

Austrian Economics Newsletter

Fall 1987 • The Ludwig von Mises Institute

AEN Celebrates 10th Anniversary

This issue marks the 10th Anniversary of the *Austrian Economics Newsletter*. During this time AEN has served as a major source of information for Austrian economists during a period of tremendous growth and activity in the Austrian school. When the AEN began publication in the fall of 1977, the revival of the Austrian school of economics was just getting underway. Ten years later, Austrian economics is presenting a strong academic challenge to the orthodoxy of mainstream economics.

The following facts are evidence of the growth in the Austrian school of economics.

* There are now major programs in Austrian economics located at Auburn University, George Mason University, and New York University. New programs are being established at the University of Nevada, Las Vegas, and California State University at Hayward.

* The first Austrian journal, *The Review of Austrian Economics*, edited by Murray Rothbard and co-edited by Walter Block will publish its second Volume this fall.

* This past summer 115 students gathered to attend the Mises Institute's first Advanced Instructional Conference in Austrian Economics at Stanford University.

* Austrian conferences, sessions at professional conferences, and publications in mainstream journals are now regular events.

* The academic and international mailing list of the AEN has increased six-fold since moving to the Mises Institute and Auburn University in 1984.

The purpose of the AEN is the same now as it was in the beginning: to serve as an "information device" for those interested or working within the Austrian school of economic thought. To this end the AEN still provides reports on conferences, interviews of prominent economists, review articles, annotated bibliographies, reprints of earlier and lesser known Austrian works, critiques of trends in mainstream economics, and, of course, book reviews.

Several contributions to the AEN have become "classics" such as the "White-Lachmann exchange" and the "dual" reviews of W.H. Hutt's book *The Keynesian Episode* by Leland Yeager and John Egger. Recognition and citations of more recent contributions such as Roger

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AEN BEGINS PUBLICATION

This issue marks the first publication of the *Austrian Economics Newsletter*. The Newsletter is intended to serve as a research aid and communication device for those working in Austrian Economics. For a number of years there have been only a few scholars actively writing in the Austrian tradition. However, there has recently been quite a resurgence of scholarly interest in Austrian economics. Much of this interest has been stimulated by those who studied in von Mises' advanced seminar at New York University.

Evidence of this resurgence is abundant as the following indicate:

- * This summer over twenty-five scholars spent three months doing research in the Austrian tradition at the Institute for Humane Studies (Menlo Park, CA) with grants provided by the Liberty Fund. Most of the participants were graduate students or recent Ph.D's.
- * In the last four years there have been twelve major conferences on Austrian economics and additional conferences are being scheduled for the future.
- * The Austrian Economics Seminar is now in its third year of monthly meetings at NYU. The express purpose of this seminar is to encourage scholars interested in the Austrian approach to present working papers for comments and criticism. This academic environment has proved helpful in stimulating young scholars to integrate their independent research pursuits with that of their colleagues.
- * An impressive series of lectures by Austrian economists was held at the University of Chicago this past year, a program to be expanded by the Cato Institute to other universities.
- * At present there are Austrians doing graduate work at a number of major universities including UCLA, Harvard, Virginia, Chicago, and of course NYU.
- * In recent years several new Austrian works have been published. The newly established *Studies in Economic Theory* series promises to republish all of the Austrian works now out-of-print, and will provide a valuable outlet for publishing new contributions by contemporary Austrian theorists.

With this resurgence, the future offers great opportunities for Austrians. Several insights, long of interest to Austrians, are at present being discussed by the economic profession. For example, Sir John Hicks' recent work has focused on the unique role of time in economics. Axel Leijonhufvud has incorporated Austrian ideas on the importance of relative price changes in his analysis of inflation. G.L.S. Shackle's writings on time, uncertainty and knowledge have generated much work on radical subjectivism and market process. In addition the work of James Buchanan on subjective cost poses a major challenge to the current emphasis on the measurement of costs. Finally, with F.A. Hayek's recent Nobel Prize, Austrian ideas are again being noticed.



Friedrich A. Hayek

Unfortunately many individuals concerned with Austrian economics are not aware of the rapid growth of interest in these ideas. Many of these individuals have been working in isolation with little knowledge of the resurgence. Because those involved in this field are so widely scattered and because there exists at present no formal means to keep them informed of Austrian activities, the *Austrian Economics Newsletter* should be of value. Thus the Newsletter will be directed first and primarily at those individuals engaged in on-going work in Austrian Economics.

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Garrison's "'Rational Expectations' Offers Nothing That's Both New and True," Robert Ekelund's "Wieser's *Social Economics: A Link to Modern Austrian Theory?*," Joseph Salerno's "The True Money Supply: A Measure of Supply of the Medium of Exchange in the U.S. Economy," and the recent controversy over hermeneutics all testify to the important function that the AEN plays in the Austrian school.

The founding editor, Gary Short, pioneered the *Newsletter* and oversaw operations over the first three issues. Regrettably, he did not pursue an academic career. His successor, Don Lavoie received his doctorate from New York University and now teaches at George Mason University. Next, Don Boudreaux and Sanford Ikeda served as co-editors during the AEN's move to Auburn University. Don Boudreaux is now teaching at George Mason University and while Sanford Ikeda is teaching at California State University at Hayward. Richard Ebeling, now at the University of Dallas, also deserves mention for his many fine contributions to the early issues of the AEN.

The present editors would like to congratulate all the people who played a role in the success of the AEN. However, it is as true today as it was in the fall of 1977, that the success of the *Newsletter* is dependent on reader criticism, ideas, and feed back, as well as news and contributions.

Our fervent hope is that the AEN and the Institute which sponsors it will continue to grow and prosper, and that in another ten years we will see an issue that reports on "Another Austrian Nobel Prize," "The Formation of the Austrian Economics Association," "RAE Competes in Prestige With AER," "Austrian Professors in Demand at Major Universities," and the "20th Anniversary of the AEN."

As always, our thanks to the Mises Institute contributors who have made this all possible.

Some Events of Note:

June 21-27: The Mises Institute's O.P. Alford III Center sponsored the first "Advanced Instructional Conference in Austrian Economics" at Stanford University. This conference, directed specifically to graduate students, attracted more than 110 participants. Lecture topics included: "Pre-Misesians," "Praxeology," "Time Preference," "Utility and Welfare," "Competition and Entrepreneurship," "Theory, History, and Forecasting," "Capital and Its Structure," "Origin and Nature of Money," "Equilibrium Theory," "Business Cycle Theory," "Central Banking," "Unions and Labor Law," "Socialism," "Keynes and Keynesianism," "Subjectivism," "Ludwig von Mises," and "Ratex, Chicago, and The Supply Side." The second annual instructional conference will be held at Stanford University, June 25 through July 1, 1988.

October 16-17: The Mises Institute's Fifth Anniversary was celebrated in New York City with a dinner in honor of Henry Hazlitt and a conference on the contributions of Ludwig von Mises. Lecturers included: Prof. Israel Krizner, Prof. Leland Yeager, Prof. Roger Garrison, Prof. Hans-Hermann Hoppe, Dr. Walter Block, Professor Joseph Salerno and Prof. Murray Rothbard.

Fall Quarter George Mason Student Center: George Selgin, assistant professor of economics at George Mason University will conduct a 20-week (weekly) seminar and discussion of Mises' *Human Action*. Any students interested in participating should contact: Mises Institute, George Mason Student Center, 3977 Chain Bridge Road, Fairfax, VA 22030, (703) 385-1228.

Fall Quarter Colloquium, Auburn University: The weekly graduate student colloquium this term will include the following topics: week 1: "On the Development of the Subjective Theory of Value," by Mises; week 2: "Mises and His Critics on Ethics, Rights, and Law," presentation by Prof. Leland Yeager; week 3: "Theory of Price Controls by Mises"; week 4: A Theory of Price Controls, by John Kenneth Galbraith; week 5: "Destructionism", by Mises; week 6: "Market and Plan: Two Type of Rationality," by Ralf Dahrendorf; week 7: Monetary Trends in the United States and the United Kingdom, by Milton Friedman and Anna J. Schwartz; week 8: "Monetary Stabilization and Cyclical Policy, Part I: Stabilization of the Purchasing Power of the Monetary Unit," by Mises; week 9: "Monetary Stabilization and Cyclical Policy, Part II: Cyclical Policy to Eliminate Economic Fluctuations," by Mises; week 10: "Conception and Understanding," by Mises.

NOTICE

The administrative office of the Ludwig von Mises Institute has moved to: 851 Burlway Rd., Burlingame, CA 94010 415-579-2500 (November 1st).

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An Interview with Nobel Laureate James Buchanan

James McGill Buchanan is the founder of the New Political Economy called Public Choice. He has devoted his 40-year career to applying the economic tools of methodological individualism and subjectivism to the study of government and political decision making. He has made important and pioneering contributions in the areas of Constitutional Economics, public deficits and debt, the subjective nature of cost, public resource allocation and political theory. In recognition of his many contributions he was awarded the 1986 Alfred Nobel Prize in Economic Science.

Professor Buchanan, currently teaching at George Mason University, received his doctorate from the University of Chicago in 1948 where he was a student of Frank Knight. In 1957, he and Prof. Warren Nutter founded the Thomas Jefferson Center for Studies in Political Economy and Social Philosophy at the University of Virginia. Buchanan and Prof. Gordon Tullock established the Center for the Study of Public Choice and the journal, *Public Choice* at Virginia Polytechnic Institute in Blacksburg, Virginia in 1969. In 1982, both Buchanan and the Center relocated at George Mason University in Fairfax, Virginia.

