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A Conversation With Murray N. Rothbard

Murray Rothbard is the S. J. Hall distinguished professor of economics at the University of Nevada, Las Vegas.

Q: *Any recent thoughts on hermeneutics?*

A: That is now a history-of-thought question; hermeneutics has been crushed by Hans-Hermann Hoppe and David Gordon. Part of their critique is that the hermeneuticists were unable to demonstrate in concrete terms how this new "turn" would improve our understanding of economics. But if they hadn't been challenged, they could have carried on for years.

Q: *The initial attraction to hermeneutics was Mises's link with certain rationalist phenomenologists. What parts of this link do you like and dislike?*

A: The link was Alfred Schutz. He was a free-market phenomenologist and an anti-positivist. He did excellent work attacking the positivists for dismissing minds in favor of experiments. He would then point out that you need minds to conduct and verify the experiments. Before this, Brentano was pretty close to Menger and the Austrians. The Brentanoites taught logic, reason, the science of human action, affirmed that values exist, and pursued an objective analysis of subjectivity. But as Mises made clear: its proponents don't understand economics. The thoughts of Dilthey, Windelband, Rikert, and Weber are useful for historical analysis, but not economic theory—*Verstehen* not *Wirtschaftstheorie*. In the pursuit of subjectivism, you cannot throw out science and reason. As phenomenology developed, with few exceptions, it became irrationalist and collectivist.

The good parts of phenomenology are already a part of the Austrian tradition, as I pointed out in my article on praxeology for the Nathanson volumes, *Phenomenology and the Social Sciences*. The other economist, John O'Neill, who wrote for the volume produced pure irrationalist gabble. And there was little else useful in those two volumes.

Kirzner was also asked to contribute to this volume, but he turned it down, opining that Misesians should have nothing to do with phenomenology. I guess I was trying to be outreachy.

Murray Rothbard talked about monetary and institutional changes in Eastern Europe at the Mises Institute's De-Socialization conference in April.

Q: *What is your view of Hayek's statement that all progress in economics has been in the direction of subjectivism?*

A: It's true, but it hasn't been an upward climb. Early economic theory was rooted in the Italian, French, and Spanish traditions, which were subjectivist oriented. Then it shifted onto the terrible path taken by Smith and Ricardo and the British classical tradition, which is "objectivist"—values are inherent in production. There was a partial shift back to subjectivism, but it was blocked by Marshall. Mises brought back the subjective-value tradition, with time-preference, ordinal marginal utility, and all the rest. That's fine, but don't wipe out objective analysis. There is still a real world out there, with laws of cause and effect, and physical products being evaluated by people. Through all this, we've discovered that being anti-positivist is not enough. Subjectivism is not an

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absolute principle; it is a necessary but not sufficient condition for sound methodology.

Q: *Positivism was linked to socialism and interventionism. Do you now predict its decline?*

A: It is difficult to say. Positivism was central to socialism and planning in the same way praxeology is central to the free market. Positivism eliminates any kind of natural law principle—for example, economic laws which can be transgressed only at your own peril. With positivism, there is a tendency to leap into *ad hoc* economic theory.

When Friedman wrote his famous article defending positivism, philosophy had already rejected positivist methodology. But it fastened on economics with an iron grip for about 20 years. This is fairly typical. By the time methods are transferred from one discipline to another, they have often been rejected by the original discipline. It is high time for economics to throw out all analogies to the physical sciences.

Q: *How did* Man, Economy, and State *come to be?*

A: It ended up totally different from the way it started. After Mises had written *Human Action*, the Volker Fund—which promoted classical liberal and libertarian scholarship—was looking for a college textbook that would boil it down and spell it out. Mises hardly knew me at the time since I had just started attending his seminar. I wrote a sample chapter, "Money: Free and Unfree." They showed it to Mises and he gave his endorsement. I then received a many-year grant to work on it. I thought it was going to be a textbook. But it grew and grew. New material kept coming in. As I kept going, I found ideas Mises had left out, or steps that were implicit in Mises that needed to be spelled out. I gave periodic reports to the Volker Fund. Finally they asked me: "Look, is this going to be a textbook or a treatise?" When I delivered a 1,900-page manuscript, they knew the answer. *Power and Market* was the final chapter called "The Economics of Violent Intervention." They asked me to cut it out because it was too radical. It was published separately years later by the Institute for Humane Studies.

Contributors to this Issue

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Alexander Tabarrok, graduate student in economics, George Mason University, Mises fellow, and a correspondent of the *AEN*.

Q: *Did you write the book in sequence?*

A: Yes. I started on page one with methodology and it wrote itself.

Q: *Did anything get left out of the final version?*

A: I took chapter 5 out of *Man, Economy, and State*, which included the usual cost-curve analysis. I wrote the whole chapter before I realized my approach was nonsense. So I started over.

Q: *Is there any doubt that Mises was your primary influence?*

A: I didn't think so, but Joseph Salerno once gave a talk in which he said *Man, Economy, and State* is more Böhm-Bawerk-oriented than Mises's *Human Action*. I never thought of it that way, but it may be true. When I was spelling out capital theory, I used Böhm-Bawerk primarily. I didn't think about it since I thought Mises was a Böhm-Bawerkian and didn't see any contradiction. I would like to see Professor Salerno explore this. It's an example of the way an historian of economic thought can show something about a person's work that he himself didn't realize.

Q: *How many years did it take to complete* Man, Economy, and State?

A: This is complicated. I received the grant in 1952, but shortly afterwards I had to finish my doctoral thesis under Arthur Burns. From 1953-56 I was working partly on both. I finally finished *Man, Economy, and State* in 1960 and it was published in 1962.

Q: *How was your dissertation,* The Panic of 1819, *received?*

A: Very well. In fact, much better than any other of my books. Maybe that's because I didn't analyze the causes. I only wrote about how people wanted to cure it. I could have done much more work on it, and there is still more to say, but I am pleased with it. Plus, it remains the only book on the subject.

Q: *Were scholars anticipating the publication of* Man, Economy, and State?

A: Not really. Very few were even interested, except the Mises-seminar people and FEE people like Larry Fertig and Henry Hazlitt. Most were non-economists or friends and admirers of Mises. They were caterers, lawyers, clothing manufacturers. Other than Kirzner, Spadaro, Sennholz, Raico, Reisman, and Percy and Bettina Greaves, there was no Austrian movement to speak of.

Q: *Did you ever get discouraged and say "Why am I doing this?"*

A: No. Any chance to write a book or meet new people was terrific. But I was lonely. Mises was in his sixties, Hayek and Machlup were in their fifties, and I was in my twenties. There was nobody in between. With the possible exception of Baldy Harper, who was a libertarian, but whose Austrian knowledge was limited, there was a missing generation. It had been wiped out by the New Deal.

Q: *If we do an* It's a Wonderful Life *experiment—the state of Austrian economics without* Man, Economy, and State—*it looks pretty grim.*

A: That's an interesting point. Of the economists, Sennholz became a real-estate speculator, Spadaro didn't write much, Reisman became a Ricardian, and Hayek had drifted into philosophy and social thought. Kirzner was doing good work on entrepreneurship, but nobody was doing methodology, monetary theory, capital theory, or much else.

Q: *What were your thoughts on Mises's review of* Man, Economy, and State *when it appeared in the* New Individualist Review?

A: I liked it, but he didn't say much about the book. I would have preferred him to go into more depth.

Q: *Was he bothered by some of your corrections of his theories?*

A: I don't know because he never said. Mises and I had only two friendly arguments. One was on monopoly theory where he wound up calling me a Schmollerite. Although nobody else in the seminar realized it, that was the ultimate insult for an Austrian. The other argument was on his utilitarian refutation of government intervention. I argued that government officials can maximize their own well-being through economic interventionism, if not those of the public. He in turn argued that those kind of politicians wouldn't survive popular vote, thus changing the terms of debate.

Mises calling me a Schmollerite was the ultimate insult for an Austrian.

