at the Allied Social Science Association meetings in Dallas, Texas (1975), pp. 28-29.
- (7) Ludwig von Mises, *Human Action*, third revised edition (Chicago: Henry Regnery, 1966), p. 871. For an acknowledgment of the difference between his own emphasis and that of Mises, see Kirzner, *Competition and Entrepreneurship*, p. 86.
- (8) Kirzner, *Competition and Entrepreneurship*, p. 26.
- (9) Hayek, "Economics and Knowledge," p. 53.
- (10) See Brian J. Loasby, *Choice, Complexity and Ignorance* (Cambridge: Cambridge University Press, 1976), pp. 170, 191-192.

Summer Fellowship Program in Law and Economics

The Austrian school has a long tradition of scholarship which crosses the boundaries between disciplines. Hayek's wide interests, including psychology, politics, philosophy of science, and law, probably best exemplify the Austrian stress on an interdisciplinary approach to social sciences.

Interest in the particularly important borderline between Law and Economics has increased in recent years as modern scholars recognize the necessity to acquire a detailed knowledge of both fields in order to increase the depth of their understanding of each. Specifically, economists must be encouraged to look into the nature of legal institutions, property rights and the common law, while legal scholars need to acquire a better understanding of the strengths and limitations of economic analysis.

With this objective in mind, Liberty Fund of Indianapolis and the Center for Libertarian Studies have announced the 1979 Liberty Fund Law and Economics Summer Fellowships.

Ten outstanding graduate students, law students and junior professors will be chosen from both Law and Economics to do intensive interdisciplinary research and to develop a substantial research paper. The project director will aid the fellows in their research and in structuring that research for possible publication in an academic journal. Although the program will be mainly an out-of-residence research effort spanning the entire summer, fellows will be brought together for a week-long working seminar in mid-August. At this time their preliminary drafts or completed papers will be exposed to high-level criticism by a diverse audience of fellows and senior scholars.

Liberty Fund will provide stipends of \$2400 to cover living expenses and will pay the expenses (including travel) of the August seminar.

Advanced graduate students and junior faculty members interested in applying should send a letter of application, a current vita, and an academic transcript to Dr. Mario Rizzo, Program Director, Center for Libertarian Studies, 200 Park Avenue South, Suite 911, New York, N.Y. 10003.

Austrian Economic Seminar, Part III: 1977-78

by Don C. Lavoie

The third academic year of the AES was a forum for a number of interesting papers and discussions that illustrate distinctive features of the Austrian approach to economics. While the first two parts of this review stressed the divergence of Austrian thought, it is nonetheless an identifiable school of thought with specific features that differentiate it from other schools. No school of thought in economics can seriously reject every contribution of every other school. Austrian economic literature does not exist in a vacuum. Rather it represents a particular perspective on economic phenomena, a viewpoint which is embedded in the history of economic thought and which gains clarity by comparison with that wider context. Its contributions, seen in comparison with other schools, often represent different foci of attention rather than sharply contradictory claims. Here we will try to emphasize some of these distinguishing features of the Austrian point of view.

While the last four sessions dealt with a great variety of Austrian ideas from interest theory to methodology, the first five sessions were all devoted primarily to what can be broadly described as Austrian monetary theory. Austrian monetary and trade cycle theory is its most ambitious and difficult body of systematic theory and one of its most significant contributions. It is also illustrative of many of the particular attributes of Austrian theorizing in general: the coordinating role of prices, the emphasis on the adjustment process (rather than on long run equilibrium), the multiple stages and the time structure of capital, and the origin and spontaneous evolution of social institutions.

