this law is not a disguised definition—that they maximize what they maximize. It is true that utility has no concrete content, because economics is concerned not with the content of a man's ends, but with the fact that he has ends. And this fact, being deduced directly from the Action Axiom, is absolutely true.[10]

We come finally to Mises's ultimate heresy in the eyes of Professor Hutchison: his alleged logical deduction of "wholesale political conclusions" from the axioms of economic science. Such a charge is completely fallacious, particularly if we realize that Professor Mises is an uncompromising champion of "Wertfreiheit" not only in economics, but also for all the sciences. Even a careful reading of Hutchison's selected quotations from Mises will reveal no such illegitimate deductions.[11] Indeed, Mises's economics is unrivaled for its avoidance of unanalyzed *ad hoc* value judgments, slipped into the *corpus* of economic analysis.

Dean Rappard has posed the question: how can Mises be at the same time a champion of "Wertfreiheit in economics and of *laissez-faire*" liberalism, a "dilemma" which leads Professor Hutchison to accuse Mises of making political deductions from economic theory?[12]

The following passages from Mises give the clue to this puzzle:

> Liberalism is a political doctrine. . . . As a political doctrine liberalism (in contrast to economic science) is not neutral with regard to values and ultimate ends sought by action. It assumes that all

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[10]See Hutchison, "Professor Machlup on Verification Economics," p. 480. Alan Sweezy fell into the same error when he charged that Irving Fisher's dictum: "each individual acts as he desires," since not meant as a testable proposition in psychology, must reduce to the empty "each individual acts as he acts." On the contrary, the dictum is deducible directly from the Action Axiom, and is therefore both empirically meaningful and apodictically true. See Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," pp. 225–28.

[11]Thus: "Liberalism starts from the pure sciences of political economy and sociology which within their systems make no valuations and say nothing about what ought to be or what is good or bad, but only ascertain what is and how it is." Quoted by Hutchison, "Professor Machlup on Verification Economics," p. 483*n*.

[12]William E. Rappard, "On Reading von Mises," in *On Freedom and Free Enterprise*, M. Sennholz, ed., pp. 17–33.

> men or at least the majority of people are intent upon attaining certain goals. It gives them information about the means suitable to the realization of their plans. The champions of liberal doctrines are fully aware of the fact that their teachings are valid only for people who are committed to their valuational principles. While praxeology, and therefore economics too, uses the terms happiness and removal of uneasiness in a purely formal sense, liberalism attaches to them a concrete meaning. It presupposes that people prefer life to death, health to sickness . . . abundance to poverty. It teaches men how to act in accordance with these valuations.[13]

Economic science, in short, establishes existential laws, of the type: if A, then B. Mises demonstrates that this science asserts that *laissez-faire* policy leads to peace and higher standards of living for all, while statism leads to conflict and lower living standards. Then, Mises as a citizen chooses *laissez-faire* liberalism because he is interested in achieving these ends. The only sense in which Mises considers liberalism as "scientific" is to the extent that people unite on the goal of abundance and mutual benefit. Perhaps Mises is overly sanguine in judging the extent of such unity, but he never links the valuational and the scientific: when he says that a price control is "bad" he means bad not from his point of view as an economist, but from the point of view of those in society who desire abundance. Those who choose contrasting goals—who favor price controls, for example, as a route to bureaucratic power over their fellow men, or who, through envy, judge social equality as more worthwhile than general abundance or liberty—would certainly not accept liberalism, and Mises would certainly never say that economic science proves them wrong. He never goes beyond saying that economics furnishes men with the knowledge of the consequences of various political actions; and that it is the citizen's province, knowing these consequences, to choose his political course.

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[13]Mises, *Human Action*, pp. 153–54; also see pp. 879–81.

7

Praxeology: Reply to Schuller

Rather than prolong my discussion with Mr. Schuller[1] unnecessarily by engaging further in a point-by-point refutation, I think it important to clarify the nature of praxeology and its applicability to historical events.

The fundamental praxeological axiom is that individual human beings act. Praxeology reveals the implications of the concept of "action." Action results from the fact that the individual "actor" believes that there are other states of being preferable to the one in which he is at present, and from his belief that he may take certain steps which will bring him to a more satisfactory state. Given these preferences and "technological" ideas, the individual acts upon them in order to arrive at a more satisfactory state. The preferred state which the actor expects to attain is his "end"; the steps by which the actor attempts to attain his goal are the "means."[2] It is this praxeological concept of action that distinguishes the observed movements of men from those of inorganic matter.[3]

Originally appeared as "Praxeology: Reply to Mr. Schuller," in *American Economic Review* (December 1951).

[1]*American Economic Review* XL, no. 3 (June 1950): 418–22; XLI, no. 1 (March 1951): 181–90.