Q: *Was there a difference on foreign policy?*

A: In all the years I attended his seminar and was with him, he never talked about foreign policy. If he was an interventionist on foreign affairs, I never knew it. It would have been a violation of Rothbard's law, which is that people tend to specialize in what they are worst at. For example, Henry George is great on everything but land, so therefore he writes about land 90% of the time. Friedman is great except on money, so he concentrates on money. Mises, however, and Kirzner too, always did what they were best at.

Q: *Did Hayek ever attend Mises's seminar in the U.S.?*

A: No. They had a very strange relationship. Hayek began making very arcane anti-Misesian comments in his books, but nobody knew it, not even Mises. For example, it turns out that the anti-Walras footnote in *Individualism and Economic Order* was really an anti-Mises footnote, as Hayek admitted a few years later. When Mises read the article, he called Hayek up and said he liked it as an attack on formalism and equilibrium. He didn't realize that some of it was directed against himself. Gradually, Hayek became more and more anti-Misesian without actually refuting what he had to say. Yet Mises and Hayek are still linked in academic minds.

Q: *What happened in the 12 years between* Man, Economy, and State *and Hayek winning the Nobel Prize?*

A: Very little. There were various informal meetings, with Walter Block, and R. J. Smith. During the fifties, we had a whole group in New York, but it disbanded when Hamowy, Raico, and Liggio went to graduate school. There was another group coming up in the sixties, students of Robert Lefevre's Freedom School and later Rampart College. At one meeting, Friedman and Tullock were brought in for a week. I had planned to have them lecture on occupational licensing and on ocean privatization, respectively. Unfortunately, they spoke on these subjects for 30 minutes and then rode their hobby horses, monetary theory and public choice, the rest of the time. Friedman immediately clashed with the Rothbardians. He had read my *America's Great Depression* and was furious that he was suddenly meeting all these Rothbardians. He didn't know such things existed.

Q: *What happened to the Volker Fund?*

A: The Volker Fund collapse in 1972 destroyed a major source of funding for libertarian scholarship. The president was a follower of R. J. Rushdoony, who at the time was a pre-millenialist Calvinist, later converting to post-millenialism. He had sent me a Rushdoony book, which I blasted. Combined with other reviews, he became convinced he was surrounded by an atheist, anarchist, pacifist conspiracy to destroy Christianity. So he closed the Volker Fund in early 1972. It was a great tragedy. IHS was supposed to be established with the $17 million from the Volker Fund as an endowed think tank—publishing books, sponsoring students, funding research, and holding conferences. Instead, Baldy Harper had to start it from scratch.

Q: *How did* The Ethics of Liberty *come about?*

A: I received a Volker Fund grant to write it. It was supposed to be a reconciliation of libertarianism with conservative culture and personal ethics, what is called paleolibertarianism today. But as I worked on it, it turned into an anarcho-libertarian treatise. By the early sixties, conservatives had become pro-war and the whole idea of reconciling us with them had lost its attraction for me.

Q: *What about* Conceived in Liberty?

A: After the Volker Fund collapsed, I got a grant from the Lilly Endowment to do a history of the U. S., which I worked on from 1962-66. The original idea was to take the regular facts and put a libertarian assessment on everything. But once I started to work on it, I found many facts that had been left out, like tax rebellions. So it got longer and longer. It turned into the five-volume *Conceived in Liberty*, covering the colonial period to the Constitution. I don't like to completely chart out my research in advance. I go step by step and it always seems to get longer than anticipated. After Arlington House published volume four, they went out of business. Volume five, on the Constitution, was written in longhand and no one can read my handwriting.

Q: *What about conferences during the early seventies?*

A: The first was conducted at Cornell, the summer of 1973. Forrest McDonald and myself were giving papers. At the 1974 conference, we added Garrison, Rizzo, O'Driscoll, Salerno, Ebeling, Hutt, Grinder, and others. It was held in a tiny town in Vermont, which we called a Walrasian-General-Equilibrium town because there was no action, no competition, no interest rates. In 1976, we had a wonderful conference at Windsor Castle, but after that there was nothing.

Q: *Just so that we're clear, between the 1940s and the early 1970s, you were practically the only one that did serious scholarly work in Austrian economics?*

A: Well, Henry Hazlitt did some excellent work. But then he was uncredentialed. Hutt did some, but it wasn't really Austrian. Kirzner had written some serious articles. But basically the tradition had stagnated. By the late seventies, Austrian economics was considered Hayekian, not Misesian. Without the founding of the Mises Institute, I am convinced the whole Misesian program would have collapsed.

Q: *How is your history-of-thought book coming?*

A: Fine. I start with Aristotle, but don't spend much time on the Greeks. I leap to the early Christians. Economic theory became pretty advanced in the Middle Ages and only started falling apart later. Most history of thought assumes linear growth. But I am trying to show that there is slippage.

Unfortunately, there is a hole in my book. I got to the English mercantilists and Francis Bacon, which took me to 1620, but then bogged down and leaped ahead. This summer I am going to repair the hole. Aside from the hole, I have just finished the laissez-faire French school. The next step is to cover the pre-Austrians of the mid-19th century.

Q: *There seems to be a lengthening pattern to your projects.*

A: Maybe so. What is happening to my history of thought is the same thing that happened to *Man, Economy, and State* and *Conceived in Liberty*. It was originally going to be a short book on the history of thought, taking the same people the orthodox people do, reversing the judgment, and giving the Austrian view. Unfortunately I couldn't do that since Smith was not the beginning of economics. I had to start with Aristotle and the Scholastics and work up. I found more and more people that couldn't be left out.

Q: *How many volumes have been completed so far?*

A: I can never estimate things like that, but probably two or more. And I keep underestimating how much work I have to do. I thought I could finish off Marx in one chapter, but it took five. So I cannot give a projected date for finishing.

Q: *You have apparently taken an interest in religion as it affects the history of thought.*

A: Religion was dominant in the history of thought at least through Marshall. The Scholastics emerged out of Catholic doctrine. And John Locke was a Protestant Scholastic. I am convinced that Smith, who came from a Calvinist tradition, skewed the whole theory of value by emphasizing labor pain, typical of a Puritan. The whole objective-cost tradition grew out of that.

I am convinced that Adam Smith skewed the whole theory of value by emphasizing labor pain, typical of a Puritan.

Q: *Why has all this been overlooked?*

A: Because the 20th century is the century of atheistic, secularist intellectuals. When I was growing up, anyone who was religious was considered slightly wacky or even unintelligent. That was the basic attitude of all intellectuals. This is the opposite of the attitudes of earlier centuries when everyone was religious.

The anti-religious bias even shows up in the interpretations of the history of art, for example, in the secularist and positivist interpretation of Renaissance painting. When Jesus is painted as a real person, they assume that means it is a secular work. Whereas the real point of the Renaissance was to emphasize the Incarnation, when God became flesh. Even if art historians aren't interested in theology, they should realize that the people they study were. The same is true for economics. In doing history, you cannot read your own values into the past.

Q: *The anti-socialist revolution seems to be the fulfillment of everything Austrians have worked for.*

A: That's right. We are living through revolutionary times. Its like living through the French or American revolution and being able to watch it on television every night. Now the difference between the United States and the Eastern Bloc is that the United States still has a communist party.

Q: *This seems to be a vindication for your article, "Left, Right: the Prospects for Liberty."*

Professor Murray N. Rothbard

A: Damn right. Western conservatives cannot take credit for this. They always argued that socialist totalitarianism couldn't reform from within. Only the libertarians considered and gloried in this possibility.

Q: *Did you see the seeds of anti-socialist revolt when you visited Poland several years ago?*

A: Yes. At the first conference I attended, several dissident Marxists were there. But the next year, the organizers said they didn't need them. We went expecting dissident socialists and we found followers of Hayek, Friedman, Mises, and Rothbard. The economists and journalists that I met with had read many of my books and were publishing underground books on free markets.

Q: *Now that Marxism is dead where it has been tried, is there anything that is useful and important that should be remembered or kept?*

A: There is one good thing about Marx: he was not a Keynesian. I recently asked Yuri Maltsev, former Soviet economist, why is it that things seem to have fallen apart so rapidly in the Soviet Union in the last 20 years. He said in the last 20 years, the leaders of the Soviet Union have relaxed the money supply and have used inflation to solve short-term problems. That spelled doom for the system.