The September paper, Richard Ebeling's "Some Reflections on the 'New' Monetary Theory of Clower and Leijonhufvud", was a sympathetic though critical assessment of two self-styled 'Keynesians,' whose views on money overlap and complement those of Austrian economists in many respects. In particular their concern with the disequilibrium aspects of money and its fundamental role as the medium of exchange recall much of the Austrian monetary literature. The institution of money fits rather uncomfortably within equilibrium theorizing because some of its most essential characteristics derive from the *disequilibrium* features of the market. Clower and Leijonhufvud came under some criticism, however, for not going far enough in this direction. Ebeling suggested that while they recognize the significance of money

for business cycle theory, they fail to find the initial source of what Hayek calls the "cluster of errors" revealed in the depression, or to sufficiently examine the subsequent forces that tend to reestablish order in the market. Austrians view the world as always in disequilibrium but usually ordered by market forces that tend to coordinate the disparate and often contradictory plans of its participants. A depression is seen as an indication of a systematic monetarily induced distortion of the usually equilibrating price signals.

Also under criticism was Clower's trading-post monetary exchange analysis, which seems to imply that the existence of trading post institutions ready to accept money in transactions is a logical and temporal precondition for the emergence of money. In contrast, Menger and Mises have stressed the evolutionary origin of monetary exchange, emerging *simultaneously* with trading centers. No actor *chooses* money to facilitate trade or reduce the transaction costs of barter. It emerges as the resultant, not the design, of purposeful choices. Discussants noted that these criticisms were more an exposition of what Austrians have to *add* to these theorists' work than a criticism of what they have done.

Leijonhufvud and Clower have revived issues stressed in the Austrian tradition which were long ignored by the mainstream. It was Clower who pointed out that in the influential Patinkin model money is analytically identical to every other commodity, and who argued that the foundation of any monetary theory ought to be that money buys goods and goods buy money, but goods cannot buy goods. Thus a money economy basically differs from a barter economy. Leijonhufvud too has helped to focus attention on Austrian insights, particularly in his paper on the consequences of inflation which discusses the Cantillon distribution effects of monetary expansion. Monetary expansion does not merely raise the "price level", as often implied. Since prices are bid up unevenly, there is a "ragged price" effect.

These two insights were to play a crucial role in the October discussion of Roger Garrison's dissertation proposal (U. of Va.), "The Neoclassical-Austrian Paradox: A Study of the History of the Wicksellian Idea". Both the neoclassical (represented by Patinkin's macro model) and Austrian theories have roots in the "cumulative process" of Knut Wicksell, characterized by a lowering of the market rate of interest below the "natural" rate.

Yet they come to diametrically opposed conclusions on a number of key points. While Patinkin views the cumulative process as stable and equilibrating, the Austrians see it as a disturbing influence and the cause of periodic crises. Patinkin uses the Wicksellian idea to show the neutrality of money while the Austrians use it to demonstrate why changes in the money stock *cannot* be neutral. Garrison's dissertation will attempt to resolve this paradox by tracing the development of these divergent approaches from Wicksell, and to determine the ultimate source of this divergence. He suggests that Patinkin's link to Wicksell is indirect, through Keynes and Hicks, and that due to these influences two fundamental aspects of Wicksell's theory (the very issues revived by Clower and Leijonhufvud) were altered. Money is viewed as essentially a medium of exchange by Wicksell, but in Patinkin's model it is analytically indistinguishable from any other commodity. Secondly, Wicksell's cumulative process (and that of the Austrians) is analyzed in the context of an economy which employs time-consuming processes of production and heterogeneous capital goods. Patinkin, in contrast, assumes all capital goods and consumer goods prices to move simultaneously and in the same proportion, virtually reducing the economy to a one-good model, and assuming away Leijonhufvud's "ragged price" effects.

The Mises-Hayek development of Wicksell's idea analyzes a particular systematic relative price effect of credit expansion upon the time structure of production. When the market rate of interest is pushed below the natural rate entrepreneurs plan according to a faulty price signal, this lowered interest rate, and thereby undertake investments in overly roundabout processes of production relative to the actual time preferences as expressed in spending/saving ratios. Austrian economists view this malinvestment, taking place during the expansionary boom, as the cause of depressions.