Buchanan has authored or co-authored a prodigious 23 books. *The Calculus of Consent* written with Gordon Tullock, formed the foundation of Public Choice theory. *Cost and Choice* and *L.S.E. Essays on Cost* (edited with G.F. Thirlby) are influential "classics" on the subjective notion of costs. His work on government deficits and debt was capped off with *Democracy in Deficit: The Political Legacy of Lord Keynes* written with Richard Wagner. Also to his credit are over 300 articles and contributions to books.* The following interview was conducted by AEN editors Mark Thornton and Sven Thommesen earlier this year during Professor Buchanan's visit to Auburn University.

* * * * *

AEN: Professor Buchanan, congratulations on being awarded the Nobel Prize in Economics.

BUCHANAN: Thank you. It is an honor that I did not expect. I had heard rumors last year that I was being considered for the Prize. However, when it was awarded to Sir Richard Stone, a man who had been retired for many years, I gave up hope of ever winning the Prize.

AEN: People have often labeled your work 'normative'. Could you give us your thoughts on striking the balance between truth-seeking and advocacy?

BUCHANAN: I have never been especially concerned about making a sharp dividing line between what is positive and what is normative. I don't consider myself a scientist whose task is discovering a reality that somehow exists independently of me. The model of the hard sciences is not at all appropriate for economics. There is an important distinction to be made between taking an ideological position and then trying to make arguments to support that position, and on the other hand, working out the consequences of ideas and coming to an ideological position.

People do sometimes interpret my work as always being a defense of liberty. But it is less a preconceived notion and more a result of my methodology. It's analogous to an artist that only knows and uses red paint. You should not be surprised when his paintings come out in various shades of red. Methodological individualism characterizes everything that I've done because I simply don't know how to proceed with anything else, as if I only had red paint. Another artist might consciously decide to create a red painting so he goes out and buys red paint. But this is an entirely different approach.

AEN: You have made several important contributions in the area of government deficit finance. What do you think of Robert Eisner's (recently elected President of the American Economic Association) recent work on government deficits?

BUCHANAN: The work itself is rather confusing. What is clear, however, is that he is an unreconstructed Keynesian and starts from a position of Keynesian advocacy of government deficit financing. He argues that deficits are not really so enormous, if we use his measure. This is a very good example of how data can be manipulated to support and prove anything. And it's also very good evidence that econometrics doesn't mean much.

Professors Leland Yeager and Roger Garrison have pointed out that it is insidious to use inflation as a means to argue that the deficit is not very high. You can always totally eliminate the deficit by printing enough money. By confiscating the value of assets from people who hold dollar claims you could argue that inflation has lowered the 'real' value of the deficit, but it seems to me just perverse and extreme to do so.

AEN: There is a wide spectrum of subjectivism from mainstream orthodoxy to Shackle and Lachmann. Where would you place yourself on that spectrum?

BUCHANAN: Well, I'm certainly much closer to Shackle than I am to the mainstream. I've been tempted to go completely along with Shackle and become a very radical subjectivist. But I recognize that if you go all the way down that road you end up with a nihilistic position. I'm somewhere between von Mises and Yeager on the

one hand and Shackle on the other. The person who comes closest to my methodological position is Jack Wiseman.

AEN: Speaking of radical subjectivism, what do you think of the prospects of hermeneutics in the realm of economics?

BUCHANAN: People I respect a great deal from the German tradition, who know and work in the hermeneutics literature, are very negative on what it can offer economics. I have met some very capable people in interpretive philosophy and they do have a very convincing critique of modern science and in particular economics. But in a way, it's very much like Shackle, if you go too far you end up with nothing. It's not a viable independent research program.

AEN: Do you consider yourself an Austrian economist?

BUCHANAN: I certainly have a great deal of affinity with Austrian economics and I have no objections to being called an Austrian. Hayek and Mises might consider me an Austrian but surely some of the others would not.

AEN: You have become famous by extending economic thinking into the political arena. Other economists are also now involved in some very non-traditional areas such as experimental economics and sportometrics. Is this economic imperialism, as members of other disciplines charge?

BUCHANAN: Economics has moved into spheres that were previously barren, analytically and intellectually. Political Science was analytically empty before we started talking about Public Choice. The criticism leveled at Public Choice is that economic motivations have been elevated to a role of primary central importance. Well, it need not be that at all. We argue that economic interest is an important consideration of everybody who participates in a public choosing role. The challenge of those who criticize Public Choice is to come up with another model.

AEN: You must be very excited to see the debate on monetary constitutions growing. What would you like to see the monetary constitution look like?

BUCHANAN: I think we need some monetary constitution, but the choice of which one in particular is less important. If you could, in fact, have a gold coin system—pure and simple—that might be best. I confess that I simply cannot understand the Yeager-Greenfield BFH System. I have tremendous respect for Leland Yeager so there must be more to it than I have understood. Some argue that we are gradually evolving towards his system right now. Given the place we are now and the difficulty of making dramatic changes, I would prefer a commodity bundle system or a constant purchasing power dollar.

AEN: What about the problem of incentives for federal bureaucrats, and the tremendous information problem involved with the constant purchasing power dollar schemes?

BUCHANAN: You can design an incentive structure by indexing the salaries and pensions of the members and employees of the Federal Reserve System. Fix the salaries and pensions in nominal dollars, which would prevent them from inflation and use double indexing, so that they would lose from deflation as well.

The big problem with any of these systems is credibility, and of course, that's the big virtue of having some kind of market money like a commodity bundle or gold. It builds in predictability. However, you still have the credibility problem because you can't be sure if government will leave the system alone. They have always interfered in the past. That's also a problem with Hayek's competitive money.

AEN: What do you see as good developments in economics?

BUCHANAN: I think there are many very productive developments such as the new-institutional economics, law and economics, property rights, public choice, the new economic history, and the revival of Austrian economics. All of these areas are complementary and all, in a sense, can be seen as an attack on the conventional orthodoxy.

AEN: In the past you have said that modern economics is without any ultimate purpose or meaning. Has your opinion on that changed?

BUCHANAN: I have been quoted as saying that economics lacks passion. In the last several decades economics has taken a scientific, econometric, and formalistic turn. As a result, the economics profession has been attracting students who are not driven by an underlying passion to use the science of economics for anything except intellectual tools and exercise. In my generation people who went into economics had a real passion to save the world. We were all socialists, but some of us became converts or zealots of the market order, individual liberty, and libertarianism.

AEN: Who were the influential people in your intellectual life?

BUCHANAN: Frank Knight was very influential as a teacher, while Knut Wicksell's *Finanztheoretische Untersuchungen* (A New Principle of Just Taxation), had a tremendous impact on my career. I was not as directly influenced by Mises because I was exposed to him quite late. When I was a graduate student nobody even mentioned Mises, although Hayek's *Road to Serfdom* had just been published; Hayek was notorious in a sense.

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Adam Smith Reconsidered

by
Murray N. Rothbard

No thinker, in economics or out, has enjoyed as good, even rapturous, a "press" as Adam Smith. The orthodox view of the history of economic thought, unchallenged until the 1950s, and still served up by most textbooks, holds that both economic theory and laissez-faire policy conclusions were virtually created, in a single bound, by Adam Smith. Before Smith, in this account, were a shadowy and rather dimwitted collection of English mercantilists, who fallaciously advocated subsidies on exports and restrictions of imports, and some even believed that money should be accumulated for its own sake, rather than for goods that it can buy.

Given the status of Smith as the Creator of economics, he can then be forgiven his numerous confusions, inconsistencies, and errors, all of which may be cheerfully conceded to a man who was, after all, the pioneer and founder of his discipline. Hence, even such searching and trenchant criticisms of Smith's economics as those in the early twentieth century by Cannan, Gray, and Douglas¹ could not dent the monolith of admiration which has surrounded Smith from his day to ours.

The Smith-as-creator scenario is only plausible if Great Britain constitutes the Alpha and the Omega of one's intellectual universe; but unfortunately Britons and Americans have always tended to live in a parochial Anglo-American culture. A shocking and vitally important event in the historiography of economic thought, occurred in the 1950s, when several European-trained scholars sharply challenged the familiar Smithian paradigm.

The leader of these revisionists was Joseph Schumpeter, whose majestic *History of Economic Analysis* (1954) can be interpreted as largely a bitter and trenchant assault on the Smith-Ricardo orientation of the orthodox history of thought. Similar and even more pointed revisionist paradigms were presented, about the same time, by Emil Kauder (trained in Germany), Raymond De Roover (Belgium), and Marjorie Grice-Hutchinson (England, but specializing in Spanish literature, and fluent in Spanish and Latin). Part of the difference was linguistic; for in contrast to American or British scholars, who are generally confined to the English language, these scholars were fluent not only in major European languages but also in Latin, the language of scholastic philosophers.²

The new, and I believe correct, paradigm locates the genesis of economic theory, and also of a free-market approach, back in the medieval scholastics. In contrast to older views, scholasticism does not begin and end



Murray N. Rothbard

with St. Thomas Aquinas; it begins with Aquinas, and then continues, in a flourishing and developing tradition, for centuries, culminating in the School of Salamanca in 16th century Spain. Far from being labor, cost of production, or station-of-life theorists, as the older orthodoxy maintained, the scholastics were what we might call "proto- Austrians." The goal of production is consumption, and they located the determination of the value and prices of goods in the subjective utility of goods to consumers, interacting with the relative scarcity of the goods or resources.