Q: *What about the prospects for liberty and a freer economy in the United States?*

A: Everything is getting worse, and very rapidly. Few favor central planning, but the battleground has shifted to interventionism. There are three areas of interventionism which are the big issues, now and in the future: (1) Prohibitionism and the attempt to eliminate all risk. If, for example, automobiles cause accidents, they should be eliminated. (2) Egalitarianism and the idea that victim groups should get special treatment for the next 2,000 years for previous oppression. (3) Environmentalism or antihumanism. The implicit idea is that man is the lowest creature and every creature or inanimate thing has rights.

Q: *How are things in Las Vegas?*

A: Great. Every semester we get more students, and the Austrians are at the top of their classes. We have a *Human Action* study group. I'm teaching a graduate seminar in Austrian economics this term and Hoppe will be teaching a seminar in the spring.

Q: *What in Austrian economics is most and least advanced?*

A: In methodology, we are pretty advanced, thanks to the work of Hans Hoppe. But we can always use more since that is what sets us apart from the rest of the profession. And Joe Salerno is doing great work on calculation.

Banking theory, however, has taken a very bad turn with free banking. We have to show that this is the old currency and banking school argument rehashed. They have adopted the banking school doctrine, that the needs of business require an expansion of the money supply and credit. Moreover, the free banking people violate the basic Ricardian doctrine that every supply of money is optimal. Once a market in a money is established, there is no longer a need for more money. That is really the key point.

Q: *What about the argument that 100% reserves require government intervention?*

A: I regard fractional-reserve banking as an intervention in the free market, as any crime against person and property is intervention. With banking, the government allows the crime to be committed.

How do we address the needs of trade arguments, those who say that business has a demand for credit? There are many things demanded on the market that are also crimes. There may be a demand for killing redheads. And there is certainly a demand for government loot. What's so great about market demand? If it is not within a framework of non-aggression, there will always be a demand for fraud and theft.

The free bankers accept a kind of David Friedmanite anarchism, where there is no law, only people engaging in exchange and buying people out. If you have a group that wants to kill redheads, the redheads will have to buy them off if they value their hair. This is monstrous, and this kind of anarchism would indeed be chaos. Just because there is a demand for a thing doesn't mean it should be fulfilled.

Q: *One of the criticisms of this position is that it is normative and not economic.*

A: Yes, but the response to 100% reserves is that bank entrepreneurs have the right to offer whatever fraction of deposits they want, which is also a normative position. Any discussion of policy is inherently normative. You can't have free markets unless you have property rights.

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Book Reviews

Man, Economy, and Liberty: Essays in Honor of Murray N. Rothbard

Edited by Walter Block and Llewellyn H. Rockwell, Jr.
Ludwig von Mises Institute, 1988

Reviewed by Leonard P. Liggio

Like the missing head of a beautiful classical Greek statue, there is a major lacunae in these essays in honor of Murray N. Rothbard. There is no essay on Rothbard the historian. Since I did not have time to do such an essay at the time the essays were organized, I admit my responsibility for the absence. I will note that Murray Rothbard is an important American historian as demonstrated by his more than four volumes on the colonial and founding two centuries, and by his books on American depressions, essays and manuscripts on the Progressive-New Deal eras. In addition, he is a leading expert on American foreign policy during the 20th century. Finally, he is a master of Western intellectual history as will be shown with the publication of his magisterial history of economic thought.

A slight flavor of Rothbard as historian is indicated in the essay by Sheldon Richman concerning his book reviews during a decade as scholarly analyst for the William Volker Fund. Rothbard's doctoral research under Joseph Dorfman for *The Panic of 1819* placed him in the position of knowing the complete fallacy of Arthur Schlesinger, Jr.'s 'working class' interpretation of *The Age of Jackson*. Jackson and Van Buren were leaders of the laissez-faire middle-class opponents of central banking. Rothbard was very favorable toward Robert V. Remini's *Martin Van Buren and the Making of the Democratic Party* (1959) and Lee Benson's *The Concept of Jacksonian Democracy* (1961) (one of the crucial books in 19th century historiography). "Benson," wrote Rothbard,

> squarely and candidly refutes the "Jacksonian Democracy" thesis... Benson squarely recognizes that the Democrats were the Libertarian party, and the Whigs the Statist party, and therefore, properly, concludes that the "precursors of the New Deal" in this period were not the Jacksonians but the Whigs.

The essence of Rothbard's contribution to economic history may be summarized in his review of George Athan Billias's "The Massachusetts Land Bankers of 1740":

> The essence of modern revisionism ... is to have learned ... that, lo and behold!, the inflationists were not poor agrarians at all, but wealthy urban merchants and real estate speculators, who, while they may well have been debtors, were hardly "poor" in the

Advertising and the Market Process: A Modern Economic View

Robert B. Ekelund, Jr. and David S. Saurman
Foreword by Israel M. Kirzner
Pacific Institute, 1988

Reviewed by Roy E. Cordato

> [W]hen it comes to the point where [competitive equilibrium] misleads some of our leading thinkers into believing that the situation which it describes has direct relevance to the solution of practical problems, it is high time that we remember that it does not deal with the social process at all...
>
> F. A. Hayek (1945, p. 91)

The economics of advertising is one area where economists have fallen into the trap that Hayek describes. It is only since the 1960s that they have begun to pull themselves out. With the nearly total acceptance of perfect competition as the normative standard used to judge the efficiency of market activity, welfare economists have arrived at many value judgments that are totally at odds with reality and common-sense notions about the kinds of activities that make people better off.

This is because the assumptions of perfect competition have little or no relationship to real world market processes. From this perspective any market activity that would not exist in the never never land of perfect competition has the potential for being labeled "monopolistic." This has been the case with advertising. Obviously, in a world where producers and consumers know all there is to know about each other, businesses can enter and exit markets costlessly, and there exist no differences within product lines, there would clearly be no advertising. Traditionally, instead of raising the possibility that their view of competition might be irrelevant, industrial organization economists have dogmatically come to the conclusion that advertising must be monopolistic.

If Hayek's warning had been taken seriously in 1945, Ekelund and Saurman's book would not have been necessary. But alas it wasn't, and industrial organization economists have spent decades comparing the real-world apples of market activity to the irrelevant oranges of perfect competition. Fortunately the comprehensiveness and forcefulness of the arguments in this book should finally lay to rest the notion that advertising is evidence of market failure or could be anything but welfare enhancing. The authors pull together all of the important analysis and evidence from the economics sense generally used. Inflation *and* sound money were led by the respectably, sophisticated, urban merchants and intellectuals.

As Richman emphasizes, Rothbard opposed economic determinism, as when he defended Forrest McDonald against the charge of determinism.

> Not true, wrote Rothbard, because McDonald's very act of "atomizing" Beard's class categories—the nub of McDonald's great contribution to historiography—was to shift the emphasis from Marxist class struggle to "the actual realistic categories of *individual* economic interest. This is, indeed, a shift from fallacious Marxian historiography to realistic, individualistic, even 'libertarian', historiography."

I would attribute to Rothbard's grasp of Western intellectual history his important contributions to political and moral philosophy. Recently, a number of academics who have talked with Murray Rothbard have expressed surprise to me that he is as well versed in

Leonard P. Liggio

medieval political and moral philosophy as in modern political and moral philosophy. Some have wondered if his being deeply informed in medieval thought, like his love of Handel's music or German Baroque churches, evidenced a theological interest. Rather than a theological interest, it evidences a deep commitment to truth and beauty. First, he has always rejected the Progressive Establishment's anti-Catholicism—as Peter Verick underscored 40 years ago, anti-Catholicism is the anti-Semitism of the Progressive Establishment. Rothbard has acquired a wide knowledge of Protestant and Catholic thinking that has been expressed in lectures and published and manuscript writings, particularly in his critiques of public education. Second, he has always welcomed as friends, Jewish, Protestant and Catholic believers or nonbelievers, or atheists who pester theists. Since theism and especially Catholicism have been the *bete noir* of the Progressive Establishment, which controls the academic world, he has been particularly welcoming to them as contributors to liberty. One hardly needs to mention what is famous *in urbi et orbi* (New York City and the world), Murray Rothbard's being denounced by Ayn Rand for refusing to condemn *ipso facto* as not rational anyone who was a theist.