[2]Although he did not use the term, Professor Talcott Parsons engaged in profound praxeological analysis in his *Structure of Social Action* (Glencoe, Ill.: The Free Press, 1949). Cf., esp. chap. 2, pp. 44–50.

[3]The difficult case of animal behavior, ranging from the lower organisms to the higher primates, cannot be discussed here.

This axiom of action is indisputably an important truth, and must form the basis for social theory. To deny it would be absurdity. How has our knowledge of the truth of this axiom been attained? In this way: an individual reflects, discovers the concept of action and its applicability to all human individuals, analyzes its components, and then sets it forth orally or by the written word. Each individual, upon reflecting on the axiom of action, must agree to its truth and to its importance. It is in this respect that the action axiom must be "universally recognized as true."[4] What name we apply to this method of obtaining knowledge is basically unimportant and involves irrelevant philosophical problems; thus, it may be called "introspective," "empirical," "a priori," or "reflective." The important consideration is that it is certainly a different type of "empiricism" from the study of historical events and is definitely "a priori" to those events, and that such a situation has no parallel in the physical sciences. The physical sciences are not in the fortunate position of positively knowing their fundamental axioms. On the other hand, the physical sciences are in a position to isolate causal factors in experiments. The physical sciences, then, have to arrive at their axioms by hypothesis and by experimental testing of conclusions deduced from these hypothecated axioms. In the "social sciences," the fundamental axioms of praxeology are known from the beginning, so that substantive conclusions may be drawn by means of logical deduction. In human historical events, however, causal factors cannot be experimentally isolated, so that the historian must explain by the use of judgment which praxeological laws apply in the particular situation.

Explanation of the roles of praxeological laws and historical judgment or "understanding" may be provided by the following example: If the supply of a medium of exchange increases; and if the demand for that medium remains the same; then, the purchasing power of that medium will decline. This is a praxeological law. How may an historian apply this law? He must first determine whether or

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[4]Schuller's questioning of the validity of the praxeological axioms and procedures on the basis of the possible inability of the vast majority to grasp them is an old problem for the physical sciences. How can Einstein's theory of relativity be true if the mass of the people cannot understand the demonstration of its validity? Whatever solution physical science has developed for this puzzle may be adopted by praxeology as well.

not a decline in purchasing power (increase in prices) has taken place. This involves difficulties of an historical-statistical nature; it is not a problem for praxeology or for that elaborated division of it known as "economic theory" or "catallactics." Once he has determined that a fall in purchasing power of the medium has taken place, he searches for an explanation by applying the praxeological-catallactic law. He investigates the historical situation to discover whether there has been an increase in the supply of the medium. If he finds a considerable increase in the supply, he is then in a position to assert three truths:

A. It is an historical fact that the purchasing power of medium X has declined to such and such an extent.

B. It is an historical fact that the supply of the medium X has increased to such and such an extent.

C. The praxeological law just mentioned. It is therefore concluded: that a significant cause of the decline, A, was the increase in supply, B.

If he finds no increase in supply, then he deduces that a fall in demand for the medium was the cause of the fall in purchasing power.

Such is an example of what is involved in the work of historical explanation. The work of the "economic theorist," or praxeologist, is to elaborate the laws (such as C) from the various axioms and according to the rules of logic. Clearly, neither Mises nor myself has ever cited "facts as if they provided support for his conclusions and for the axioms, postulates, and logical procedures." I cited facts such as "dollar gaps" not as proof or test, but as illustrations of the workings of praxeological laws in (modern) historical situations. It is a praxeological law that if the government (or any other agency exercising the power of violence) intervenes in the market to establish a valuation of any commodity below what would be the market valuation, a shortage of the commodity develops. Gresham's Law is a subdivision of this law applied to media of exchange, which, in turn, leads to the explanation of the "dollar gap." The historian sees a shortage of dollars in relation to pounds develop in England, and, using praxeological laws, explains it as the consequence of governmental over-valuation of the

pound in relation to the dollar. In no way does he test or "prove" the theory.