This business cycle theory has led some Austrians to oppose fractional reserve banking in favor of the 100% reserve policy that Henry Simons had advocated in the 30's. In the first of two November papers by Walter Block (Rutgers), "Fractional Reserve Banking Reconsidered", this policy was advocated on economic and ethical grounds. He contended that issuing more money substitutes (with a promise to redeem on demand) than are backed by money assets is fraudulent. These fiduciary

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media, Block argued, ought to be clearly marked with a message indicating that they are not a perfectly sound claim to money, and he predicted that if so marked they would be discounted on the market. Participants were careful to differentiate the ethical arguments that lie beyond the scope of economics from economic analysis.

Aspects of this business cycle theory were also raised in the discussion of Block's second paper, "The DMVP-MVP Controversy: A Note". The Austrian approach always stresses the significance of time in the process of factor evaluation. *Ceteris paribus* a factor tends to earn its Discounted Marginal Value Product, discounted according to its distance in time from the ultimate consumer goods. While discussants argued that this insight is denied by few contemporary economists (Knightian capital theorists may be an exception) it is often hidden from view in discussions of the equating of (already implicitly discounted) Marginal Value Products. There is heuristic value in noting that, as Rothbard puts it, "in order for investment to take place in the higher stages, their MVP has to be far higher than the MVP in the shorter processes". By explicitly considering the discount that is involved in the evaluation of every factor, Austrians focus on the crucial role of the market interest rate on the time structure of capital. Any change of the interest rate alters relative values of factors in different stages of production. While Wicksell's natural rate of interest expresses the actual time discounts of market participants and therefore the amount of savings forthcoming, the market rate can be distorted by monetary effects, systematically misleading investors. Thus, when the interest rate is lowered, higher stage factors will be overvalued. This disequilibrating effect is likely to be missed by theorists who focus on the fundamentally timeless world of general equilibrium.

The prevalent attempt to fit money into general equilibrium models has proceeded so far that some theorists have begun to wonder why people would want to hold money at all. In the equilibrium world, devoid of transactions costs, uncertainty, and error, actors could entirely dispense with money and cover expenditures by means of perfectly timed credit transactions. While some economists (e.g. Hahn) have reasonably concluded from this that such models are inadequate to deal with monetary theory, others suggest that it is *money* that is flawed, lament the wastefulness of economic re-

sources being "unproductively" held in "idle balances," and try to devise policies to discourage money holding. The December paper, "An Analysis of the Productive Nature of Money," a chapter of Eugenie Short's (U. of Va.) dissertation, briefly discusses the history of this idle hoards idea and argues cogently that cash balances yield very productive services to the holder. In coping with uncertainty, holding money, by definition the most exchangeable commodity, is a rational way to minimize transactions costs. As W.H. Hutt points out, when rationally allocated, "idle" cash is just as productive as any other resource in the economy.

This barren asset idea received an impetus following the 1929 depression which many Keynesians viewed as a consequence of an excessive fear of investment. It was argued that investors have to be encouraged to stop their unproductive flight from real investments to money holding, and, through the multiplier, be induced to engage in employment-generating production. Of course, given a stock market crash, the demand for money is bound to increase, but the Austrian analysis of crises argues that the root cause of that crash was the prior credit expansion that caused malinvestment. The withdrawal of resources from faulty investment projects and the accompanying disemployment of workers is a rational redirection of resources toward conformity with transactors' time preferences. It is precisely policies taken to retard this allegedly unproductive demand for cash that prolong the depression by preventing the necessary relative price changes.