In particular, a remarkable subjective and almost marginal utility analysis of value was developed by the early 13th century French Franciscan Pierre de Jean Olivi, which was then resurrected and injected into the mainstream of scholastic economics a century and a half later by San Bernardino of Siena.³ The application of supply and demand analysis to the theory of money was developed by the leading early fourteenth-century French scholastic, Jean de Buridan. Buridan also rejected the Aristotelian view that two goods exchanging for each other must be equal in value. Instead, Buridan first presented the Austrian view that two goods exchange precisely because they are unequal in value for the two exchangers, and therefore exchange is an action where both parties benefit.

Particularly pertinent to Adam Smith is the fact that a large number of scholastic thinkers presented, and then resolved, the value paradox, with which Adam Smith bedeviled economics in the *Wealth of Nations*. Why are bread or water, intrinsically so valuable to the human

race, so cheap on the market? Why are diamonds, on the other hand, a mere frippery, yet so expensive on the market? In short, why does there seem to be a conflict between "use-value" (high for bread, low for diamonds) and "exchange value" or price, of a good? The scholastics and their successors in France and Italy in the early modern period solved this problem very well, and without quite developing the marginal analysis by which the Austrians, Jevons, and Walras had solved it again in the 1870s. The scholastics noted that the key to the mystery is relative scarcity. Bread, while philosophically useful, is so abundant that its market value is low, whereas, diamonds, relatively much scarcer, command high economic value. Choice on the market is not between whole classes of goods, but in the context of the relative abundance or scarcity of the good.

If we then consider the scholastics, and their Continental successors, notably eighteenth century French thinkers such as Cantillon, Turgot, Galiani, and Condillac, a very different picture emerges of the history of economic thought. Not only did Adam Smith not create economic theory, but his economics was a large and calamitous step downward from the heights of the Continental tradition, most notably in Cantillon and in Smith's contemporary and acquaintance, Turgot.⁴ By the time of Turgot, this tradition had developed: a subjective utility- and scarcity theory of value; a supply and demand (or utility and scarcity) theory of the value of money; an Austrian-type process analysis of international monetary equilibrium (Cantillon); a structure of production theory of capital and a time preference theory of interest (Turgot); and a sophisticated theory of the vital importance of the entrepreneur in the capitalist economy (Cantillon; Turgot). All of this developed structure of economic theory from the Middle Ages through the 18th century, was swept overboard by Adam Smith, and, at least in Great Britain, disappeared completely from economic thought for an entire century.

There are also striking puzzles and anomalies in the Smith saga. In his Lectures, delivered at the University of Glasgow in the early 1760s, Smith follows his teacher Francis Hutchinson by presenting and then solving the value-paradox in the traditional manner. But then, a decade or so later, in the *Wealth of Nations*, he totally reverses his field, and the field of economic thought, and asserts that the value-paradox cannot be solved, therefore there is no connection whatever between use-value, or consumer utility, and the price or exchange value of a good. But if consumer utility is sundered from economic value, this meant that Smith had to search for the cause of value in the production process, which implied a form of labor theory, or at best, cost of production theory of value embodied in a product. Ricardo and Marx were already foreshadowed in Adam Smith.⁵

I am convinced that the puzzling deterioration in Smith's theory of value was closely linked with the equivalent deterioration, over the same time period, in his theory of international money. Smith was a close friend of David Hume, and in his Lectures he enthusiastically accepted his friend's celebrated specie-flow-price mechanism of process toward international monetary equilibrium. Hume's formulation was influenced by Cantillon, although he unfortunately added a mechanistic split between micro and macro that had not plagued Cantillon's micro-process analysis. But the quantity of money-price-balance of payment deficit analysis, sound as far as it went, was totally forgotten by Smith when he came to the *Wealth of Nations*, a curiosity that Jacob Viner has called "one of the mysteries of the history of economic thought."⁶ Instead of the Humean process from dislodgement back toward equilibrium, Smith asserts that every country will always have as much specie as it supposedly needs to circulate trade, any surplus immediately overflowing the "channels of trade" in order "to seek that profitable employment which it cannot find at home."

Smith's contention has generally been dismissed as primitive doctrine, but it seems likely that Smith was in fact assuming, not only that all nations are always in monetary equilibrium, but also that any displacement from equilibrium will be instantaneously removed, so that there will be no time for any Humean process to take place.

This interpretation is strengthened by the fact that the degeneration in Smith's value theory had a similar focus. By abandoning consumer utility, Smith was able to dispense with what he considered the fripperies and trivialities of consumption, a process which he held to affect only the ephemera of daily life on the market. But Smith wished to dispense with the real world of markets and to concentrate solely on the allegedly more deeply real, but actually non-existent world of long-run equilibrium.

In what Smith called the long run "natural price," in contrast to mere market prices, consumption dropped out as a cause, and value and price were now determined solely by the real, hard costs of labor toil. In both value theory and monetary theory, Adam Smith abandoned the centuries-old Continental focus on consumption and the real world of markets, to indeed bring an innovation—but a deeply pernicious one—to the discipline of economic theory: exclusive focus on the never-never land of long-run equilibrium.

We now come to a speculative but brilliant insight of Emil Kauder's: it was no accident that the labor toil theory of value was introduced into economics by a man steeped in the outlook and the values of Scottish Calvinism, nor that the centuries-old tradition of Continental economics was, from the scholastics to

Turgot, almost exclusively Catholic. Catholics and Thomists saw the economy, and society in general, driven by the goals and wants of consumers, and moderate enjoyment in consumption was considered a licit and even worthy goal. Calvinism, on the other hand, tended to insist on society as a community of saints. Consumption, let alone enjoyment was frowned on as a frippery, and consumption was only grudgingly allowed as a necessary fuel for continuing labor. Whereas in Catholicism, labor was considered a necessary burden on the path to consumption, in Calvinism labor takes on a virtually holy quality as an end in itself. It is surely no coincidence that the labor theory of value emerged out of the milieu of Scottish Calvinism.

There are clues to Smith's Calvinist orientation in many places in the *Wealth of Nations*. A hatred of luxurious consumption permeates the work: in calling for heavy taxes on luxurious consumption, in asserting not merely that diamonds are luxuries but that they have "scarce any value in use", and particularly in Smith's endorsement of usury laws. E.G. West, who tries hard to cast Smith in the role of a laissez-faire partisan, is puzzled by Smith's support of usury laws; does Smith not realize that a low ceiling on interest rates will cause a shortage of credit to marginal buyers? But Smith knows precisely what the effects of usury laws are, and therefore he favors them. Smith is unhappy with free market allocations of consumption and saving; he wants a usury law precisely to divert credit from luxurious consumers and speculators to what he considered worthy prime borrowers.⁷

Smith, furthermore, was scarcely the inventor of laissez-faire. On the contrary, his devotion to the free market was limited, and ringed by many exceptions, including usury laws and navigation acts. His devotion to free trade may be gauged by his actions as Customs Commissioner for Scotland. As Anderson and Tollison have recently shown, this was not a no-show sinecure for Smith; on the contrary, he pursued "smugglers" and tax evaders with a will, and delightedly advanced measures designed to maximize the State's revenue from customs tariffs.⁸

In contrast to Smith's inconsistency and moderation, the tradition of laissez-faire in French thought had flourished since the late seventeenth century. From Fenelon to de Gournay to d'Argenson to the Physiocrats, Turgot, and Condillac, French theorist pursued a deepening and consistent policy of laissez-faire, and fought hard and courageously in its behalf. In contrast to Smith's venality and pusillanimity, when Turgot became Controller-General of France in 1774, he and his laissez-faire cadre (which included Condorcet and Dupont de Nemours) fought bravely for free trade, for drastic reductions in taxes, and for abolition of the system of forced labor on the public roads. When they were kicked out by the king two years later, it became clear

that reform of the ancient regime from within was impossible, and the stage was set for the French Revolution.

In recent years, Smith and his friends and colleagues who constituted the Scottish Enlightenment of the eighteenth century, have come into scholarly fashion. One reason for this, and for F.A. Hayek's laudation of the Scottish Enlightenment, is precisely because the Scottish advocacy of freedom and free markets was cautious, limited, and all too moderate—a trait which was wrapped up in the irrationalism, the appeal to man's ignorance, to custom, and tradition, which was important for these Scots as well as for Hayek. In contrast, the French theorists, rationalists who descended from scholastic emphasis on reason, natural law, and natural rights, were far more ardent and consistent champions of laissez-faire tradition, from Fenelon to Bastiat and Molinari.

There is another important difference between the Scottish Enlightenment and the better known French Enlightenment of the eighteenth century. The French theorist and philosophers, even when not laissez-fairist, were virtually all radical—that is, they were strongly opposed to the existing polity that fused State and Church into one despotic regime. They saw the State and Church as both irrationalist and tyrannical, and held separation of Church and State to be of supreme value to both reason and liberty.

The Scottish Enlightenment, on the contrary, had a diametrically opposite outlook. This Enlightenment consisted of a generation of friends and colleagues in Glasgow and Edinburgh who constituted the Moderate faction within the Presbyterian Church of Scotland. The Moderates were a brilliant group of Calvinist ministers, attorneys, and professors—including Adam Smith—who, though a minority within the Church, were able to dominate it by being close to, and manipulating royal patronage. The crucial point was that the Church of Scotland was established by the British government, and so its ministers and ruling elite were selected by royal, central government patronage. The political views of the Moderates, far from being anti-establishment or devoted to individual liberty and laissez-faire, were apologetic for the State Church establishment in Scotland.⁹

In the great battle that raged for over half a century between the Moderates and the majority of the Evangelicals in the Scottish Church, the Moderates were only more libertarian on religious questions. Whereas the Evangelicals would give short shrift to religious heretics, the Moderates, though also steeped in Calvinism, believed in toleration, and believed in friendliness towards Anglicans and to even such atheist or deist colleagues as David Hume. [It is doubtful, however, whether such toleration would ever be extended

to the hated Catholics.] Politically, the Moderates were far more statist. They defended the State Church and its system of royal patronage [referred to as "corruption" by radicals], and their major goal was to defend the might of the British State and its Scottish appendage against all its enemies, foreign and domestic. Thus, the Moderates believed in crushing Ireland and its Catholics, and though Smith was ambivalent on the American Revolution, his friends such as the Rev. Alexander Carlyle and the Rev. Adam Ferguson (a particular favorite of Hayek's) believed in smiting the American rebels root and branch. In contrast, the Evangelicals strongly defended liberty for the Americans.