How may praxeology be applied to forecasting, to the prediction of future historical events? The process is essentially that of the historian, except that the difficulties are greater. Thus, using the above example, the forecaster may see a considerable increase in the money supply take place. He asserts B; C he knows as a praxeological truth. In order to forecast the probable future course of purchasing power, he must make an estimate of the probable course of the demand for money in the period under consideration. If, on the basis of his judgment, he decides that the relative change in demand will be negligible, he is in a position to predict that the purchasing power of the money unit will decline in that period. With the help of praxeology, his judgment is the best he can offer, but it is still inexact, dependent on the correctness of his estimates—in this case, of the movement in the demand for money. If he wishes to make a quantitative estimate of the change in purchasing power, his estimate is still more inexact, for praxeology can be of no help in this attempt. If his prediction proves erroneous, it is not praxeology that has failed, but his judgment of the future behavior of the elements in the praxeological theorem. Praxeology is indispensable, but it does not provide omniscience. It furnishes laws in the form of: If X, and if Y remains unchanged, then Z. It is up to the historian, and his counterpart, the forecaster, to determine the specific cases in which the law is applicable. It should now be quite clear that there are no praxeological laws of historical development, and that neither Mises nor myself need "reconcile" any "dilemmas" in setting forth such a law. If there were, then the task of the historian would be far easier than it is. Historical events are complex results of numerous causal factors: praxeologic, psychologic, physical, chemical, biological, etc. The historian must determine which science and its laws apply, and, more difficult, the extent to which each causal factor operated in the events he is attempting to explain or predict. Historians will legitimately differ on the order of importance to be attributed to each factor. Thus, various factors, praxeologic-economic, military, moral, and psychologic might be enumerated as causes of the Bolshevik Revolution. But there is no exact, scientific way of deciding the precise extent of importance to be assigned to each factor.

What of the relation between praxeology and economic theory *per se*? Economic theory as has been developed is a component part of praxeology. It is deduced from the apodictic axiom of action, and most of economic theory, including the laws and implications of Uncertainty, Time Preference, the Law of Returns, the Law of Utility, etc. can be deduced directly with no further assumptions. With the help of a very small number of subsidiary axioms which are rather more "empirical" in nature—such as "the disutility of labor"—the rest of economic theory can be deduced.

The categories of praxeology may be outlined as follows:

Praxeology—the general, formal theory of human action:

A. The Theory of the Isolated Individual (Crusoe Economics)
B. The Theory of Voluntary Interpersonal Exchange (Catallactics, or the Economics of the Market)
    1. Barter
    2. With Medium of Exchange
        a. On the Unhampered Market
        b. Effects of Violent Intervention with the Market
        c. Effects of Violent Abolition of the Market (Socialism)
C. The Theory of War—Hostile Action
D. The Theory of Games (e.g., Von Neumann and Morgenstern)
E. Unknown

Clearly, A and B—Economics—is the only fully elaborated part of praxeology. The others are largely unexplored areas.

A concluding word on all the bother about democracy, dictatorship, and government. Clearly, the praxeologist qua praxeologist cannot advocate any course of action. As a citizen, however, he may, along with other citizens, try to decide on the proper course of social policy, and, in making that decision, he will be likely to use the aid of praxeology and call attention to its usefulness. For socio-political problems, praxeology presents the citizen with one great lesson, i.e., that the use of violence for purposes of plunder injures not only the victim (which is self-evident) but, in the long run, the plunderer also. The goal of the good citizen, then, is to try to eliminate, or at

least minimize, violent plunder in the society.[5] The problem of how to arrive at this goal is still unsolved, as a glance at the state of the world today will make dramatically clear. The great problem is how to convince or persuade the would-be plunderer to consult his long-run rather than what he might interpret as his short-run interests. The traditional *laissez-faire* solution was to establish a government that would have an effective monopoly on the means of violence, and would use these means solely to prevent and punish attempts at violence within the society. This largely (although not completely) ended the problem of sporadic social violence, but created a new problem:

> *Quis custodes custodiet?* Who will guard the state itself from using its effective monopoly of violence for plunder? The most ambitious attempt to solve this problem was the "Jeffersonian" one—to establish a government that would be tightly and securely ringed with definite constitutional restrictions to confine it to its "anti-invasive" function, to instill into the people a spirit of perpetual vigilant distrust of the government and particularly the appointed bureaucracy, and to keep the government small and local in order to permit direct popular control and vigilance. In the light of the history of the past century, it is possible that this method is impracticable, and that some other means may have to be found.

Finally, may I state that though I share Schuller's hope that my interpretation of *Human Action* agrees with that of Mises, there is no warrant for any assumption to that effect.

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[5]This is aside from any moral considerations which might also lead the citizen to the goal of eliminating or minimizing the use of violence.

8

The Hermeneutical Invasion of Philosophy and Economics

In recent years, economists have invaded other intellectual disciplines and, in the dubious name of "science," have employed staggeringly oversimplified assumptions in order to make sweeping and provocative conclusions about fields they know very little about. This is a modern form of "economic imperialism" in the realm of the intellect. Almost always, the bias of this economic imperialism has been quantitative and implicitly Benthamite, in which poetry and pushpin are reduced to a single-level, and which amply justifies the gibe of Oscar Wilde about cynics, that they (economists) know the price of everything and the value of nothing. The results of this economic imperialism have been particularly ludicrous in the fields of sex, the family, and education.