Naturally enough, business cycle theory, as one of the most complicated areas of analysis, is also one which most seriously cries out for more theoretical and historical work. The January, 1978, AES paper, "Problems with Austrian Business Cycle Theory" by Jeffrey Rogers Hummel (Univ. of Texas) begins to address this need by raising a number of important questions. For example, he asked why there is an asymmetry between the boom, when resources are being shifted from relatively lower to relatively higher stages of production, and the bust, when resources are shifted in the other direction. Why, is the first shift smooth and prosperous but the latter not? Underlying this and most of his arguments was a clearly stated assumption that violent fluctuations of time preferences would have the same effects as business cycles. This was challenged in the lively discussion where it was

argued that the monetary distortion of price signals, unlike fluctuations in time preferences, set in motion self-reversing effects. While changing time preferences have to gradually work their way up the Hayekian structure of production from consumption/savings decisions toward higher order investment, the malinvestments induced by a faulty interest rate are suddenly discovered too late, when irreversible investment decisions have already been made. Thus while in the boom workers are gradually bid away from lower stage enterprise in the bust they are unexpectedly disemployed.

In Hayek's writings on monetary theory and methodology he often emphasized that to understand the subtle effects of monetary disturbances it is necessary to go beyond correlations of statistical variables. Often in the study of the complex phenomena of economics the causal sequences which are most important are not the ones which are the most econometrically visible. It is notoriously difficult to measure the rippling price effects of monetary disturbances that Mises and Hayek discuss, yet these effects may be more significant than more empirically tractable effects.

Probably the most significant distinguishing characteristic of the Austrians is the controversial stance on methodology, being critical not only of excessively formal equilibrium modeling but also of the search for empirical laws by some econometricians. The Austrian school has a tradition of arguing for a "methodological dualism" in the sciences and against too facile an adoption of "natural science" methods in the social sciences. However, the exact nature of this dualism has not always been clear. There has been more agreement among Austrians about what the method and purpose of economics should be than there has been about exactly why.

The February paper, John Kunze's (NYU) "Methods of Understanding Simple and Complex Phenomena", drawing on the methodological contributions of Karl Popper, T.W. Hutchison, and F.A. Hayek, attempts to clarify this dualism. Mises had argued that it derives from the fact that the social sciences make deductions from introspective observation concerning purposiveness, while the natural sciences concentrate on external observations of the physical world. Kunze, following Hayek, argued that a dualism in method is necessary but that the distinction should not be between natural and social science but rather between simple

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and complex phenomena. In the study of relatively simple phenomena it is often possible to formulate hypotheses that can be tested with controlled experiments. However, in the study of complex phenomena, it may not be helpful to construct falsifiable predictions, because in complex phenomena we seek not empirical laws, but rather the logical consequences of observations (and perhaps natural science laws). As Hayek argues, the scientist may have to be content with more general "pattern predictions". The natural science theory of evolution employs a deductive method, tracing theoretically conceived patterns rather than relying upon specific falsifiable predictions. In the discussion some argued that Kunze's statement that "the distinction between natural and social sciences is the wrong distinction" is too strong and that there is room for more than one distinction. As Kunze had noted, some attributes of our economic method derive from the complexity of the phenomena we study; others derive from the introspective source of our knowledge of these phenomena.

While its method is distinguished primarily by complexity and purposiveness, the *content* of Austrian economics is primarily distinguished both by its "radical subjectivism", as Lachmann puts it, and by its emphasis on the importance of time. These were underscored in Frank Arnold's (Harvard) paper in March, "Some Discussion of Selected Aspects of the Pure Time-Preference Theory of Interest." As opposed to the Marshallian-scissors exposition of the influences of supply and demand on price—and to the Fisherian diagram in the case of interest rates—Austrians accentuate the fact that the supply offered itself depends on the subjective desires of potential suppliers. There is no *independent* objective supply blade of the scissors. This is not to say that objective conditions are irrelevant but only that they exert their influence only through affecting individual minds. Like all valuation, time preference is purely subjective, rooted in the separate decision-makers' perspectives of reality.