Indeed, that famous furor was due to one of the many important differences between Murray and Ayn

literature of the last several decades to present an economic defense of advertising that will be difficult if not impossible to refute. Ultimately this book should be on the required reading list of every industrial organization class. But first it needs to be read by the professors of those classes.

The authors present their analysis and evidence under the banner of a single analytical rubric that blends insights of both the Austrian school, primarily the works of Hayek and Kirzner, and the "new-neoclassical" economics. This is often referred to elsewhere in the industrial organization literature as the "new learning," pioneered primarily by Chicago school economists such as George Stigler, Harold Demsetz, and Armen Alchian. This approach allows the authors to utilize key Austrian insights concerning the nature of entrepreneurship and competition as a rivalrous process while remaining within a framework of analysis that could be appreciated by more traditional neoclassical economists. Whereas Austrian analysis would lead to a rejection of certain issues as simply irrelevant (more on this below), the blending of some aspects of the Austrian view into a fundamentally neoclassical approach allows the authors to communicate to a wide audience of economists. It should also be pointed out that the authors' non-technical approach makes the book completely accessible to anyone who is seriously interested in the issue.

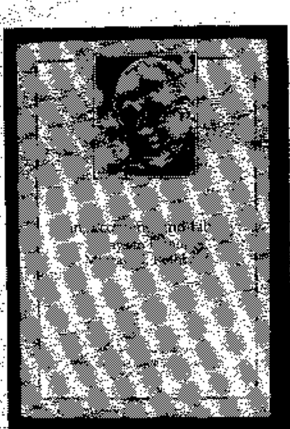
Implicit in Ekelund and Saurman's analytical framework is an acceptance of the results of perfect competition as a long-run normative benchmark. This is the "new-neoclassical" influence in their approach. From a strictly Austrian perspective, with its emphasis on subjective-value theory and the complete openendedness of market processes (see Kirzner's foreword to the book), the results of perfect competition have no normative significance. But by invoking Austrian insights about the nature of disequilibrium market processes, the authors are able to argue that in a non-perfect world advertising acts as a catalyst that brings us closer to the perfectly competitive results.

For example, one traditional argument against advertising is that it creates barriers to entry into markets by generating brand loyalties that result in a less elastic demand for any given product. While Austrians would

Roy E. Cordato

—Murray had a very thorough knowledge of the intellectual history of the West. Ayn Rand was very contemporary in sharing with current academic philosophers a contempt for the history of philosophy. Murray had studied the Western philosophers who had followed in the tradition of Aristotle and had found in them the source of a rational and complete explanation of man and his human actions. The Aristotelian tradition is the source of Western progress and liberty.

Of great importance for contemporary classical liberalism has been Rothbard's returning classical liberalism to its traditional moorings. Although Ludwig von Mises and F. A. Hayek shared Rothbard's tolerance of non-pestering theists and atheists, and although both founded their philosophy in Kantian thought, Mises and Hayek were utilitarians, as too many 19th-century classical liberals tended to be. Although classical liberalism's roots lie in the 2300-year-old Aristotelian tradition, the Enlightenment took classical liberalism on a wrong turn into utilitarianism, which meant that in the 20th century classical liberalism had nothing to stand upon. For 40 years Rothbard has emphasized the crucial importance of natural-rights theory to classical liberalism's restoration to a key position in the intellectual debate. From the beginning, Rothbard read widely in natural-rights theory and encouraged research in that area. The surface of the results is merely scratched when one notes that Douglas Den Uyl and Douglas Rasmussen publish in *The New Scholasticism*, or that Henry Babcott Veatch's works such as *Rational Man*, *For an Ontology of Morals*, or *Human Rights: Fact or Fancy?* are associated with Rothbard's work.



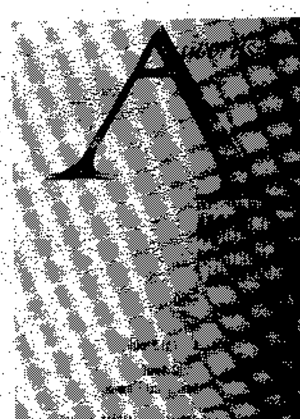
Important contributions to this volume that relate to philosophy are the essays by Ellen Frankel Paul, Jeffrey Paul, Leland Yeager, Douglas Den Uyl, Anthony Flew, David Gordon, Tibor Machan, Randall Holcombe, David Osterfeld, and Hans-Hermann Hoppe.

Among the economics essays, those of Dominick Armentano on monopoly theory, Roger Garrison on the theory of interest, Israel Kirzner on welfare economics, and E. C. Pasour on economic efficiency and public policy are required reading. Walter Block and Gregory Christainsen each made valuable contributions regarding banking and monetary issues.

Particularly impressive was Roger Arnold's "Prisoner's Dilemma, Transaction Costs, and Rothbard." The important recent work in this area by Robert Axelrod, *The Evolution of Cooperation*, has put on center stage academic issues Rothbard never lost sight of. Arnold shows how Rothbard's criticism of the

find no normative significance in this result, it is, of course, inconsistent with a perfectly competitive world. Brand loyalty implies that the product under consideration is being differentiated in the mind of consumers. By pointing out the dynamic nature of markets and entrepreneurship, Ekelund and Saurman are able to show how advertising is best viewed as a method of breaking down barriers, i.e., as a way of gaining entry into already established markets and therefore overcoming brand loyalty. Advertising is used as a way of distracting consumer's attention away from brands that they might be loyal to, enticing them to consider alternatives.

This kind of analysis also has direct implications for the issue of market concentration and "monopoly power." In the traditional, static framework of analysis, if advertising is a barrier to entry then it would also lead to high concentration ratios and "monopoly" profits, i.e., any revenues that are more than enough to cover opportunity costs. The approach taken by the authors does not question whether market concentration or monopoly profits should have any normative significance, as a more narrow Austrian analysis would. They instead invoke market process analysis to show that, by overcoming barriers to entry, advertising can be expected to decrease market concentration and reduce prices and profits. In pursuing this analysis they draw on a wealth of sound empirical evidence.



Another example of this kind of approach is the issue of advertising and information. Under perfect competition consumers and producers have perfect knowledge. In such a setting there would be no advertising. It would benefit neither producers nor consumers. Again, the authors point out that the traditional literature in this area misses the boat by focusing on the end results of competition. The question that they ask is this: are consumers more knowledgeable with advertising or without it? Their conclusion is that while advertising may not have a role in a perfect world, in an imperfect world it will definitely produce more knowledgeable consumers. This point dovetails nicely with the distinctly Austrian view of markets and market phenomena presented most forcefully by Hayek, who argued that the primary function of markets is to capture and disseminate information.

My emphasis on the fact that Ekelund and Saurman's approach is not an example of "pure" Austrian economics should not be construed as a criticism of the book. In fact, it is clearly of value. First, it is an excellent example of how certain Austrian insights can be incorporated into and improve upon the orthodox theory of transaction costs has placed him in conflict with Judge Richard Posner. Dominick Armentano's essay had introduced us to the Rothbardian critique of the antitrust concepts of both Judges Richard Posner and Robert Bork.

Arnold states the Posnerian position:

> Posner, drawing on the highly-idealized Coasian setting—when there are zero transaction costs and no income effects—argues that government, through the courts, ought to assign property rights to the party who would buy them, and place liability (in liability cases) on the party who could have averted the accident at a lower cost.

Rothbard demonstrates that coercion by the state decreases social welfare. Although sound social science must begin with the concept that numbers should not count, as John Tarurek showed when analyzing ("Should the Numbers Count?", *Philosophy and Public Affairs* 6 [1977]) whether it could be moral to cause injury to one person for two or more to benefit, Rothbard has indicated, according to Arnold, "as long as we can not measure whether the "winners" gain more in terms of utility than the "losers" lose, we can not guarantee that there is even, at minimum, a net gain to having the State."