So why then does the present author, not a Benthamite, now have the temerity to tackle a field as arcane, abstruse, metaphysical, and seemingly unrelated to economics as hermeneutics? Here my plea is the always legitimate one of self-defense. Discipline after discipline, from literature to political theory to philosophy to history, have been invaded by an arrogant band of hermeneuticians, and now even economics is under assault. Hence, this article is in the nature of a counterattack.

Originally appeared in the *Review of Austrian Economics* 3 (1989): 45–59. The article was adapted from a paper delivered at a Conference on Recent Trends in the Social Sciences held by the London Academic and Cultural Resources Fund and the Institute of Philosophy of the Jagellonian University of Krakow at Krakow, Poland, in April 1987.

To begin, the dictionary definition of hermeneutics is the age-old discipline of interpreting the Bible. Until the 1920s or 1930s, indeed, hermeneutics was confined to theologians and departments of religion. But things changed with the advent of the murky German doctrines of Martin Heidegger, the founder of modern hermeneutics. With the death of Heidegger, the apostolic succession of head of the hermeneutical movement fell upon his student, Hans-Georg Gadamer, who still wears this mantle.

The greatest success of the hermeneutical movement has been achieved in recent decades, beginning in the closely related movement of "deconstructionism" in literary criticism. Headed by the French theorists Michel Ricoeur, Paul Ricoeur, and Jacques Derrida, deconstructionism in the Western Hemisphere is led by the formidable English department at Yale University, from which it has spread to conquer most of the English-literature departments in the United States and Canada. The essential message of deconstructionism and hermeneutics can be variously summed up as nihilism, relativism, and solipsism. That is, either there is no objective truth or, if there is, we can never discover it. With each person being bound to his own subjective views, feelings, history, and so on, there is no method of discovering objective truth. In literature, the most elemental procedure of literary criticism (that is, trying to figure out what a given author meant to say) becomes impossible. Communication between writer and reader similarly becomes hopeless; furthermore, not only can no reader ever figure out what an author meant to say, but even the author does not know or understand what he himself meant to say, so fragmented, confused, and driven is each particular individual. So, since it is impossible to figure out what Shakespeare, Conrad, Plato, Aristotle, or Machiavelli meant, what becomes the point of either reading or writing literary or philosophical criticism?

It is an interesting question, one that the deconstructionists and other hermeneuticians have of course not been able to answer. By their own avowed declaration, it is impossible for deconstructionists to understand literary texts or, for example, for Gadamer to understand Aristotle, whom he has nevertheless written upon at enormous length. As the English philosopher Jonathan Barnes has pointed out in his brilliant and witty critique of hermeneutics, Gadamer, not having anything to say about Aristotle or his works, is reduced to reporting his own subjective musings—a sort of lengthy account of "what

Aristotle means to me."[1] Setting aside the hermeneutical problem of whether or not Gadamer can *know* even what Aristotle means to him, we push back the problem another notch. Namely, why in the world should anyone but Gadamer, except possibly his mother or wife, be in the least interested in the question of what Aristotle means to him? And even in the improbable event that we *were* interested in this earth-shattering question, we would in any case be prevented on hermeneutical principles from understanding Gadamer's answer.

Deconstruction and hermeneutics are clearly self-refuting on many levels. If we cannot understand the meaning of any texts, then why are we bothering with trying to understand or to take seriously the works or doctrines of authors who aggressively proclaim their own incomprehensibility?

Incomprehensibility

Indeed, a crucial point about the hermeneuticians is that, for them, incomprehensibility is a self-fulfilling prophecy. As a colleague of mine ruefully told me: "I have read everything on hermeneutics I can lay my hands on, and I understand no more about it than I did when I first started." Even in a profession—philosophy—not exactly famous for its sparkle or lucidity, one of the most remarkable qualities of the hermeneuticians is their horrendous and incomparably murky style. Stalactites and stalagmites of jargon words are piled upon each other in a veritable kitchen midden of stupefying and meaningless prose. Hermeneuticians seem to be incapable of writing a clear English, or indeed a clear German sentence. Critics of hermeneutics—such as Jonathan Barnes or David Gordon[2]—are understandably moved to satire, to stating or quoting hermeneutical tracts and then "translating" them into simple English, where invariably they are revealed as either banal or idiotic.

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[1]Jonathan Barnes, "A Kind of Integrity Review of Hans-Georg Gadamer," *Philosophical Apprenticeships* (Cambridge, Mass.: MIT Press, 1985); Hans-Georg Gadamer, *The Idea of the Good in Platonic-Aristotelian Philosophy* (New Haven, Conn.: Yale University Press, 1986); *London Review of Books* (November 6, 1986): 12–13.