Arnold's paper raises four issues concerning this approach to time preference and interest, the middle two of which comprise an excellent exposition of the relationship between subjective time preference and objective possibilities, and a criticism of Fisher's treatment. The first section criticizes Mises' analysis of the nature of time preference where he derives, from the fact that men act, the assertion that *ceteris paribus* men always

prefer sooner to later. Arnold argues that this does not explain why market interest rates must be positive. Some discussants were willing to concede this but nevertheless argued for Mises' theory as a helpful analysis of one component, the "originary" interest rate, of the market rate of interest. The last section of the paper summarizes and criticizes Leland Yeager's concept of 'waiting' as a factor of production, and interest as the price of this factor. Yeager's analysis comes remarkably close in many respects to the pure time preference theory of interest, but Arnold shows why the Austrians prefer to think of time as a subjective discount of future utility rather than as an input in the production process. Also while Yeager is himself critical of the use of one commodity models in interest theory, Arnold charges Yeager with slipping into just such a model in his example of a "50% machine".

One of the most important differentia of the Austrian school is its focus on the subjectivity and divergence of expectations. Expectations are particularly significant in the analysis of stock prices where the ebb and flow of expectations continually influence the willingness of actors to hold stocks. In April these issues were addressed in J. Stuart Wood's (Tulane) "Divergent Expectations as a Cause of Non-Equilibrium Changes of Stock Prices". Wood attacked Tobin and Sharpe's Capital Asset Pricing Model, and the Efficient Markets hypothesis for assuming homogeneous expectations while dealing with a kind of market whose most essential properties derive from the divergence of expectations. Such an approach prevents treatment of important questions about the way the market disperses information and the significance of security analysts, forward traders, and insiders in the converging of some expectations.

While Wood's theoretical exposition found substantial agreement, his attempt to find empirical corroboration of this thesis was criticized on a number of grounds. Most fundamental was whether the economist could ever empirically discover the causal sequences in the process of entrepreneurial information dispersal without himself being a kind of super-entrepreneur. Were the econometrician to somehow reveal that a particular source of information systematically leads to asset price movements, this would itself alter the nature of information dispersal on the market. What the econometrician who investigates the stock market is trying to discover on a

grand scale, reliable indicators of asset price movements, is precisely what all its participants are engaged in trying to discover in particular pieces.

There is probably no better exposition of the distinctively Austrian view of the limitations of equilibrium theory, and the necessity to examine the equilibrating process, than Israel Kirzner's *Competition and Entrepreneurship*. Building on the work of Mises, he argues that the 'Robbinsian' framework (the optimization of given means to achieve given ends) is incomplete. Action is not merely optimization, it also entails alertness to new, unforeseen opportunities, and the restructuring of new ends/means frameworks. Market equilibration is only possible because of entrepreneurial action, the rivalrous bidding of prices up and down in grasping for profit opportunities. In his May paper, "Entrepreneurship, Entitlement and Economic Justice", Kirzner applies entrepreneurship to the theory of justice. Not only many scientific expositors of the market economy but also many of its ethical defenders have relied on a narrow Robbinsian framework. To defend the justice of the market it would be necessary not only to defend the factor returns, wages, rents, interest, etc., in equilibrium, but also the pure profit that goes to the alert and lucky. Kirzner argued that Robert Nozick's entitlement theory of justice does not include an adequate consideration of this pure profit element. He suggested that the voluntariness of the transfer of titles might be undermined when actors seriously err in their assessment of the items being exchanged. This point was disputed in the discussion where many interpreted "voluntariness" to mean strictly *ex ante*, in which case any *ex post* regret would be irrelevant. But clearly those who would advocate, as much as those who would describe, the market economy must come to grips with the pervading disequilibrium aspects of the real world.

In general, by its insistence on radical subjectivism, and its focus on the market process rather than the final equilibrium state (and on the consequent importance of time in economics), the Austrian school brings attention to many facets of economic phenomena which are often missed in contemporary theory.