Rothbard's analyses show that the state decreases social welfare. According to Arnold, his argument is:

> One, the State uses coercion. Two, if individuals are coerced it follows that they are doing something they wouldn't be doing. Three, one can not get more utility from doing something he wouldn't be doing than doing something he would want to do. We conclude that the State decreases utility levels—if not of all persons, of at least some.

David Osterfeld parallels this discussion in his essay. He quotes Rothbard:

> *the free market benefits all its participants*. ... We are led inexorably, then, to the conclusion that the processes of the free market always lead to a gain in social utility. And we can say this with absolute validity as economists, without engaging in ethical judgments. ("Toward a Reconstruction of Utility and Welfare Economics," *On Freedom and Free Enterprise* [Princeton, 1956])

This is drawn from one of Rothbard's earliest works, reflecting an expansion of the basic ideas of Mises, and forming a foundation for Rothbard's succeeding work, such as *Man, Economy, and State*, and *Power and Market*. The continuing importance of this work is indicated by the essays by Israel Kirzner and Leland Yeager.

At this moment, we are witnessing a rediscovery of Rothbard's economic analysis by a younger generation of economists. They are faced on all sides by the failures of the Marxist, Keynesian, and Monetarist explanations. Hayek and Friedman, as one example, have developed strong critiques of contemporary monetary thinking paralleling the work already introduced by Murray Rothbard.

One of the concluding essays, "John Prince Smith and the German Free-Trade Movement" by Ralph Raico, provides an appropriate parallel. Just as Prince Smith was temporarily eclipsed by the state socialism of Gustav Schmoller and the German Historical School, the logical conclusion of interventionist thinking caused Mises and Hayek to go into exile while the National Socialists adopted Keynesianism. After 1945, Germany was able to adopt the market ideas of Mises and Hayek and to bring about the German Economic Miracle. Prince Smith declared: "Liberalism only recognizes one task which the state can perform, namely, the production of security." Raico quotes Gide and Rist that

> Liberalism had nowhere assumed such extravagant proportions as it had in Germany. Prince Smith, who is the best known representative of Liberalism after Dunoyer, was convinced that the State had nothing to do beyond guaranteeing security, and denied that there was any element of solidarity between economic agents save such as results from the existence of a common market.

To extend Raico's conception, there is no greater set of giants of economics than Dunoyer, Prince Smith, Mises, and Rothbard. ■

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framework of analysis. Second, by framing their analysis in a way that addresses the concerns of the profession at large, the authors bring many Austrian insights to an audience that might otherwise reject them out of hand.

Unfortunately, Austrian welfare economics has not yet been developed to the point where it could sustain a full-blown analysis of advertising, or most other normative issues. While Austrians have rightfully rejected perfect competition as a relevant normative benchmark, they have not developed a completely coherent alternative to take its place.[1] Austrian criticisms of standard welfare analysis are sound and fundamentally damaging, but no widely agreed-upon alternative standard of efficiency has emerged. The absence of a well-defined and agreed-on standard makes policy debate with the wider audience of economists difficult, if not impossible.

In regard to this issue I would like to draw attention to Kirzner's insightful foreword to this book (pp. xv-xxii). His central point is that advertising is best understood within the context of an "open-ended universe," as opposed to the closed-ended world of general equilibrium. This is a world where, not only is there imperfect knowledge in the rational ignorance sense, but where the element of "surprise" is always present. It is a world where individuals not only consider the marginal benefits associated with obtaining additional amounts of knowledge that they know is out there, but are also faced with the possibility of discovering information that they "don't know they don't know." This element of "surprise," the result of what Kirzner calls utter ignorance, does not exist in the closed ended framework of perfect competition, even when market process analysis is used to amend it. In emphasizing this world view, Kirzner is implicitly defining the context from which an Austrian welfare economics must ultimately emerge. The question that needs to more thoroughly be addressed is this: what is meant by economic efficiency when end-state results—resource allocations, market structures, demand elasticities, etc.—are not relevant issues?

In closing, the arguments and evidence that Ekelund and Saurman present are overwhelming. From a public policy perspective they demonstrate conclusively that there is no economic justification for restricting, regulating, or in any way discouraging non-fraudulent advertising. Going even farther, they argue that to do so actually reduces social welfare. Unfortunately this message has not yet reached Capitol Hill. In recent years we have heard the social engineers in Washington call for further restrictions on all kinds of advertising—from the advertising of alcohol to Saturday morning childrens' advertising. The authors bring sound economic reasoning to bear on all of these issues. In addition, tax policy makers have also been eyeing the tax treatment of advertising as a possible avenue for revenue raising. There have been several proposals to reduce the tax value of right-offs associated with advertising expenses. Part of the argument for this has been that advertising is inherently anticompetitive and therefore should be discouraged (see Cordato, 1987). Ekelund and Saurman put all such "justifications" for raising revenues on the backs of advertisers to rest. Ultimately, those who continue to view advertising in the knee-jerk market failure tradition of J. K. Galbraith, Paul Samuelson, and F. M. Scherer, without addressing the arguments made here, are either showing their ignorance or being dishonest.

[1]There have been several approaches to welfare economics that Austrians have developed and occasionally invoked (see Rothbard, 1956; Kirzner, 1973, 1988; Armentano, 1982; and Cordato, 1989). My point is that none of them have been developed to the point where they could be considered a fully developed alternative to the perfectly competitive model.

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Against Mechanism: Protecting Economics From Science

Philip Mirowski
Rowman & Littlefield, 1988

Reviewed by Peter G. Klein

Of the new generation of economic methodologists—Bruce Caldwell, Lawrence Boland, perhaps Arjo Klamer—the most talented and outspoken may be Philip Mirowski of Tufts University. Modern methodological discussions tend to fall into one of two categories: "meta-methodology" (What should we do about all these competing research programs?) and "rational reconstruction" (What did Friedman really mean in 1953?). Mirowski, by contrast, prefers a frontal assault on the hard core of neoclassical economic theory itself: the entire constrained optimization paradigm. This technique, he claims, was imported directly from mid-19th-century physics by Jevons, Walras, and their successors, with little thought to its applicability; and most of us have been using it uncritically ever since.

Mirowski has been elaborating this position over the last few years in scattered journal articles and two books (neither of which has received very much attention).[1] A definitive statement of his thesis has been in preparation for some time in the book, *More Heat Than Light* (now available fromCambridge). Because of the delay *Against Mechanism,* a collection of 12 essays, most of them previously published, was released in 1988 by Rowman & Littlefield.

The core of the volume, and easily the best essay, is the first chapter, "Physics and the 'Marginalist Revolution,'" an article that originally appeared in the *Cambridge Journal of Economics* in 1984. Here Mirowski offers the bold claims that (1) the distinguishing characteristic of the new marginalist economics of the 1870s and 1880s (at Manchester and Lausanne, at least) was not marginal utility at all, but the fact that the new theory was patterned explicitly after physics—in particular, the new physics of energy and the field—in a conscious and deliberate attempt to make economics more "scientific"; and that (2) this same 19th-century energetics model has persisted as the basis of modern economics, even long after its abandonment in the physical sciences. This thesis, Mirowski says (pp. 24-25),

> explains a number of issues which have eluded other attempts at locating the hard core of neoclassical theory ... First, it explains why neoclassical theory and mathematical formalism have been indissolubly wedded since the 1870s, even though a cogent defense of the necessity of the link has been notable by its absence. Second, it explains the success of neoclassicism in preempting other research programs in economics by means of the forceful claim that it is scientific, even though standards of scientific discourse in the larger culture have changed periodically during the last hundred years. Third, it explains the preference for techniques of constrained maximization over any other

analytical techniques ... Fourth, it explains the persistent use of an unobservable and unmeasureable value determinant—utility—in textbooks and in applied research, despite protestations that utility is not "needed" for neoclassical results ... Fifth, it explains the modern controversy over the necessity for a "microfoundation for macroeconomics," which can be interpreted as a complaint that Keynesian economics has not conformed to the hard core research strategy and is therefore somehow illegitimate ... All these characteristics are borrowed from nineteenth century energetics.