[2]Barnes, "A Kind of Integrity;" and David Gordon, *Hermeneutics versus Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1986).

At first, I thought that these German hermeneuticians were simply ill-served by their translators into English. But my German friends assure me that Heidegger, Gadamer et al. are equally unintelligible in the original. Indeed, in a recently translated essay, Eric Voegelin, a philosopher not normally given to scintillating wit, was moved to ridicule Heidegger's language. Referring to Heidegger's master work, *Sein und Zeit* (Being and Time), Voegelin refers to the meaningless but insistent repetition of a veritable philosophical dictionary of phrases as the *Anwesen des Anwesenden* ("the presence of that which is present"), the *Dingen des Dings* ("the thinging of the thing"), the *Nichten des Nichts* ("the nothinging of the nothing"), and finally to the *zeigenden Zeichen des Zeigzeugs* ("the Pointing sign of the pointing implement"), all of which is designed, says Voegelin, to whip up the reader "into a reality-withdrawing state of linguistic delirium."[3]

On Gadamer and the hermeneuticians, Jonathan Barnes writes:

> What, then, are the characteristic features of hermeneutical philosophy? Its enemies will wade in with adjectives like *empty, vapid, dreamy, woolly, rhetorical*. Gadamer himself tells an uncharacteristic story. At the end of a seminar on Cajetan, Heidegger once startled his devoted audience by posing the question: "What is being?" "We sat there staring and shaking our heads over the absurdity of the question." Quite right too, say the enemies of hermeneutics: the question is perfectly absurd. But Gadamer has only a frail sense of the absurd, and his own readers ought to react as he once—but alas, only once—reacted to Heidegger.

Barnes goes on to say that Gadamer admits "that his thought has sometimes been less than pellucid." He further quotes Gadamer as saying:

> Certainly I sometimes spoke over my pupils' heads and put too many complications into my train of thought. Even earlier my friends had invented a new scientific measure, the "Gad," which designated a settled measure of unnecessary complications.

Barnes adds that:

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[3]Eric Voegelin, "The German University and the Order of German Society: A Reconsideration of the Nazi Era," *Intercollegiate Review* 20 (Spring/Summer, 1985): 11.

> Some may prefer to this self-congratulatory little story a remark which Gadamer makes of his younger self: "Despite my title of doctor, I was still a 22-year old boy who thought rather murky thinking, and who still did not really know what was going on."

Barnes adds: "Did the boy ever grow up?"[4]

At this point we may cite Sir Karl Popper on G.W.F. Hegel, who counts along with Friedrich Schleiermacher as at least a great-grandfather of hermeneutics. What Popper lacks in satiric gifts he makes up in the vehemence of the scorn that he heaps upon the legion of his philosophical enemies, real or imagined. After denouncing Hegel's "high-flown gibberish" and "imbecile fancies," Popper quotes with obvious relish the attack on Hegel by his contemporary Schopenhauer as:

> a flat-headed, insipid, nauseating, illiterate charlatan, who reached the pinnacle of audacity in scribbling together and dishing up the craziest mystifying nonsense. This nonsense has been noisily proclaimed as immortal wisdom by mercenary followers and readily accepted as such by all fools, who thus joined into as perfect a chorus of admiration as had ever been heard before.[5]

Why this enormous acclaim and influence exerted by mystifying nonsense? In addition to noting its establishment in the interests of the Prussian state, Popper offers the following explanation:

> For some reason, philosophers have kept around themselves, even in our day, something of the atmosphere of the magician. Philosophy is considered a strange and abstruse kind of thing, dealing with those mysteries with which religion deals, but not in a way which can be "revealed unto babes" or to common people; it is considered to be too profound for that, and to be the religion and theology of the intellectuals, of the learned and wise.[6]

For a final citation on the incomprehensibility of hermeneutics, let us turn to the witty and devastating demolition by H.L. Mencken of Thorstein Veblen, another early protohermeneutician and an institutionalist opponent of the idea of economic law. In the course

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[4]Barnes, "A Kind of Integrity," p. 13.

[5]Karl R. Popper, *The Open Society and its Enemies*, 4th ed. (New York: Harper and Row, 1962), vol. 2, p. 33.