One amusing note on Hayek's favorite concept of events that "are the results of human action, but not of human design." Contrary to Hayek, the Scottish Moderates did not develop this idea, and the study of the unintended consequences of human action, as a method of explaining and extolling the free market. On the contrary, the concept originated in what was for the young Moderates the highly traumatic Jacobite (Catholic) rebellion of 1745.

While Smith was away to help crush the rebellion, Carlyle and Ferguson preached sermons trying to explain why God permitted this evil rebellion, and almost permitted the Jacobite savages to conquer Scotland. They concluded that while the Jacobites were consciously pursuing evil [i.e. Catholic] ends, they were really, unconsciously pursuing God's good ends, which were to rouse the Presbyterians out of their apathy and whip them into the proper religious fervor. Thus, consequences unintended by human action (in this case, of the Jacobites) actually and unconsciously were furthering God's providential goals. We are close to the determinist Christian heresy that there is no real evil in the world, that apparent evil is down deep and in reality good, a view that would soon appear in the pantheism of Hegel and other nineteenth century German and English Romantics. We may wonder if Hayek and his contemporary followers would be quite so enthusiastic about the doctrine of unintended consequences if they realized its origins in Calvinist apologetics and its closeness to Hegel's notorious concept of the "cunning of reason."

We are very far from the old notion of Adam Smith as founder of economic theory and prince of laissez-faire. On the contrary, his devotion to laissez-faire was dubious at best, and his "contributions" to economics were retrograde and disastrous. It took a century for thinkers outside of Britain, especially in Austria, to revive and develop the French utility and subjective value tradition. And it should not be neglected that, in contrast to Lutheran and Hegelian Germany, Austrian thought was still, in the late nineteenth century, steeped in Aristotelian philosophy, and that Carl Menger's epistemology and even value theory were strongly influenced by the

Catholic Aristotelian philosopher Franz Brentano. And even then, the remarkable contributions of the Austrian School were deliberately vitiated and trivialized by Alfred Marshall, himself steeped in Evangelical thought and the last of the great Smith-Ricardians. It was one more battle in the long-standing war between British and Continental economic philosophy.¹⁰

Dr. Rothbard, the S.J. Hall Distinguished Professor of Economics at the University of Nevada, Las Vegas, is Vice President for Academic Affairs at the Ludwig von Mises Institute.

1. See Edwin Cannan, *A History of the Theories of Production and Distribution in English Political Economy* (1899, London: Staples Press, 1953); Cannan, "Adam Smith as an Economist," *Economica*, 6 (June 1926), pp. 123-134; Alexander Gray, *The Development of Economic Doctrine* (London: Longmans, 1931); Gray, *Adam Smith* (London: the Historical Association, 1948); and, in particular the devastating critique of Smith's Value theory by Paul Douglas, "Smith's Theory of Value and Distribution," in J.M. Clark et al., *Adam Smith, 1776-1926* (Chicago: University of Chicago Press, 1928) pp. 78-115.

2. Emil Kauder, "Genesis of the Marginal Utility Theory," *Economic Journal* (Sept. 1953), pp. 638-650, a concise and strikingly important new paradigm for the history of economic thought; Raymond de Roover, "The Concept of the Just Price: Theory and Economic Policy," *Journal of Economic History*, 18 (December 1958), pp. 418-434; de Roover, "Joseph A. Schumpeter and Scholastic Economics," *Kyklos*, 10 (1957-2), pp. 115-146; de Roover, *Business, Banking, and Economic Thought: In Late Medieval and Early Modern Europe* (ed. J. Kirshner, Chicago: University of Chicago Press, 1974); Marjorie Grice-Hutchinson, *The School of Salamanca: Readings in Spanish Monetary Theory, 1544-1605* (Oxford: the Clarendon Press, 1952); Grice-Hutchinson, *Early Economic Thought in Spain, 1177-1740* (London: George Allen & Unwin, 1978). The most up-to-date and developed work on the Spanish scholastics, also steeped in Spanish and Latin sources, which now takes its place as the best book on the subject, is Alejandro Chafuen, *Christians for Freedom: Late-Scholastic Economics* (San Francisco: Ignatius Press, 1986).

3. Raymond de Roover, *San Bernardino of Siena and Sant' Antonino of Florence: the Two Great Economic Thinkers of the Middle Ages* (Boston: Baker Library, 1967), pp. 19-20, 41-42.

4. Indispensable for Turgot is the translated and splendidly edited, collected economic works in P.D. Groenewegen, ed., *The Economics of A.R.J. Turgot* (The Hague: Martinus Nijhoff, 1977). For an interpretative essay on Turgot, see Murray N. Rothbard, *The Brilliance of Turgot* (Auburn: Ludwig von Mises Institute, 1986).

5. See Douglas, "Smith's Theory."

6. Jacob Viner, *Studies in the Theory of International Trade* (New York: Harper & Bros., 1937), p. 87.

7. For Smith's bias against consumption, see Roger W. Garrison, "West's 'Cantillon and Adam Smith': A Comment," *Journal of Libertarian Studies*, 7 (Fall 1985), pp. 291-292; Gerard W. Ditz, "The Calvinism in Adam Smith," (unpublished MS, 1983); and Nathan Rosenberg, "Adam Smith on Profits—Paradox Lost and Regained," *Journal of Political Economy*, 82 (Nov.-Dec. 1977), pp. 1187-1188.

8. Gary M. Anderson, William F. Shughart II, and Robert D. Tollison, "Adam Smith in the Customhouse," *Journal of Political Economy*, 93 (August 1985), pp. 740-759.

9. See the illuminating work by Richard B. Sher, *Church and University in the Scottish Enlightenment: the Moderate Literati of Edinburgh* (Princeton University Press, 1985).

10. W. Grassl and B. Smith, eds., *Austrian Economics: Historical and Philosophical Background* (London: Croom Helm, 1986), especially Barry Smith, "Austrian Economics and Austrian Philosophy," pp. 1-36; and Reinhard Fabian and Peter M. Simons, "The Second Austrian School of Value Theory," pp. 37-101.

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Hutt's Critique of Keynes

Two Reviews of *The Keynesian Episode*

by William H. Hutt, Indianapolis: Liberty Press, 1979, 449 pp., pb. \$4.50, hd. \$10.00.



W.H. Hutt

Reviewed by John B. Egger

The Keynesian Episode is Professor Hutt's second edition of his *Keynesianism—Retrospect and Prospect* (1963). He cautions us in his preface, however, that the changes are enough to make *Episode* "a new book," and this is substantially accurate. While pages 3 through 291 of *Keynesianism* appear as pages 87 through 401 of *Episode*, about 120 pages of the earlier work are omitted and 65 pages of new material added. Even in those pages which reproduce *Keynesianism* in substance, Professor Hutt has rewritten many of its most confusing parts, adding and omitting words, phrases, sentences, and even paragraphs here and there, revising their orders, and employing a more modern style. Paragraphs are no longer numbered, terms like "whilst" have disappeared, and most of his long lists of cases have been curtailed and incorporated into ordinary paragraphs. In short, *Episode* is much more pleasant to read than its ancestor, and it's different enough that bibliophiles cannot give up their used-bookstore searches for *Keynesianism*.

The first six chapters of *Episode* deal explicitly with Keynes and "Keynesianism." The next seven, while frequently mentioning the ideas and policies of

Reviewed by Leland B. Yeager

Professor Hutt's new book began as an intended second edition of his *Keynesianism—Retrospect and Prospect*, 1963 (which, Hutt says, he had originally thought of entitling *The Curse of Keynes*). Not surprisingly, then, the book echoes familiar themes. I shall try to summarize them, not necessarily in Hutt's own terminology.

Fundamentally, behind the veil of money, people specialize in producing particular goods and services to exchange them for the specialized outputs of other people. Any particular output thus constitutes demand for other (non-competing) outputs. Since supply constitutes demand, there can be no

Keynes and his followers, are focused on the functioning of the market economy. The final five chapters zero in on popular macro concepts—the multiplier and accelerator, for examples—and discuss "the retreat" from Keynesianism by both Keynes and later economists. (Hutt is both modest and realistic enough to observe that, despite his 1963-stated hopes, *Keynesianism* has apparently had no impact whatsoever in accelerating this process.)