These general concerns should be familiar to modern Austrians (who, by the way, are not cited anywhere in the book), but Mirowski goes much farther in emphasizing the details of the energetics metaphor and the special difficulties in its application to economics. One problem is that any constrained maximization problem assumes some sort of conservation principle. In energetics, it is the total energy of a moving object (the sum of potential energy and work accomplished) that is conserved. Walras's system, it turns out, implicitly assumes that in the process of exchange the sum of total expenditure and total utility is somehow conserved, a proposition that clearly isn't sensible. Yet neoclassical theorists have continued to "surreptitiously" assume some form of conservation principle in their work (p. 19). A second problem is that the early energetics models assumed all physical processes to be fully reversible in time; that is, they should exhibit no hysteresis or time dependency. In economics this means that "in equilibrium bygones are bygones; thus one could practically ignore how a market actually functions in real time, paying attention only to putative 'eventual' outcomes" (p. 26).[2]

Such assumptions are rarely questioned (or even noticed), according to Mirowski, because the early neoclassicals themselves didn't fully understand the implications of the energetics metaphor, and few economists then or since have known enough physics to question it. (In chapter 2 Mirowski presents correspondence between the mathematician Hermann Laurent and Walras, and later Pareto, in which Laurent outlines at length the mathematical inconsistencies of the new economics; Walras's and Pareto's responses indicate that clearly neither was exactly sure what he was doing.) This should come as little surprise when one recalls the number of noted economists who began as dissatisfied physical scientists.[3] The author also makes it quite clear that Menger, by these criteria, is not a "neoclassical" economist at all, having rejected both the law of one price and the view that traded goods are equivalent in value (pp. 22-25). The analysis here is consistent with the recent work of Erich Streissler and William Jaffé on "de-homogenizing" the Jevons-Walras-Menger triumvirate.[4]

The other essays in the book develop these basic themes, although the quality of the selections is somewhat uneven. Especially noteworthy are chapter 6, a further exploration of the role of conservation principles in economics; the review of McCloskey's *Rhetoric*; and the first few pages of chapter 10 on Morishima's *Marx's Economics*. Less satisfactory, however, are the chapters on Mirowski's own version of "neo-institutionalist" economics, which he sees as the preferred alternative to the neoclassical orthodoxy (although nowhere in the volume is a research program explicitly stated). Apparently Mirowski does not mean, by the way, the so-called "New Institutional Economics," which comprises the formal contracting and agency literature and Oliver Williamson's transaction cost economics; none of these are mentioned in the text, even though this is clearly a "hot topic" in microeconomics. In addition, there is no comment on any modern Austrian school writers, Misesian, hermeneutician, or otherwise, despite the fact that the Austrians have been loudly "against mechanism" for a long time.

A few other minor quibbles: Mirowski's self-conscious attempt to cultivate a flashy and clever writing style is often forced and uninspiring; while it is certainly true that "it behooves economists who repudiate the slavish imitation of physics to rediscover their literary and philosophical roots" (pp. 7-8), it doesn't follow that one cannot be simple, clear, and direct. (Fortunately Mirowski doesn't come close to the difficult and confusing style of Georgescu-Roegen's *The Entropy Law and the Economic Process*,[5] a work cited favorably in the text.) Furthermore, the book's examples and illustrations from physics are not particularly elegant or clear, which is unfortunate because conveying a basic understanding of energetics to the non-specialist is so central to Mirowski's purpose. Also several of the chapters are burdened with an extremely annoying combination of endnote and parenthetical references that sends the reader flipping back and forth throughout the book.

In sum, though, *Against Mechanism* is an important work that deserves to be widely read, especially for its penetrating and original analysis of the meaning of the "marginal revolution" and the problems of scientism in modern neoclassical economics. Only now with the appearance of *More Heat Than Light*, however, can we judge Mirowski's own neo-institutionalist agenda.

[1]The books are *The Birth of the Business Cycle* (New York: Garland Publishing, 1985), and *The Reconstruction of Economic Theory* (Boston: Kluwer, 1986), a collection of essays by several authors edited by Mirowski.

[2]The reviewer has found the reversibility problem acknowledged in only one other place, W. W. Bartley's *Unfathomed Knowledge, Unmeasured Wealth* (La Salle, Ill.: Open Court, forthcoming), chap. 8

[3]Compare, for example, Alan Blinder's personal story in Arjo Klamer's *Conversations with Economists* (Totowa, N. J.: Rowman and Allenheld, 1983).

[4]Erich Streissler, "To What Extent Was the Austrian School Marginalist?," *History of Political Economy* 4 (Fall 1972): 426-41; William Jaffé, "Menger, Jevons and Walras De-homogenized," *Economic Inquiry* 14 (December 1976): 511-24.

[5]Nicholas Georgescu-Roegen, *The Entropy Law and the Economic Process* (Cambridge, Mass.: Harvard University Press, 1971). ■

Conferences

Hillsdale College Hosts Austrian Economics Conference

On April 21-24, 1990, Hillsdale College in Hillsdale, Michigan, sponsored a conference on Austrian economics that testified to the current intellectual vibrancy of the Austrian school.

Professor Richard Ebeling of Hillsdale College, who organized the conference, presented a history of Austrian economics, from its birth to its modern state. Professors Kurt Leube, of the California State University, Hayward, and Norman Barry, Bowling Green University were the respondents.

Professor Hans-Hermann Hoppe presented his paper "Austrian Methodology in the Age of the Decline of Positivism." He argued against positivism, presented the Misesian alternative, and extended *a priorism* into political theory and property rights. Controversy broke out when Professor Robert Formaini of the University of Dallas said Hoppe's *a priori* political theory was too new and unpersuasive to be incorporated into the Austrian edifice. Professor J. Patrick Gunning of the University of Papau, New Guinea, also responded during this lively session.

Professor Israel Kirzner of New York University presented his paper "The Idea of 'Competition' in Contemporary Economic Theory and the Austrian Theory of the Market Process." He also engaged Gerald O'Driscoll's position that Mises held a neoclassical view of monopoly. Professors Stephen Littlechild of the University of Birmingham and W. Duncan Reekie of the University of Witwatersrand were the respondents.

Professor Peter Boettke of New York University presented "The Austrian Critique of Central Planning and the Decline of Socialism around the World" which addressed issues of economic calculation and Soviet attempts at reform. Professor Samuel Bostaph of the University of Dallas responded, and Boettke fielded questions from Soviet experts in the audience.

Professor Jack High of George Mason University presented "Government Regulation and the Austrian Critique of Industrial Organization Theory." He attacked static monopoly diagrams on Hayekian grounds and offered a public-choice critique of regulation. Professors Charles Van Eaton of Hillsdale College and Sanford Ikeda of California State University, Hayward responded.

Professor Roger Garrison of Auburn University presented "Austrian Capital theory and the Future of Macroeconomics," in which he surveyed macroeconomic thought and argued against the Keynesian fixed-capital framework that dominates the views of even many anti-Keynesians. Professor Joseph Salerno of Pace University and Peter Lewin of Dallas, Texas, responded.

Professor Mark Skousen of Rollins College argued in "Austrian Capital Theory and the Problems of Economic Development in the Third World" that only capital accumulation brought about in the free market can bring economic development to the Third World. Professors Sudha Shenoy of the University of Newcastle, Australia and John Egger of Towson State responded.

Professor George Selgin of the University of Georgia presented "Monetary Equilibrium and the 'Productivity Norm' of Price-Level Policy," argued that monetary authorities, instead of stabilizing the price level, should allow it to adjust with changes in productivity. Professor Lawrence White of the University of Georgia said that such a policy assigned to monetary authorities is not a substitute for free banking.

There were more than 100 attendees and many said the informal discussion was as fruitful as the official conference itself. The papers will be published by Hillsdale College in its series *Champions of Freedom*.

Mises Institute Hosts De-Socialization Conference

On April 23, 1990, in Washington, D.C., the Ludwig von Mises Institute sponsored the first Austrian look at the post-socialist age: "After the Revolution: De-Socializing the Socialist Bloc." It went a long way toward developing a blueprint, consistent with the Austrian tradition, for dismantling the command economy after the 1989 anti-socialist revolution.