[6]Ibid., p. 30.

of an essay featuring the "translation" into English of Veblen's indecipherable prose, Mencken wrote that what was truly remarkable about Veblen's ideas:

> was the astoundingly grandiose and rococo manner of their statement, the almost unbelievable tediousness and flatulence of the gifted headmaster's prose, his unprecedented talent for saying nothing in an august and heroic manner. . . .
>
> Marx, I daresay, had said a good deal of it long before him, and what Marx overlooked had been said over and over again by his heirs and assigns. But Marx, at this business, labored under a technical handicap; he wrote in German, a language he actually understood. Prof. Veblen submitted himself to no such disadvantage. Though born, I believe, in these States, and resident here all his life, he achieved the effect, perhaps without employing the means, of thinking in some unearthly foreign language—say Swahili, Sumerian or Old Bulgarian—and then painfully clawing his thoughts into a copious and uncertain but book-learned English. The result was a style that affected the higher cerebral centers like a constant roll of subway expresses. The second result was a sort of bewildered numbness of the senses, as before some fabulous and unearthly marvel. And the third result, if I make no mistake, was the celebrity of the professor as a Great Thinker.[7]

Collectivism

Marx, in fact, has been hailed by the hermeneuticians as one of the grandfathers of the movement. In 1985, for example, at the annual meeting of the Western Political Science Association in Las Vegas, virtually every paper offered in political theory was a hermeneutical one. A paradigmatic title would be "Political Life as a Text: Hermeneutics and Interpretation in Marx, Heidegger, Gadamer, and Foucault." (Substitute freely such names as Ricoeur and Derrida, with an occasional bow to Habermas.)

I do not believe it an accident that Karl Marx is considered one of the great hermeneuticians. This century has seen a series of devastating setbacks to Marxism, to its pretensions to "scientific truth," and to its theoretical propositions as well as to its empirical assertions

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[7]H.L. Mencken, "Professor Veblen," *A Mencken Chrestomathy* (New York: Alfred A. Knopf, 1949), p. 270.

and predictions. If Marxism has been riddled both in theory and in practice, then what can Marxian cultists fall back on? It seems to me that hermeneutics fits very well into an era that we might, following a Marxian gambit about capitalism, call "late Marxism" or marxism-in-decline. Marxism is not true and is not science, but so what? The hermeneuticians tell us that nothing is objectively true, and therefore that all views and propositions are subjective, relative to the whims and feelings of each individual. So why should Marxian yearnings not be equally as valid as anyone else's? By the way of hermeneutics, these yearnings cannot be subject to refutation. And since there is no objective reality, and since reality is created by every man's subjective interpretations, then all social problems reduce to personal and nonrational tastes. If, then, hermeneutical Marxists find capitalism ugly and unlovely, and they find socialism beautiful, why should they not attempt to put their personal esthetic preferences into action? If they feel that socialism is beautiful, what can stop them, especially since there are no laws of economics or truths of political philosophy to place obstacles in their path?

It is no accident that, with the exception of a handful of contemporary economists—who will be treated further later—every single hermeneutician, past and present, has been an avowed collectivist, either of the left- or right-wing variety, and sometimes veering from one collectivism to another in accordance with the realities of power. Marx, Veblen, Schmoller, and the German Historical School are well known. As for the modern hermeneuticians, Heidegger found it all too easy to become an enthusiastic Nazi once the Nazi regime had been established. And Gadamer had no difficulty whatever adapting either to the Nazi regime (where he was known for having only a "loose sympathy" with the Third Reich) or to the Soviet occupation in East Germany (where, in his own words, he won "the special esteem of the Russian cultural authorities" for carrying out "their directives exactly, even against my own convictions").[8]

"Openness" and Keeping the "Conversation" Going

Here we must note two variants of the common hermeneutical theme. On the one hand are the candid relativists and nihilists, who

[8]Barnes, "A Kind of Integrity," p. 12.

assert, with an inconsistently absolutist fervor, that there is no truth. These hold with the notorious dictum of the epistemological anarchist Paul Feyerabend that "anything goes." Anything, be it astronomy or astrology, is of equal validity or, rather, equal invalidity. The one possible virtue of the "anything goes" doctrine is that at least everyone can abandon the scientific or philosophic enterprise and go fishing or get drunk. This virtue, however, is rejected by the mainstream hermeneuticians, because it would put an end to their beloved and interminable "conversation." In short, the mainstream hermeneuticians do not like the "anything goes" dictum because, instead of being epistemological anarchists, they are epistemological pests. They insist that even though it is impossible to arrive at objective truth or indeed even to understand other theorists or scientists, that we all still have a deep moral obligation to engage in an endless dialogue or, as they call it, "conversation" to try to arrive at some sort of fleeting quasi-truth. To the hermeneutician, truth is the shifting sands of subjective relativism, based on an ephemeral "consensus" of the subjective minds engaging in the endless conversation. But the worst thing is that the hermeneuticians assert that there is no objective way, whether by empirical observation or logical reasoning, to provide any criteria for such a consensus. Since there are no rational criteria for agreement, any consensus is necessarily arbitrary, based on God-knows-what personal whim, charisma of one or more of the conversationalists, or perhaps sheer power and intimidation. Since there is no criterion, the consensus is subject to instant and rapid change, depending on the arbitrary mind-set of the participants or, of course, a change in the people constituting the eternal conversation.