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fundamental problem of deficiency of aggregate demand. Any apparent problem of that sort traces to impediments to exchange of goods and services for each other—to failures of markets to clear because of wrong prices. Impediments to exchange discourage production of goods and services destined for exchange. Say's Law, as Hutt further interprets and extends it, points out why cutbacks in production in some sectors of the economy, meaning as they do cutbacks in the real demands for the outputs of other sectors, cause cutbacks of production in those other sectors also. With demands curtailed, what might otherwise have been equilibrium prices for the outputs of those other sectors are now too high, and unless these prices are adjusted downwards, they impede exchanges and production. In this way, wrong prices and production cutbacks in some sectors make existing prices wrong and cause production cutbacks in other sectors also; the rot is cumulative. In the opposite and cheerful direction, anything that promotes market-clearing prices and the recovery of production in some sectors promotes cumulative recovery

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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 H. 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 contends 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 reinterpet the key issues at stake in order to discredit the popular presumption resulting from the debate that all methodological disputes are either irreducible or counterproductive. From comments by Ludwig von Mises and Joseph Schumpeter, Bostaph develops the thesis that the central disagreements between Menger and the Historicist 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 more uniformly 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 avoid one 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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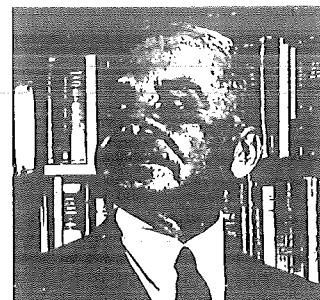
Theory and History

by
Murray N. Rothbard

Ludwig von Mises published many books and articles in his long and productive life, each of them making important contributions to the theory and application of economic science. But there stand out among them four towering masterpieces, immortal monuments to the work of the greatest economist and scientist of human action of our century. The first, which established Mises in the front rank of economists, was *The Theory of Money and Credit* (1912), which for the first time integrated the theory of money and the theory of relative prices, and outlined his later theory of the business cycle. Mises' second great work was *Socialism* (1922), which provided the definitive, comprehensive critique of socialism and demonstrated that a socialist order could not calculate economically. The third was his stupendous treatise *Human Action* (1949), which set forth an entire structure of economics and analysis of acting man. All three of these works have made their mark in economics, and have been featured in the "Austrian" revival that has flowered in the United States over the past decade.

But Mises' fourth and last great work, *Theory and History* (1957), has made remarkably little impact, and has rarely been cited even by the young economists of the recent Austrian revival. It remains by far the most neglected masterpiece of Mises. And yet it provides the philosophical backdrop and elaboration of the philosophy underlying *Human Action*. It is Mises' great methodological work, explaining the basis of his approach to economics, and providing scintillating critiques of such fallacious alternatives as historicism, scientism, and Marxist dialectical materialism.

It might be thought that, despite its great importance, *Theory and History* has not made its mark because, in this age of blind academic specialization, economists will have nothing to do with anything that smacks of the philosophic. Certainly, hyper-specialization plays a part, but in the last few years, interest in methodology and the basic underpinnings of economics has blossomed, and one would think that at least the specialists in this area would find much to discuss and absorb in this book. And economists are surely



Ludwig von Mises, 1881-1973

not so far gone in jargon and muddled writing that they would fail to respond to Mises' lucid and sparkling prose.

It is likely, instead, that the neglect of *Theory and History* has more to do with the content of its philosophical message. For while many people are aware of the long and lone struggle that Ludwig von Mises waged against statism and on behalf of laissez-faire, few realize that there is far greater resistance in the economics profession to Mises' methodology than there is to his politics. Adherence to the free market, after all, is now not uncommon among economists (albeit not with Mises' unerring consistency), but few are ready to adopt the characteristically Austrian method which Mises systematized and named "praxeology."

At the heart of Mises and praxeology is the concept with which he appropriately begins *Theory and History*: methodological dualism, the crucial insight that human beings must be considered and analyzed in a way and with a methodology that differs radically from the analysis of stones, planets, atoms, or molecules. Why? Because, quite simply, it is the essence of human beings that they act, that they have goals and purposes, and that they try to achieve those goals. Stones, atoms, planets, have no goals or preferences; hence,

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Perception, Opportunity, and Profit: Studies in the Theory of Entrepreneurship

by Israel M. Kirzner, University of Chicago Press, Chicago, 1979, xiv + 274pp, \$15.00

Reviewed by Jack High

The essays that make up Israel Kirzner's new book, *Perception, Opportunity, and Profit*, both criticize and construct. They criticize economists' preoccupation with market equilibrium; they construct at least the rudiments of a theory of market process. Kirzner's criticism of equilibrium theory goes deep. He doubts that maximizing behavior, the core of neoclassical modeling, will sustain a realistic theory of the market. Maximizing takes too much for granted, and leaves too much unexplained. It is too narrow to encompass much of what we see in the market. We need a broader base on which to build economic theory.

Human action, in the sense developed by Mises, involves courses of action taken by the human being to remove unmaxims and to make himself "better off." Being broader than the notion of economizing (i.e., maximizing), the concept of human action does not restrict analysis of the decision to the allocation problem posed by the juxtaposition of scarce means and multiple ends. The decision, in the framework of the human action approach, is not arrived at merely by mechanical computation of the solution to the maximization problem implicit in the configuration of the given ends and means. It reflects not merely the manipulation of given means to correspond faithfully with the hierarchy of given ends, but also the very perception of the end-means framework within which

allocation and economizing are to take place. . . . Mises' homo agens . . . is endowed not only with the propensity to pursue goals efficiently, once ends and means are clearly identified, but also with the drive and alertness needed to identify which ends to strive for and which means are available. [Reference, p. 28. Kirzner is quoting himself from *Competition and Entrepreneurship*.]

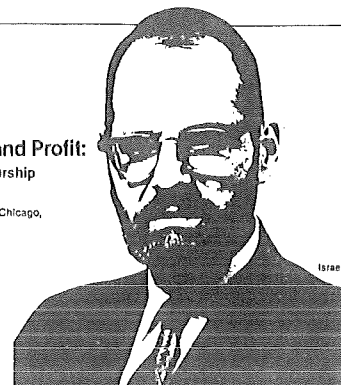
A central theme of Kirzner's, first expressed in his *Economic Point of View* [1962] and recurring in all his later work, is that maximizing presupposes that everyone knows which ends to pursue and which means to employ. In the market, this knowledge requires everyone's plans to be coordinated, since the means one person employs almost always involve the actions of other people. How do people come to know about the ends they pursue, and the best means by which to pursue them? How do they come to know about the planned actions of others? What happens if people are mistaken in their perception of ends and means? To answer these questions in order to yield a theory of market change, Kirzner has proposed that we broaden economic behavior to include entrepreneurship. For Kirzner, economic activity involves not only maximizing, but also

alertness to opportunities for gain. We not only husband our resources, we also perceive new uses for them, so that they go even further than before. "This alertness is the entrepreneurial element in human action." (p. 7) and it means that "we see the entrepreneur as a creator . . . in the sense of his being the discoverer of an available opportunity." (p. 215)

We will have something to say about this conception of entrepreneurship later, but for now let us take Kirzner's entrepreneurship as given, and see how he sets in motion a market process. In maximizing, the consumer or producer uses equilibrium prices. These prices are given to him, and their employment implies that the resulting plans to buy or sell can be carried out (although the maximization process says nothing about the actual carrying out). Now, Kirzner says, "The difficulty with a theory of the market couched exclusively in Robbinsian [i.e., maximizing] terms is that in disequilibrium many of the plans of Robbinsian economists are bound to be unrealized." (p. 6)

If we keep in mind that buyers and sellers are alert to opportunities for

Continued on page 12



Israel M. Kirzner

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"The Minimum Wage": A Major Cause of Poverty

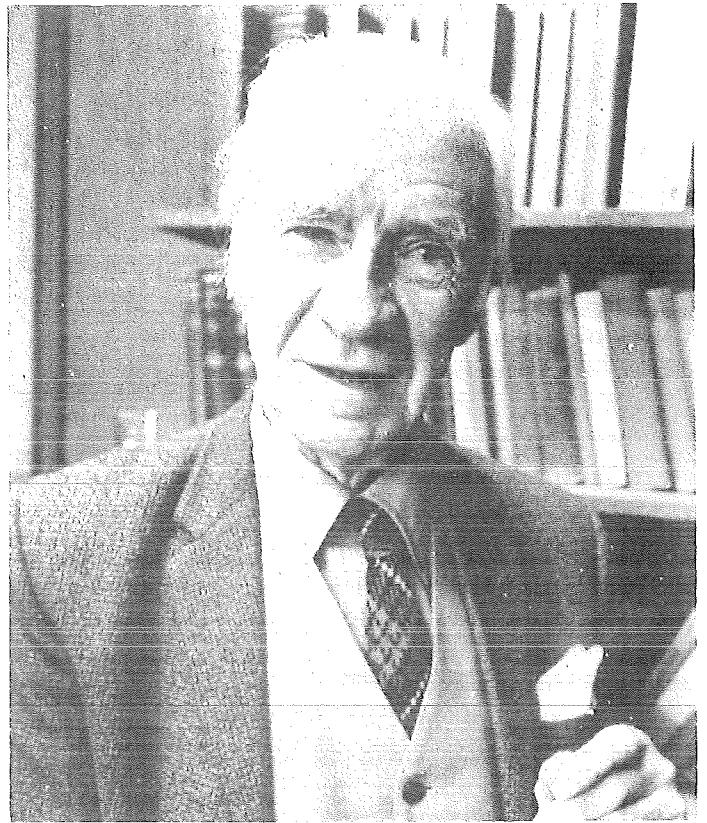
by
W. H. Hutt

In a free society, people's incomes are determined in the market for the services and products they (and their assets) provide. Hence it will be profitable for people in what we call their entrepreneurial capacity to employ and remunerate any person who does not ask more for his services than the value of his marginal product. It can be shown that when this process is fostered and unconstrained, the flow of real income (wages and salaries, plus interest plus profit) is maximized and any inequality in the distribution of this aggregate magnitude is minimized.