Professor Hans-Hermann Hoppe of the University of Nevada, Las Vegas, who is from Germany, noted the mistakes that have been made already on the path to German unification and offered an alternative route that avoids the stagnation of social democracy.

Professor Krzysztof Ostaszewski of the University of Louisville, a Polish emigré, critiqued Poland's limited reforms and described the obstacles t to be faced in attempting to become a fully capitalist society.

Dr. Yuri N. Maltsev of the International Center for Development Policy, and former reform adviser to Gorbachev, described the miserable standards of living in the Soviet Union and explained how the economy could be fully privatized. His short-term outlook for the Soviet economy was extremely pessimistic.

Professor Gottfried Haberler, of the American Enterprise Institute and former president of the American

Economic Association, introduced Dr. Maltsev, and noted his elation at the revolutionary events. "I only wish Ludwig von Mises could have seen his prediction come true," said Professor Haberler.

Dr. Kestutis Baltramaitis, of the economic reform team of the Lithuanian Council of Ministers, was the special guest lecturer. He spoke of Lithuania's plan to completely privatize their industry and dramatically cut the size of their public sector. He assured the audience they want complete de-socialization. Especially notable was his revelation that Lithuania plans to offer foreign entrepreneurs free and total access to its markets and resources, with no restrictions on the size or type of investment.

Professor Murray Rothbard of the University of Nevada, Las Vegas explained that Mises and the Austrians forecasted the collapse of socialism, and pointed to the tremendous opportunity that now exists for a new social experiment in freedom. He focused specifically on what must be done—monetarily, institutionally, and ideologically—to achieve it, and urged a stroke-of-the-pen dismantling of the old order.

Kestutis Baltramaitis, a member of the Lithuanian delegation, spoke in Russian on the transition to a free market in Lithuania while Yuri Maltsev translated into English for the audience.

Finally Joseph Sobran of *National Review* cautioned against foreign aid, called for the breakup of NATO, and suggested that America's most important export is free market economics and its Founders' vision of the liberal society.

Attending the conference were University professors and students, local think-tank scholars, and Mises Institute members from around the country. Tapes from the conference are now available from the Mises Institute and the papers will soon be published. ■

Mises Institute's Lawrence Fertig Center Hosts Lithuanian Delegation

The Fertig Center of the Ludwig von Mises Institute, in Fairfax, Virginia, hosted a delegation of Lithuanian economists for a productive three-hour colloquium on the future of free markets in their country.

Dr. Ed Hudgins of the Heritage Foundation opened the meeting with a discussion of the central elements of a capitalist economy: private property, freedom of contract, and the rule of law. Professor David Meiselman of Virginia Polytechnic Institute spoke on stock markets, emphasizing their multifarious structures and their evolution out of the market. Richard Hite, a Mises fellow, urged completely open borders, with no import or export restrictions, tariffs, or subsidies. Dr. Roy Cordato of the Institute for Research on the Economics of Taxation explained how taxes can be destructive to prosperity. Sheldon Richman of the Institute for Humane Studies cautioned against starting a state social security or welfare system and explained how private alternatives are more responsive to people's needs. Edwin Vieira of the National Right to Work Foundation lectured on the economics of labor and monetary reform. Joe Cobb of the Joint Economic Committee gave a blueprint for moving away from the ruble toward a sound Lithuanian currency. Doug Bandow of the Cato Institute chronicled the failures of foreign aid and urged them not to accept any if offered. Dr. Yuri N. Maltsev, International Center for Development Policy, and former economic reform adviser to Gorbachev, spoke about the obstacles, in the form of foreign interference and special interest pleading, that they face in privatizing industry. Alex Tabarrok, a Mises fellow, urged that reforms take the shape of revolution rather than evolution, and credited Ludwig von Mises with laying the proper theoretical discussion. Fertig Center Director Jeffrey Tucker organized the conference and moderated the discussion.

The Lithuanians attending were pleased with the advice they received and engaged in a wide-ranging question and answer session. The Lithuanians were: Filomean Jaseviciene, head of the economics department of the Council of Ministries; Kestutis Claveokac, professor of economics at Vilnius University (and translator of *The Incredible Bread Machine*); Kestutis Baltramaitis, member of the Economic Reform Commission of the Council of Ministries; Algis Dobrovolskis, minister of social security; Vytenis Aleskaitis, member of the Economic Reform Department in the Ministry of Economic Affairs; and Romualdas Visokavicius, president of the Bank of Commerce and Industry. Saul Anuzis, Michigan political consultant, served as their interpreter.

Some Remarks to the Lithuanian Delegation

by Roy E. Cordato

There is no point in talking about taxes in the context of a socialist economy without private property, a price system, or rational economic calculation. So my remarks assume you have already made radical changes toward a free market.

Taxes are an intrusion into the free market system and keep it from operating as efficiently as it otherwise would. In a fundamental sense, taxation subverts private property and is inconsistent with the notion of voluntary exchange. I emphasize this point because taxation should not be viewed as a 'tool of fiscal policy,' i.e., as a way of enhancing market outcomes or 'controlling aggregate demand'—regardless of what you may have read in Paul Samuelson's textbook on the principles of economics. If you must have taxation, it should be structured so that it does the least amount of damage to market decision-making and the price system as possible. I would like to mention a few basic principles.

First, a tax system can easily be a deterrence to saving and investment. Broad-based income taxes are, by their very nature, biased against saving relative to consumption. There are many ways of demonstrating this point but the easiest is to simply point out that, under such a system, the returns to savings, for example interest income, is taxed while the returns to consumption, inherently non-pecuniary, are not. Because of this the tax system will cause savings rates to be inordinately low, interest rates to be high, and investment and capital formation to be lower than they otherwise would be. There are several possible ways to remedy this bias, the most straightforward of which is to exempt all returns to saving from the taxable income base.

Second, avoid progressive taxation. A progressive tax inordinately penalizes increased work effort and productive efforts of all kinds and therefore adversely affects economic growth.

Third, keep tax rates low. By definition, income taxes penalize productivity; the higher the tax rate, the greater the penalty. Both the economic well-being and the freedom of the population will best be served by the lowest possible tax rate. Finally, and this is especially true in a democratic society, the tax system should serve the function of making the people acutely aware of the cost of government. This means that hidden taxes—such as corporate taxes, value added taxes, inflation taxes, and deficit spending—should be avoided. This is also an argument against withholding taxes from paychecks as is done in this country.

You have an opportunity to create an economy that incorporates the lessons taught from our country's mistakes. Taxation is a great place to start.

A tax system should serve to make people acutely aware of the cost of government.

by Alexander Tabarrok

There are two opposing schools of thought on how quickly to de-socialize: the evolutionary and the revolutionary. The evolutionists argue that to avoid painful dislocations and frictions de-socialization must occur gradually and it must follow a well-publicized plan. According to this argument, slow and well-publicized privatization, de-regulation, and spending cuts gives people time to adapt themselves to changes which they know must eventually occur, thus reducing the costs of de-socialization. In my judgment instituting this plan would be a profound mistake. A successful program to de-socialize must involve rapid change on all fronts. It requires revolutionary change, a complete break with the past. There are three reasons for the superiority of a revolutionary program of de-socialization: political, economic, and empirical.

First, the political reasons. The socialist state benefits special interest at the expense of the general interest. De-socialization, whether done quickly or slowly, upsets the status quo. Many groups in society will initially lose power, prestige, and wealth. There will be a time of political turmoil when such groups may even comprise a majority of the population. There are, short-term losses which must precede long-term gains. Although everyone in society will eventually benefit from de-socialization, no one will want to take the first painful steps. In fact, powerful special interest groups from all sectors of society will oppose any changes no matter how beneficial and necessary. Given time to prepare a counterattack these groups will exert intense political pressure to maintain the status quo. The only way to overcome such pressures is to make changes quickly and with little warning.