Atlantic Economic Association Highlights Carl Menger

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ignorance and error, Kirzner insists that while William Jaffe's interpretation of Menger's entrepreneur as a "bumbling, erring, ill-informed creature" (p. 36) is appealing, Menger in fact deliberately brushed aside any reference to error as a "pathological abnormality" when discussing his theory of price. Similarly on equilibrium, Kirzner dismisses Erich Streissler's view that Menger's was primarily a disequilibrium, dynamic theory of economic processes by pointing to the fifth chapter in *Principles* on "The Theory of Price" where Menger "provides no hint of any time-consuming market process (entrepreneurial or otherwise)..." (p. 36). However, Kirzner concedes that Menger *correctly* ignored error here, inasmuch as Menger is concerned with economic prices arising out of complete information.

But Menger is not absolved. In the remaining sections, Kirzner notes that Menger lacked any notion that people learn from yesterday's prices, failed to see competition as primarily responsible for economic progress and, while transcending the model of perfect competition, did not pioneer the theory of the entrepreneur.

Kirzner explains Menger's failing as the result of his singleminded pursuit of subjective value: he was not interested in portraying the market process as an entrepreneurial one. For that reason, Kirzner expects too much of the founder of the Austrian school. While his analysis of Menger is painstakingly thorough and a positive contribution to the meager pickings on the early Austrians, his emphasis is misplaced. Compared to the economic literature prior to and for decades following the publication of *Principles*, Menger's work on the entrepreneur and the market process was indeed pioneering and should not be faulted for failing to fully elucidate a concept with which present day Austrians are still struggling.

Harvey Nelson Gram of Queens College and Vivian Charles Walsh of the New School for Social Research explore "Menger and Jevons in the Setting of Post-von Neumann-Sraffa Economics" in the collection's fourth article. Gram and Walsh maintain that, since a marginal utility theory had been consistently embodied in the modern classical models springing from the work of John von Neumann and Piero Sraffa, the distinguishing characteristics of the neo-classical model could no longer be the theory of marginal utility. They suggest rather that neoclassical writers developed a theory of allocation which was a signif-

icant departure from classical allocation theory. As Arrow and Starret put it, in the classical model, *price* is determined by purely technological considerations and the quantities are then determined by the demand at those prices. On the other hand, in the neoclassical model, the total *quantities* of goods are given. Demand then determines the set of prices for which the given supply of goods will just equal the demand. In this light, Gram and Walsh consider the question of whether Menger should be heralded as one of the founders of neoclassical allocation theory.

Several areas of Menger's work create problems for the authors. His resistance to mathematical formulations causes some concern. Drawing heavily on Streissler, the dynamic aspects of the theory are highlighted along with Menger's emphasis on imperfect foresight, disequilibrium, and uncertainty while the marginalist aspects are denied.

While time, uncertainty, and information play a central role in Menger's work, Gram and Walsh have difficulty reconciling this with Menger's concern with allocation of given resources. But there need be no inconsistency here, as Wagner points out in his concluding remarks. Menger's ability to draw on both classical and neoclassical ideas is a tribute to the uniqueness of his work. There is also no inconsistency in employing different tools for different tasks. Where the theory of allocation or exchange is at issue, taking certain factors as given aids one's perception of the solution, whereas other less abstract problems demand a more complex, empirically-grounded approach. In short, Gram and Walsh almost miss the significance of what Menger had to say, so eager are they to place each of his ideas firmly in one school or the other.

In his short piece entitled "Carl Menger and the Incomplete Revolution of Subjectivism", Ludwig Lachmann of New York University explores several aspects of Menger's work which prevented him from carrying his subjectivism as far as might otherwise have been possible. Although quick to acknowledge Menger's pivotal role in the development of the subjectivist movement, Lachmann notes two areas where Menger could have used help. First, in his treatment of the nature of human needs, Menger appears to have assumed that men face objective wants. Secondly, "exact laws" may seem to theoreticians raised in a positivist climate to be inhospitable to subjectivism. Menger, however, saw these "exact laws" as

absolute unchanging, and necessary because the nature of what it described could not allow it to be otherwise. But Menger's search for "exact laws" and his subjectivist approach to these laws are not at odds with each other; exact laws refer to the category of laws to which he addressed himself while his subjectivism was applied to the substance of those laws.