But politicians are motivated to promise and enact minimum wage-rates which make it an offense to employ any person the value of whose product, however "high", is less than the stipulated minimum. And special interest organizations--labor unions--have used the threat of disruption to force the price of the workers' services in different fields above the free market value, with like consequences.

Such constraints, whether misguided or cynically exploited, have survived, after two centuries of clever propaganda which leaves the impression that the low marginal productivity of the poor, and hence their low incomes under capitalism, are to be blamed on those who employ them. Everyone is expected to believe that the poor generally, or certain groups of the poor, are the victims of "exploitation". Now the denigrators of capitalism who write of "exploitation" never define it except in the vaguest terms. I myself have defined it rigorously as follows:

any action taken, whether or not through discernible private coercion (collusion), or governmental coercion, or whether through monopolistic power, which, under a given availability of resources (including the stock of knowledge and skills), reduces the value of the property or income or of another person or group of persons, or prevents that value from rising as rapidly as it otherwise would, unless this effect is brought about through (a) the dissolution of some monopolistic privilege, or (b) the substitution of some cheaper method (labor-saving or capital-saving) of achieving any objective (including the production and marketing of any output); or (c) the expression of a change in consumers' preference; or (d) through taxation authorized by explicit legislation accepted as legitimate in any context.



W.H. Hutt

In several previous publications¹ I have proved that the aggregate flow of real wages and salaries in a community is maximized and any degree of inequality in the distribution of that flow is minimized, when every person is offered and accepts the minimum needed to attract him from other occupations (or from idleness) into a particular occupation, and a parallel rule determines remuneration for the services of cooperant assets.

It follows that every person ought to enjoy the effective right of accepting any terms of employment offered which he believes will increase his income or enhance his prospects of future income, irrespective of any harm caused by his so doing to the person earning more than he is. For when he moves from, say, unskilled work to semi-skilled work, or from any lower-paid work to higher-paid work, he tends to raise remuneration in the field he leaves, to reduce it in the field he enters and to raise society's aggregate real income. This effect tends always to reduce inequalities of income. Indeed, every upward mobility so caused has a similar tendency.

We should bear in mind also that, in the United States, well over 50 percent of the low income earners who seem to benefit belong to families in which the average income greatly exceeds the minimum (indeed, well over half of the workers whose earnings are boosted through the non-market determination of these rates belong to families that should be classed as relatively well-to-do). The greater percentage of low income families are disadvantaged by the system.² Only a small proportion

of the income earned by poorer families is due to employments to which the minimum applies.

It has been estimated that at least four-fifths of the families in the low income groups have been harmed by the system. Moreover, as we have just asserted, many higher income families are net beneficiaries. The facts seem to prove that few among the families in which some incomes are subject to the minimum actually do benefit from the system. Moreover, the minimum wage system affects most supposed beneficiaries negatively through forcing them to pay inflated prices for the kinds of outputs they demand.

In stressing this issue, we must emphasize also that nearly all intended income transfers, via the overriding of the free market determination of remuneration, whether this objective is sought through raising the prices of individual categories of labor, or through progressive taxation, or through the inflationary debasement of the money unit (with open or disguised handouts), or through other State enactments, reduce or destroy the possibility of achieving not only a povertyless society, but a good society in the fullest sense.

1. *The Theory of Collective Bargaining* (1930, 1954 and 1975); *Economists and the Public*, chapter XX, 1936; *The Strike-Threat System*, 1973.

2. About 10 percent of families with higher total incomes include such beneficiaries while the majority of lower-income families have no member who benefits from any minimum wage enactment.

Professor Hutt, is currently Professor of Economics at the University of Dallas, and is a Distinguished Scholar of the Ludwig von Mises Institute. The following is a list of some of his major contributions.

The Theory of Collective Bargaining

London: P.S. King & Sons, 1930. New York: The Free Press, 1954. 2nd Edition, London: Institute of Economic Affairs, 1975

Economists and the Public

London: Jonathan Cape, 1936

The Theory of Idle Resources

London: Jonathan Cape, 1939,
Indianapolis: Liberty Press, 1977

Plan For Reconstruction

London: Kegan Paul, 1943

Keynesianism-Retrospect and Prospect

Chicago: Regnery, 1963
Indianapolis: Liberty Press, 1977

The Economics of the Colour Bar

London: Institute of Economic Affairs, 1964

Politically Impossible. . . ?

London: Institute of Economic Affairs, 1971

The Strike-Threat System

New Rochelle, N.Y.: Arlington House, 1973

A Rehabilitation of Say's Law

Athens, Ohio: Ohio University Press, 1975

The Keynesian Episode: A Reassessment

Indianapolis: Liberty Press, 1979

BUCHANAN (continued from page 4)

I didn't become acquainted with Mises until I wrote an article on individual choice and voting in the market in 1954. After I had finished the first draft I went back to see what Mises had said in *Human Action*. I found out, amazingly, that he had come closer to saying what I was trying to say than anybody else.

* Among his many works include two contributions to volumes in honor of Ludwig von Mises and a book review in the *Austrian Economics Newsletter*. For a complete bibliography of his works published to date see, Vol. 54, No. 1 of the *Southern Economic Journal* (July, 1987).

HOROWITZ and BOETTKE (continued from page 14)

of the natural sciences and the nihilism of historicism. He argues that the humane sciences must deal with "knowledge from within" (i.e. the knowledge we have of human action because we ourselves are human), a point where Mises agreed completely.⁷ Gadamer is seeking truth, and he and the other hermeneuticans are no more nihilists than Mises himself, who made similar arguments.⁸

Whether or not one agrees with hermeneutics, the influence and parallels of these ideas on Mises and other Austrians seem undeniable. To blithely assume that any and all attacks on hermeneutics and Continental philosophy are necessarily pro-Misesian is highly questionable. If the proper place, if any, of Continental thought in Austrian economics is to be critically assessed, the discussion has to move to a level of scholarship commensurate with the ideas of one of the greatest minds of the 20th century, Mises himself.

Steven Horwitz and Peter Boettke are currently working on their Ph.Ds in economics, specializing in Austrian economics at George Mason University.

1. Rothbard, Murray N., preface to *Theory and History* by Ludwig von Mises, Auburn, AL: The Ludwig von Mises Institute, 1985.

2. Mises, Ludwig von, *Theory and History*, op cit., p. 308, emphasis added.

3. Mises, Ludwig von, "The Historical Setting of the Austrian School of Economics," Auburn, AL: The Ludwig von Mises Institute, 1984, p.29.

4. *Ibid*

5. Collingwood, R.G., "Economics as a Philosophical Science," *International Journal of Ethics*, V.36, no. 2, January 1926, p. 163-4, emphasis added.

6. Gadamer, Hans-Georg, *Truth and Method*, New York: Crossroads Publishing Co., 1985, p. 446-7, emphasis added.

7. Mises, Ludwig von. *Epistemological Problems in Economics* (New York: New York University Press) 1976, p. 130ff.

8. For an argument that Gadamer's thought leads to classical liberal policy conclusions see Tom Palmer, "Gadamer's Hermeneutics and Social Theory", *Critical Review* Vol. 1 No. 3 (Summer 1987).

Rationality in the Public-Debt Controversy

by
Don Boudreaux

The title of this essay has two distinct, yet related, interpretations. The first and most important concerns use of the rationality assumption in analyses of the causes and effects of public-debt issue. The second, and more literal, interpretation refers to the methodological insightfulness of some of the economists participating in the controversy over public debt. I argue here that insightful analysis of the full causes and effects of public-debt financing is impossible if theorists assume that every person in society has full relevant knowledge of the structure of the economic system. Further, it seems somewhat irrational to take the position—as is done by economists of the Rational Expectations school—that the utility functions of children are taken fully into account by parents.¹

The individual-rationality paradigm within which all good theories of economic and social interaction are constructed does not imply the type of “rationality” that forms the core of Rational Expectations theory. Despite the claims of Rational Expectations theorists, the methodological precept of individual rationality is quite consistent with the conclusion that there is a nonequivalence between debt financing and tax financing of public expenditures. Therefore, arguments in favor of models in which individuals take into complete consideration, the appropriate rate of discount, their own and their children’s future tax liabilities do not find their justification in any methodological norms which dictate that the actors in the model be rational.

Of course, models of economic phenomena are typically constructed so that the economist is very much of an omniscient observer of the goings-on within the model. Upon seeing the model-economy’s government issue an additional dollar of public debt, the economist says to himself (and to all who will listen) that if the people in this model economy do not increase their savings by one dollar, future taxpayers will have to pay for whatever amount of current expenditures are not offset by increased savings. With a few plausible assumptions about political behavior—e.g., that politicians act to please their current constituents and ignore future citizens/taxpayers—the economist can confidently predict that current consumption will be higher than is justified by the economy’s real wealth and the time preferences of people in the economy. The economist thus learns from his model that the possibility

of public-debt financing by government leads to excessive expenditures by government and excessive taxation of future citizens.

So far, the economist is on target. But the Rational Expectations economist ‘reasons’ ahead one step too far. He thinks: “Gosh, don’t those people in my model realize that the mere printing of government bonds does not create wealth? Bond issuing by the government doesn’t justify the increased total expenditure in the current period. These people must be irrational. Because such irrationality is inconsistent with the basic assumptions of my theory I will have to modify my theory to avoid this irrational outcome of debt financing.”