Second, the economic reasons. The economy is an integrated system. Every part of it affects every other part. Freeing one sector of the economy while leaving another chained is like pulling a string in two directions at once. It creates strain and tension and if the pressures are great enough the string (the economy) may break. To take one example, the Chinese learned that the profit motive is an important incentive for the production of goods, but the concept of profit is only meaningful in a free market price system. In a free market, profits indicate to entrepreneurs what goods are highly valued. A system with profits but no free market prices is the worst of all. Entrepreneurs then have greater incentives to produce goods which no one wants. Such a system is completely unstable and worse than one with neither profit nor market prices. Hence all areas and aspects of a free market should be instituted at one time.

Third, the empirical reasons. Gorbachev began his reforms slowly. The Russian economy has, in consequence, remained moribund and in some respects the situation has gotten worse. He is now being forced to proceed faster, to move up the date of planned reforms, to become more radical. All of this is good but he is likely to face more opposition to reforms than if he had done this several years ago. [Note: Several weeks after this meeting, Gorbachev was forced to retract and compromise on his promise to speed up the pace of reform.] People are more suspicious of reforms which seem to only have made things worse; their patience is wearing thin. If Gorbachev had begun reforms on a more radical note, there would have been dislocations but they would have been resolved fairly quickly and they would have occurred at a time when the people were more willing to bear the costs of a new program. Compare the example of Russia today with West Germany of 40 years ago. At the end of the war, the German economy was in worse shape than the Russian economy of today. The German finance minister Ludwig Erhard was advised by British and American economists to reform slowly and to maintain a large measure of government control over the economy. Erhard, however, disagreed and in a show of courage he issued orders that all price controls be lifted immediately. Because he knew that the British and American advisers would never support such a policy he issued his orders on a Sunday when they were absent. Within weeks the store shelves began to fill and Germany was on its way to becoming a largely free enterprise and extremely successful economy.

That Ludwig Erhard supported free enterprise was no accident. He was a student of the ideas of Ludwig von Mises, one of the 20th century's greatest defenders of liberty. Mises's advice and thought have been of paramount importance to defenders of liberty everywhere. I hope they can benefit your country as well. ■

(Rothbard continued from page 5)

Q: *Why isn't private deposit insurance viable ?*

A: Insuring any bankrupt industry isn't viable. You can't insure entrepreneurs because they engage in uninsurable risk. You can reasonably predict how many fires there will be in New York; the unlucky few who get burned can dip into the pool of resources. But entrepreneurship is not heterogeneous; it is completely unpredictable, and each attempt is non-random. The entrepreneur assumes the risk. If an insurance company insures it, it becomes the entrepreneur. Who then insures the insurer? With banks, either they don't need insurance, since they are 100% covered, or are uninsurable because they are taking entrepreneurial risk.

Q: *Why are you critical of Larry White's book on free banking?*

A: For one thing, it says the Scottish banking system was more successful than the English. But he doesn't say one word about prices, inflation, or business cycles. His only statistic is there were fewer bank failures in Scotland than Britain. What's so great about not having failures? An industry that doesn't have failures might be doing poorly. What if we applied this test to the Soviet Union, where no industries fail? When you say one banking system is more successful than another, it seems the test should be less inflation and fewer business cycles. Yet this is never mentioned.

Q: *What role do you think* The Review of Austrian Economics *is playing?*

A: It is finding and gathering Austrian economists, getting them to write, and developing economic doctrine. Kluwer Academic Publishers is very excited about it. Now that we are twice a year, many more people are interested in the *RAE* as an important publishing medium. Kluwer is also publishing a series of books in Austrian economics, for which we are the general editors.

Q: *What should young Austrians be concentrating on?*

A: Adding to the theoretical edifice. Rent theory is underdeveloped. And the theory of the transition from socialism to capitalism is crying out for more work. Most importantly, we should never stop refuting mainstream economics. ■

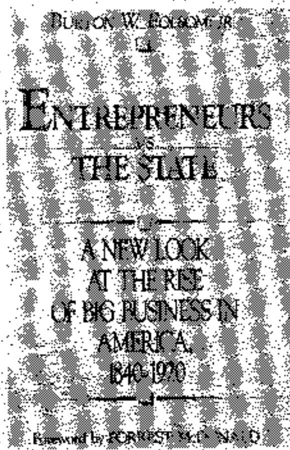
Book Bites

Entrepreneurs vs. The State: A New Look at the Rise of Big Business in America: 1840-1920

Burton W. Folsom
Young America's Foundation 1987

If there were awards for books that explode the most fallacies in the shortest space, Hayek's *Road to Serfdom* and Hazlitt's *Economics in One Lesson* would be front runners. And to this list we must now add Burton W. Folsom's masterful work *Entrepreneurs vs. the State*. While Hayek and Hazlitt dealt with politics and economics, Folsom deals with history—the history of the so-called Robber-Baron period of the late 19th- and early 20th-century America.

Folsom tells the story of five American entrepreneurs: Commodore Vanderbilt (steamships), James J. Hill (railroads), the Scranton family (iron), Charles Schwab (steel), and John D. Rockefeller (oil). His perspective is revisionist. As Folsom notes, with the "triumph of market entrepreneurs" came technological improvements, lower prices, more services, and a higher standard of living. For example, Vanderbilt managed to cut his New York to Albany steamship fare "from 3 dollars to one dollar, then to ten cents, and finally to nothing," by improving efficiency, cutting costs, and selling snacks. It seems anything Vanderbilt touched, he improved. This anecdote only



hints at the treasure trove of fact and economic insight contained here. Folsom shows that each entrepreneur achieved great things, even if they have gone unrecognized. He also provides excellent discussion of the shameful misconceptions that pervade our history textbooks.

The only lacuna is Folsom's neglect of public-choice insights. In places, Folsom suggests government intervention sounded noble but ended up being harmful because of "unintended consequences." This however is a minor oversight in this bold and exciting look at America's true entrepreneurial heritage. It deserves the widest possible readership. AT ■

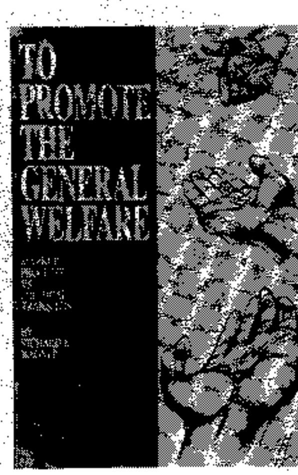
To Promote the General Welfare: Market Processes vs. Political Transfers

Richard E. Wagner
Pacific Research Institute for Public Policy, 1989

Written for both academic and non-academic audiences, this is a readable introduction to how public-choice analysis can enhance understanding of the political system. It concentrates on the effectiveness of government transfer programs and the incentives they create.

There are two types of contractarian states, says Wagner, the protective and the productive. The protective is a night-watchman; an enforcer of constitutional laws and not their creator. The productive state is a mechanism for collective groups to circumvent the occurrence of externalities rather than insuring against them. Although transfers occur, they are incidental and not intentional.

The welfare state is entirely different; it redistributes income intentionally. Wagner dissects the welfare state and evaluates the effectiveness of government taxation and redistribution programs, showing that they consistently fail to achieve their alleged purpose. For example, they can enhance income inequality rather than reduce it. He examines two empirical studies of the progressivity of the U. S. income tax system that demonstrate its social costs and show the superiority of the proportional tax. This section, and his analysis of the Samaritan dilemma, are the most enlightening of the book. Also covered is the nature of competition among potential transfer recipients for government rents and startling empirical results on the effect of welfare programs on labor-leisure choices, horizontal and vertical group transfers, and private charity. Wagner doesn't overlook the more subtle forms of transfer programs, including government regulation, the minimum wage, professional licensing, and unionization—and shows who gains and loses in the process.



The operation and faults of majoritarian democracy are also analyzed, showing the role logrolling plays in political decision making and how democracy gives rise to transfer programs which enables politicians to secure rents. Transfers are viewed by legislators in a partial equilibrium context; members only consider the impact of programs under their control and thus try to maximize their rents. Calculations are not made in full equilibrium, under which the entire impact of increased spending and regulation would be considered.

It is an outstanding contribution which subjects performance of the welfare state to rational economic analysis. RH ■

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