Finally, Lachmann seeks to reconcile Menger's views on subjectivism and determinism. Unfortunately Lachmann only briefly touches on some of the most telling aspects of Menger's work here. While quoting Menger where he refers to strictly determined goals and courses of action, Lachmann notes that Menger's unwillingness to portray man as a "lightning calculator" bode well for the genesis of subjectivism. It is hoped that Lachmann will further enlighten us on some of these very issues himself.

Karen Vaughn of George Mason University comments on the birth of recent Menger scholarship. She places each of the papers in the context of this recent work noting that all emphasized Menger's approach to uncertainty and error rather than his work solely as the founder of marginal utility. Vaughn discovers that each of the papers, with the exception of Moss's, attempts to explain some inconsistency in Menger's thought; Lachmann reconciles Menger's determinism with subjectivism, while Kirzner, Gram and Walsh grapple with the relationship between Menger's preoccupation with time and uncertainty, and his analytic work on the theories of price, exchange, and allocation. Vaughn is most amenable to Moss's view of Menger's economics as primarily a study of exchange and not one of price.

Wagner displays a welcome good humor and no little insight in his closing remarks on the five papers. He finds merit in each effort, pausing occasionally to elaborate this point or examine that consideration from a different perspective. Of particular interest to Wagner is Menger's thoroughgoing subjectivism which he applauds most heartily along with Lachmann's efforts to elaborate upon Menger's initial groundbreaking work.

In short, this collection is well worth the reading. It represents a substantial and noteworthy addition to the meager scholarship on Carl Menger. Hopefully future entrepreneurs will take Moss's lead and generate additional opportunities for further work of this caliber on the Austrians.

The Ultimate Foundation of Economic Science

Ludwig von Mises

Sheed, Andrews, and McMeel, Kansas City, 1978, xvii, 148pp.

Reviewed by Matthew Krogdahl

The subject of this small but weighty volume is the epistemological nature of the sciences of human action, particularly economics (praxeology). Mises shows how the theorems of economics—the “pure logic of choice”—are deduced from *a priori* mental categories enjoined on all human thought by the “logical structure of the human mind.” Theorems deduced from these categories are neither established nor verified by experience. They are thus of an epistemological character entirely different from that of “laws” based solely on observation of social phenomena, whose validity is limited to unique historical periods and places.

The epistemological doctrine known as positivism, however, “does not acknowledge any other ways of proving a proposition than those practiced by the experimental sciences and qualifies as . . . nonsensical all other methods of rational discourse.” (p. xii) The contributions of praxeology to human knowledge are therefore ignored by those under positivism’s sway, including, in greater or lesser degree, a large majority of contemporary economists. It is on this empiricist prejudice that Mises has trained his formidable intellectual artillery in this book, with the intent “to expose the fallaciousness . . . of positivism . . . to depict

will be handled in the same satisfactory way in which modern technology supplies electric current.” (p. 121) The widespread assumption today that private, individual interests are in perpetual and irreconcilable conflict with the “interests of society” is likewise traceable to the hypostatization of social phenomena (e.g., “society,” “economy,” “state,” etc.) resulting from the holistic approach to their investigation. Observation of society uninformed by praxeological insight has permitted the interpretation of cooperation through the market as the human parallel of the biological competition of the lower animal species. Ideas such as these, if they continue unchecked, Mises believes, will lead to the destruction of the market, and with it, human civilization.