The economist who reasons as such confuses rationality at the level of the acting person with rationality at the level of the collective. He forgets that individual rationality (i.e., purposive behavior) in no way implies collective rationality (i.e., ‘correct’ social outcomes). Nevertheless, because he believes that the rationality assumption is inconsistent with less-than-optimal collective outcomes, the Rational Expectations economist feels the need to amend his model so that collective outcomes are ‘correct’. To guarantee ‘correct’ collective outcomes the Rational Expectations economist assumes that all persons in his model have full knowledge of the economy. He also assumes that these persons are concerned, in this completely informed sense, with the tax liabilities of their children. These assumed traits are misnamed “rationality”.

By endowing the people of their models with such complete and indelible knowledge and preferences, the Rational Expectations theorist is guaranteed a particular answer to the question of the effects of public-debt financing: A one-dollar increase in public debt will ipso facto cause a one-dollar increase in current savings. “Ricardian equivalence”—the equivalence between tax financing and debt financing—is assured, for it is assumed in the way the model is constructed. Let’s examine this modeling procedure more closely. For Rational Expectations theorists such as Barro, the time horizon of people extends fully into the complete lifetimes of their children. This type of theory is called an “overlapping- generations model”. Thus, any debt currently incurred by a person—or by the government for that person—will not be regarded by that person as representing an increase in wealth; there are no wealth effects attributable to debt issue. This conclusion holds even if the debt extends so far into the future as to come due only after the person incurring the debt has died. After all, children must pay whatever is not paid by their debt- incurring parents and parents are assumed to take all tax obligations of their children into full account. By “full account” I am referring to the assumption that a child’s utility function is fully contained within the parent’s utility function. Empathizing so much with their

offspring that it becomes impossible to distinguish parents from children (and from all grandchildren, great-grandchildren, etc.) debt is incurred by current generations as if those alive today will remain alive and productive forever. Hence, all debt liabilities are fully provided for through increased saving by those who incur the debt. Every dollar of debt has a corresponding dollar of additional saving put aside so that it can be taxed to pay for the debt when it comes due. It follows that the person incurring the debt is indifferent between debt financing and outright purchase. In both cases he gains a source of utility (i.e., the purchased commodity), but he also has a sum of money (corresponding to the debt obligation) withdrawn from his 'spendable' assets. If the commodity is purchased outright, this sum of money is given up at purchase time. If the commodity is purchased via debt creation, this sum of money is sunk into an interest-bearing bond coming due at the same time the debt comes due. The equivalence is genuine in such a model.

But notice what has been done. A very complex economic and political intertemporal process has been modeled as a timeless static condition. Although the persons in such a model each live only a finite number of years, the peculiar assumption of intergenerational utility functions serves to create one immortal being who simply changes bodies intermittently. Because immortals live a long time, the time preference of immortals is likely to be very low (if not zero). Consequently, the real rate of interest is also likely to be very low -- or at least lower than it is in a world of mortals. Budget balancing for immortals is not of the same necessity nor urgency as it is for we beings of finite life span. Further, because time is not scarce it is of little significance to immortals. Combining this fact with the assumption of complete structural knowledge of the economy, it is difficult to see how exchange between a number of immortals is anything more than that which is modeled in atemporal static models. Thus, a crucial distinguishing feature of debt—its time element—is assumed away in these models of hyper-rationality.

In addition to the conceptual problems that mark a theory whose primary decision maker is immortal and practically omniscient, Rational Expectations models of debt financing suffer the same methodological illness that Hayek diagnosed in 1937 in his article "Economics and Knowledge"². Hayek found illegitimate assumptions about the role of knowledge in economies and economic science as being responsible for numerous weaknesses in models of perfectly competitive markets, especially as these models were developed and used by the Lange-Lerner type of "market socialists". Hayek showed the relative fruitlessness of conceiving of the economy as a grand and logical system of preferences and constraints

in the middle of which is a single mind to whom all knowledge of the economy is given. In such models it is this single all-knowing mind who works out all economic problems in order to obtain the optimal pattern of resource allocation. This model is really that of Crusoe world, and Crusoe need only construct a single plan whose component parts conform to the "external facts".³ This type of behavior is true economizing behavior.

The social scientist should not be much concerned with economizing behavior as such.⁴ The task of the social scientist is to explain the formation of social orders in light of the fact that these are not the 'rational' product of a designing mind. Spontaneous orders are not usefully explained as if they are produced by a single economizing mastermind.

The economist's task, as Hayek sees it, is to explain how complex social orders can emerge and survive. For such complex orders to exist they must make use of an amount of knowledge that is incapable of being possessed by one person. Relatedly, the actions of people within these orders must be mutually adjusted. The emergence of such an order can be understood only by inquiring into the nature of the processes that are functioning to convey each person's limited knowledge to all other relevant persons so that plans might mesh. The resulting order may appear to be the product of an omniscient and omnipotent being, but it is not. We should not attempt to explain it as if it were.

In the case of public-debt issue, the conclusions of an analysis based upon limited knowledge, Knightian uncertainty, non-homogeneous utility functions, and other 'imperfections' will be different from those derived from Rational Expectations theory. If a person in the model can take actions whose detrimental effects will not materialize until some time far in the future, then why is it irrational for that someone to be unconcerned about a future someone bearing the burden of these actions? To define rationality as knowledge (and concern) of all people with the structure and state of the current and future economic system and all of its inhabitants is pure ad hocery. It may be true that immortal and omniscient beings would undertake a sequence of actions that are different from those actions variously taken by people as they really are. But this fact does not imply that real-world people are any less rational than are immortal beings. It is trite but true that scientific analysis is only hindered by assuming that the human beings in the model are fundamentally different creatures from what they are in reality. If it is human action and human institutions that we want to understand we ought to accept and model man as he actually is.

The problem is to explain the constraints that define real-world choices between public-debt financing and tax financing. Models of the kind used by Rational

Expectations theorists are designed more for the purpose of achieving implausible theoretical possibilities rather than to help us understand the real-world problems of public finance.

Don Boudreaux, a former Mises Institute Fellow and editor of the Austrian Economics Newsletter, is an Assistant Professor of Economics at George Mason.

1. Such an assumption is used, for example, by Robert Barro. See his "Are Government Bonds Net Wealth?" *Journal of Political Economy* Vol. 82 (November) 1974, pp. 1095-1117.

2. In F.A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 33-56.

3. *Ibid.*, p. 37.

4. See James M. Buchanan, *What Should Economists Do?* (Indianapolis: Liberty Press, 1979), especially Chapters One and Two.

The Myth of the Plan

by
Peter Rutland

Open Court Publishing, 1986 282pp.
Reviewed by Mark Thornton

When the Polish Marxist economist, Oskar Lange suggested that socialists erect a monument in honor of Ludwig von Mises, he strategically and very conveniently closed the door on the Socialist Calculation Debate. Lange praised Mises because it was Mises who asked the key questions of socialists, questions that needed to be answered, and questions that Lange had claimed to have answered. Thus with this gesture (and the neo-classical mindset of the economics profession) Lange was able to give the perception that the socialists had won the debate.

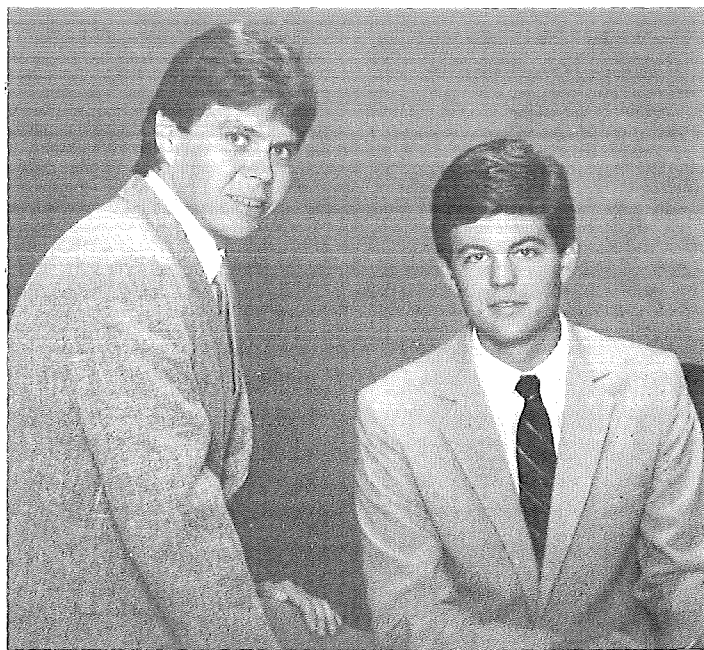
Seventy years of experience in the Soviet Union and recent contributions and restatements by Buchanan, Hayek, and Lavoie have reopened the Debate and taken the advantage. *The Myth of the Plan* is important step in the Debate because it marks the first time a socialist economist has both read *and* understood the Austrian arguments against socialism. Knowledge and understanding of the Soviet economy makes the book both insightful and informative. Rutland show the historical development of the Soviet command economy, how the modern command economy operates, and provides details on how this system works with respect to health care and social welfare, a supposed success of the Soviet system. He is however unconvinced by the "extreme" versions of Mises calculation argument and Hayek's road to serfdom theme.

Despite his sympathy towards socialism, Austrians will find his highly critical approach in examining the "plan" very refreshing. Rutland asks some very basic and crucial

questions of his comrades. Is central planning an necessary element of Marxian thought? Is central planning 'economic' at all? Is real reform possible in a country of continual "reform"? His questions are startling to socialists and his answers maybe startling to market oriented economists.