A new group of hermeneutical economists, eager to find some criteria for consensus, have latched onto a Gestalt-like phrase of the late economist Fritz Machlup, perhaps taking his name very much in vain. They call this criterion the "Aha! principle," meaning that the truth of a proposition is based on the exclamation of "Aha!" that the proposition may arouse in someone's breast. As Don Lavoie and Jack High put it: "We know a good explanation when we see one, and when it induces us to say aha."[9] Somehow I do not find this criterion for truth, or even for consensus, very convincing. For example, many

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[9]Don Lavoie and Jack High, "Interpretation and the Costs of Formalism" (unpublished manuscript), p. 14.

of us would find the prospect of being confronted with the option of engaging in endless and necessarily fruitless conversation with people unable to write a clear sentence or express a clear thought to be the moral equivalent of Sartre's *No Exit*. Furthermore, I have a hunch that if someone came up with the proposition: "It would be a great thing to give these guys a dose of objective reality over the head" or at the very least to slam the door on their conversation, that this would elicit many more fervent "Ahas!" than the murky propositions of the hermeneuticians themselves.

The prime moral duty proclaimed by the hermeneuticians is that we must at all times keep the *conversation* going. Since this duty is implicit, it is never openly defended, and so we fail to be instructed why it is our moral obligation to sustain a process that yields such puny and ephemeral results. In keeping with this alleged virtue, the hermeneuticians are fervently and dogmatically opposed to "dogmatism" and they proclaim the supreme importance of remaining endlessly "open" to everyone in the dialogue. Gadamer has proclaimed that the highest principle of hermeneutic philosophy is "holding oneself open in a conversation," which means always recognizing "in advance, the possible correctness, even the superiority of the conversation partner's position." But, as Barnes points out, it is one thing to be modestly skeptical of one's own position; it is quite another to refuse to dismiss *any other* position as false or mischievous. Barnes points out that the modest skeptic:

> recognizes that he himself may always be wrong. Gadamer's "open" philosopher allows that his opponent may always be right. A modest skeptic may . . . indeed, in his modest way, regard the history of philosophy as a ceaseless campaign, marked by frequent defeats and occasional triumphs, against the ever powerful forces of fallacy and falsehood. . . . [W]ith some opponents he will not be "open": he will be quite sure that they are wrong.[10]

The most important hermeneutical philosopher in the United States is Richard Rorty, who, in his celebrated book, *Philosophy and the Mirror of Nature*, devotes considerable space to the prime importance

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[10]Barnes, "A Kind of Integrity," p. 13. For a critique of the triumph of the ideal of "openness," see Allan Bloom, *The Closing of the American Mind* (New York: Simon and Schuster, 1987).

of "keeping the conversation going." In his sparkling critique of Rorty, Henry Veatch points out that, to the crucial question of how can we conversationalists ever know which ideals or "cultural posits" (in the Rortian language) are better than others, "Rorty could only answer that, of course, there can't be any such thing as *knowledge* in regard to matters such as these." So, if there is no knowledge and, hence, no objective criteria for arriving at positions, we must conclude, in the words of Veatch, that "although Aristotle may well have taught that 'philosophy begins in wonder,' . . . present-day philosophy can only end in a total conceptual or intellectual permissiveness."[11] In short, we end with the Feyerabendian "anything goes" or, to use the admiring phrase of Arthur Danto in his summary of Nietzsche, that "everything is possible."[12] Or, in a word, total "openness."

But if all things are open, and there are no criteria to guide conversationalists to any conclusions, how will such conclusions be made? It seems to me, following Veatch, that these decisions will be made by those with the superior Will-to-Power. And so it is not a coincidence that leading hermeneuticians have found themselves flexible and "open" in response to the stern demands of state power. After all, if Stalin, Hitler, or Pol Pot enters the "conversational" circle, they cannot be rejected out of hand, for they too may offer a superior way to consensus. If nothing is wrong and all things are open, what else can we expect? And who knows, even these rulers may decide, in a sardonic burst of Marcusean "repressive tolerance," to keep some sort of Orwellian "conversation" going in the midst of a universal gulag.

In all the blather about openness, I am reminded of a lecture delivered by Professor Marjorie Hope Nicholson at Columbia University in 1942. In a critique of the concept of the open mind, she warned: "Don't let your mind be so open that everything going into it falls through."