Mises distinguishes two fundamental branches within the science of human action, each with a distinct epistemological character. Praxeology, the general branch, “starts from the *a priori* category of action and develops out of it all that it contains.” (p. 41) It “abstracts from the concrete content of the ends men are aiming at.” (p. 43) and is concerned only with the formal relationship of means to ends. History is the particular branch, dealing with action in the concrete, seeking to identify what “meaning the actors attached to [their] situation . . . and what was the meaning of their reaction, and, finally, what was the result of these actions.” (p. 43)

Mises introduces apriorism by explaining how “our representation of . . . reality . . . is conditioned by the structure of our mind as well as of our senses.” (p. 19) Man’s mental processes take place within the framework of certain *a priori* categories of thought which are anterior to his experience. “Experience tells us something that we did not know before and could not learn but for having had the experience. But the characteristic feature of a *a priori* knowledge is that we cannot think of the truth of its negation or of something that would be at variance with it. What the *a priori* expresses is necessarily implied in every proposition concerning the issue in question.” (p. 18)

Positivists refuse to grant the capacity of propositions deduced from the allegedly arbitrary axioms of praxeology to convey reliable knowledge of external reality. (Even Hayek is “reluctant to accept von Mises’ claim of an *a priori* character of the whole of economic theory” although agreeing “with him that much of it consists merely in working out the logical implications of certain initial facts.”) Yet they do not question the serviceability of

logic or mathematics in advancing human knowledge. The achievements made possible by such purely deductive systems attest that “they are not arbitrarily made, but imposed upon us by the world in which we live and act. . . .” (p. 14)

All human thought, both in the natural and social sciences, presupposes “regularity” or “causality,” “the awareness of

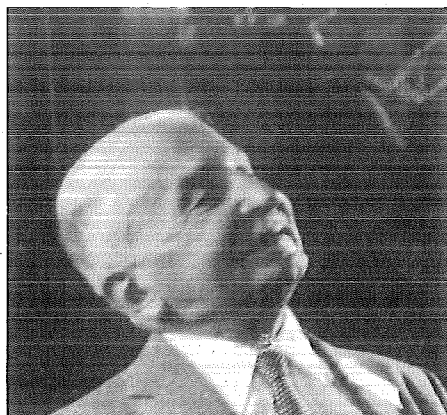


Ludwig von Mises (1958)

constant relations among the external phenomena that affect our senses.” (p. 20) But, “what distinguishes the field of human actions from . . . the natural sciences is the category of finality. We do not know of any final causes operating in . . . nature. But we know that man aims at definite goals chosen.” (p. 36) From this concept of purposive human action are derived the corollary concepts of means and ends, valuation and choice—the basic tools of economic analysis—concepts that are completely absent from the realm of natural science.

It is most appropriate that this new edition of Mises’ final book includes a Foreword by his distinguished student, Professor Israel Kirzner. Kirzner notes the “passion” which animates the book. Mises’ ardor and tenacity in championing the cause of classical liberalism has seemed paradoxical to some in view of his insistence on *Wertfreiheit* in scientific inquiry. But, as Kirzner shows, Mises understood that liberal goals—peace and prosperity—could be served only by taking account of truths established by scientific inquiry, untainted by value judgments.

Kirzner observes that “since the first publication of this book . . . the pendulum of philosophical fashion has . . . swung decisively in Mises’ direction.” He is optimistic that “this work cannot fail to leave its impression in this present more hospitable intellectual atmosphere.” (p. ix) We hope he is right.



Mises Photos courtesy of Bettina Bien Greaves

its disastrous consequences” (p. xii), and to demonstrate the existence of phenomena with which positivist methods are wholly inadequate to cope.

The “disastrous consequences” which Mises ascribes to the influence of positivism include a wide spectrum of ideas ranging all the way from esoteric social scientific doctrines to fallacies current in popular thought. Its legacy includes the utopian vision prevalent among intellectual elites of a “blissful age of ‘social engineering’” in which “all human affairs