Rutland focuses his attack on the politicalization of the Soviet Union and its economy. He concludes that central planning is only a method of continuing the political structure of the Russian bureaucracy; planning' is primarily an exercise in the preservation of political power". Central planning works in maintaining political stability but not for the goals of socialism. Rutland also stings the Marxist theory of history, which is built around "economic change", with his politicization of the economy theme.

But, alas, he drops the ball in the last few pages of his otherwise rewarding book. On the last five pages of the book he begins the topic of "the myth of the market". Apparently, he has taken to heart Austrian criticisms of socialism but has not investigated Austrian contributions that show the market "works". He refers to the "unreformable" economy of the Soviet Union and high cost and trauma of change as reasons for his disappointing conclusions. This however is not as disheartening as his call in the last pages for "organizational studies". This final retreat however is the result of viewing the Soviet Union as inherently unchangeable and unreformable. The end result is that his examination of the Soviet economy is not for the purpose of reforming the Soviet Union, which lacks the key ingredient of democracy. His purpose is to warn his socialist friends in democratic countries of the problems of planning and the "possibility" of Hayek's thesis coming true. Good luck, Peter.



Don Boudreaux and Mark Thornton

Misesian Integrity: A Comment on Barnes

by

Steven Horwitz and Peter Boettke

We read with great interest the reprint of Jonathan Barnes' review of Gadamer in the Summer 1987 issue of the *Austrian Economics Newsletter*. While a short comment is not the place to tackle all of the complex issues involved in the relationship between hermeneutics and Austrian economics, we would like to bring one point to the attention of Misesian scholars. In discussing hermeneutics as the interpretation of philosophical texts of the past, Barnes writes, quite critically, that:

The hermeneutic programme thus appears to demand a scholarly approach to the philosophical questions: hermeneutics is interpretation, and in particular, the interpretation of the philosophical texts of the past. All this will remind English philosophers of the ideas of R.G. Collingwood, who believed that philosophy was a branch of history - the history of the prejudices and presuppositions of the human mind. (*AEN* Summer 1987, p.6)

What is interesting is that an article that is being used to attack supposedly anti-Misesian developments in Austrian economics would attack one of Mises' favorite historians R.G. Collingwood. This is especially relevant as it is an attack on Collingwood's epistemology which Mises liked in particular. In *Theory and History*, a book that Murray Rothbard calls "the philosophical backstop and elaboration of the philosophy underlying *Human Action*,"¹ Mises says:

[This] disparagement of the methods of history moved first Dilthey, then Windelband, Rickert, Max Weber, Croce and Collingwood to opposition. Their interpretations were in many regards unsatisfactory. They were deluded by many of the fundamental errors of historicism. All but Collingwood failed entirely to recognize the unique epistemological character of economics... But the fact remains that they succeed brilliantly in elucidating the epistemological features of the study of history. They destroyed forever the prestige of those epistemological doctrines that blamed history for being history and for not being 'social physics'.²

In another essay, Mises repeats his claim that these thinkers, the acknowledged predecessors of Gadamer and hermeneutics, opposed positivism as Mises did, "[Schmoller] did not realize the gulf that separated his views from those of the German philosophers who demolished positivism's ideas about the use and

treatment of history- first Dilthey, and later Windelband, Rickert, and Max Weber."³ Lest we think these pre-hermeneuticians to be historicists, Mises reassures us, "But [Schmoller] did not grasp the fact that the tenor of Dilthey's doctrine was the annihilation of the fundamental thesis of his own epistemology [i.e. historicism]."⁴ Clearly then, these other pre-hermeneuticians were both anti-historicist and anti-positivist, like Mises himself. But what about Collingwood? Allow us to quote at length from an essay of his:

[T]here is a special type of action, which we ordinarily distinguish by such epithets as expedient, useful, profitable, and the like; that this utilitarian or economic type of action is the fundamental fact with which all economic science is concerned; that a pure or philosophical economics would consist of the analysis of this special type of action and its implications; and finally that the ultimate or fundamental problems of economics are solvable only by abandoning any attempt to solve them empirically or inductively, and dealing with them according to their true nature, as philosophical problems to be approached by philosophical method.⁵

Collingwood is clearly giving economics a place as an apriori theory of action, denying both historicism and positivism. Again, it is no surprise that he was admired by Mises.

Barnes, though does not stop with his attack on Collingwood. He also accuses Gadamer of historicism, much as many "Austrians" have also charged Gadamer and hermeneutics with a nihilistic denial of truth. To the contrary, Gadamer's whole project is to defend the truth claim of the human sciences, including economics, against the historico-empiricists. He, like Mises, closes his magnum opus with a concise statement of his purpose:

[T]he use of scientific methods does not suffice to guarantee truth. This is so especially of the human sciences, but this does not mean a diminution of their scientific quality, but, on the contrary, the justification of the claim to special humane significance that they have always made. The fact that in the knowing involved in them the knower's own being is involved, marks, certainly, the limitation of 'method', but not that of science. Rather what the tool of method does not achieve must - and effectively can - be achieved by a discipline of questioning and research, a discipline that guarantees truth.⁶

This paragraph is as far from "impenetrably dark or pompously inflated" as one can get. Gadamer clearly states that the human sciences can only achieve truth when they throw off both the chains of the methods

(continued on page 10)

Reply to Horwitz and Boettke

by
David Gordon

Steven Horwitz and Peter Boettke have chosen a daring strategy in their criticism of Jonathan Barnes' review of Gadamer. They propose to concentrate their assault on a seemingly minor detail in Barnes' account, his remarks about R.G. Collingwood. In their view, appearances are deceiving; a "minor" matter really assumes crucial significance: "What is interesting is that an article that is being used to attack supposedly anti-Misesian developments in Austrian economics would attack one of Mises' favorite historians-R.G. Collingwood. This is especially relevant as it is an attack on Collingwood's epistemology which Mises liked in particular." (p.1)

While Messrs. Horwitz and Boettke deserve praise for their close study of Mises, they seem to me to have devoted their admirable interest and energy to a position beyond hope of salvation. First, Barnes' review of Gadamer was just that—it was not a defense of Austrian economics. Thus, the supposed fact that Mises liked Collingwood's epistemology hardly counts as a point against Barnes. Perhaps, though, Horwitz and Boettke mean that the *Austrian Economics Newsletter* should not have used Barnes' article to attack anti-Misesian developments in economics. This is, I am constrained to say, a strange position. Apparently, their view is that one cannot use Barnes' arguments to attack people who try to combine Mises with Gadamer, because Gadamer resembles Collingwood and Mises liked Collingwood.

If this is what Horwitz and Boettke mean, several comments immediately spring to mind. First, Barnes merely said that Gadamer's position will remind English readers of the ideas of Collingwood. He attempted no detailed analysis of Collingwood; and it is quite conceivable that he erred in comparing Collingwood with Gadamer while still being correct about the latter. It is also conceivable that Mises erred in his understanding of Collingwood.

In fact, though, neither Barnes nor Mises made a mistake. Barnes' reference to Collingwood is obviously to his late work *An Essay on Metaphysics*, of which Barnes' remarks are a terse and accurate summary. As T. M. Knox so well brought out in his Preface to *The Idea of History* which he, as Collingwood's literary executor, prepared for publication, Collingwood's early works, culminating in the *Essay in Philosophical Method* of 1933 adopted a position in many respects far removed from his late work, written after a series of strokes. Collingwood's early work, heavily indebted to the Italian philosopher Benedetto Croce, certainly was more than tinged with relativism. Yet, from the *Speculum Mentis* to the *Essay* of 1933, his work bears little resemblance

to Gadamer.

Thus, if Mises praises Collingwood, we need to ask, to which opinions of Collingwood did he mean to refer? The answer is readily available: it is to be found in the passage from Collingwood that our authors cite in their article. Mises praised Collingwood for arguing that economics is a deductive science. This is exactly the point the opponents of hermeneutics wish to emphasize: Collingwood, in the cited essay, supported just the "Euclidean" approach our latter-day irrationalists oppose. Mises makes no statement whatever endorsing Collingwood's general views about epistemology, much less the relativism of his late works to which Barnes makes reference.

If Collingwood was, as Horwitz and Boettke think, "one of Mises' favorite historians," one can only say that Mises kept his enthusiasm under quite remarkable control. Where in the vast corpus of his work does Mises discuss Collingwood at length? When it is suggested, further, that Mises liked Collingwood's epistemology "in particular," I rub my eyes in astonishment. What else is Mises supposed to have liked? Collingwood's work on the history of Roman Britain? His speculative philosophy of history in *The New Leviathan*?

But what about Mises' praise for Dilthey, Windelband, Weber, and Rickert? Did he not distinguish them from Schmoller and the other members of the German Historical School? Indeed he did: but what he praised emerges once more from the passage Horwitz and Boettke cite. Mises approved of their contention that the method of historical study differs from that of the natural sciences. He says here nothing at all about these writers' views of economic theory. This is hardly surprising since, except for Max Weber, they did not write about economic theory at all.

As to the closing citation from Gadamer, which calls for a discipline of the human sciences that will guarantee truth, surely, before acclaiming the similarity with Mises, one ought to inquire what Gadamer means by truth. This task I cannot undertake here; but once again a brief reference to the passage our authors themselves quote suffices to refute their contention. Gadamer opposes the "tool of method": the discipline of which he speaks relies on tradition and interpretation rather than fixed rules of procedure. That this is hardly Mises' praxeological method should go without saying, but unfortunately does not. So far as the debate on the value of Gadamer to Austrians is concerned, then, let us leave the last words to the Lord High Executioner of *The Mikado*. Mises' views about Collingwood, like "the flowers that bloom in the spring, tra la! / Have nothing to do with the case."

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