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[11]Henry Veatch, "Deconstruction in Philosophy: Has Rorty Made It the Denouement of Contemporary Analytical Philosophy?" *Review of Metaphysics* 39 (December 1985): 313–14, 316.

[12]Arthur C. Danto, *Nietzsche as Philosopher* (New York: Columbia University Press, 1980), p. 12; cited in Veatch, "Deconstruction," p. 312.

There is another self-serving aspect to the hermeneutical demands for universal openness. For if nothing—no position, no doctrine—can be dismissed outright as false or mischievous or as blithering nonsense, then they too, our hermeneuticians, must be spared such rude dismissal. Keeping the conversation going at all costs means that these people must eternally be included. And that is perhaps the unkindest cut of all.

If one reads the hermeneuticians, furthermore, it becomes all too clear that typically no one sentence follows from any other sentence. In other words, not only is the style abominable, but there is no reasoning in support of the conclusions. Since logic or reasoning are not considered valid by the hermeneuticians, this procedure is not surprising. Instead, for reasoning the hermeneuticians substitute dozens or scores of books, which are cited, very broadly, in virtually every paragraph. To support their statements, the hermeneuticians will list repeatedly every book that might possibly or remotely relate to the topic. In short, their only argument is from authority, an ancient philosophic fallacy which they seem to have triumphantly revived. For indeed, if there is no truth of reality, if for logic or experience, we must substitute a fleeting consensus of the subjective whims, feelings, or power plays of the various conversationalists, then what else is there but to muster as many conversationalists as possible as your supposed authorities?[13]

Armed with their special method, the hermeneuticians are therefore able to dismiss all attacks upon themselves, no matter how perceptive or penetrating, as "unscholarly." This lofty rebuttal stems from their unique definition of *scholarly*, which for them means ponderous and obscurantist verbiage surrounded by a thicket of broad citations to largely irrelevant books and articles.

So why then have not the distinguished critics of hermeneutics played the game on their opponents' own turf and waded through the mountains and oceans of hogwash, patiently to cite and refute the hermeneuticians point by point and journal article by journal article? To ask that question is virtually to answer it. In fact, we have asked some of the critics this question, and they immediately responded in a heartfelt manner that they do not propose to dedicate

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[13]I am indebted for this point to Sheldon Richman of the Institute for Humane Studies at George Mason University.

the rest of their lives to wading through this miasma of balderdash. Moreover, to do so, to play by the hermeneuticians' own rules, would be to grant them too much honor. It would wrongfully imply that they are indeed worthy participants in our conversation. What they deserve instead is scorn and dismissal. Unfortunately, they do not often receive such treatment in a world in which all too many intellectuals seem to have lost their built-in ability to detect pretentious claptrap.[14]

Hermeneutical Economics

Economists like to think of their discipline as the "hardest" of the social sciences, and so it is no surprise that hermeneutics—though having conquered the field of literature and made severe inroads into philosophy, political thought, and history—has yet made very little dent in economics. But the economics discipline has been in a state of methodological confusion for over a decade, and in this crisis situation minority methodologies, now including hermeneutics, have begun to offer their wares.

In the economics profession, of course, the practitioners down in the trenches only loosely reflect, or indeed have scarcely any interest in, the small number of methodological reflections in the upper stories of the ivory tower. But these seemingly remote philosophical musings do have an important long-run influence on the guiding theories and directions of the discipline. For approximately two decades, Lionel Robbins's justly famous *The Nature and Significance of Economic Science* was the guiding methodological work of the profession,

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[14]In a witty and perceptive article, the distinguished Yale philosopher Harry Frankfurt calls this phenomenon "bullshit," which he asserts to be a greater enemy to the truth than an outright lie, since a liar recognizes that he is violating the truth whereas the bullshitter does not. Frankfurt writes:

> The contemporary proliferation of bullshit also has deeper sources, in various forms of skepticism which deny that we can have any reliable access to an objective reality and which therefore reject the possibility of knowing how things truly are. These "antirealist" doctrines undermine confidence in the value of disinterested efforts to determine what is true and what is false, and even in the intelligibility of the notion of objective inquiry.

See Harry Frankfurt, "On Bullshit," *Raritan* 6 (Fall, 1986): 99–100.

presenting a watered-down version of the praxeological method of Ludwig von Mises. Robbins had studied at Mises's famous *Privatseminar* at Vienna, and his first edition (1932) stressed economics as a deductive discipline based on the logical implications of the universal facts of human action (for example, that human beings try to achieve goals by using necessarily scarce means). In Robbins's more widely known second edition (1935), the Misesian influence was watered down a bit further, coupled with intimations no bigger than a man's hand of the neo-classical formalism that would hit the profession about the time of World War II.[15] After the war, the older economics was inundated by an emerging formalistic and mathematical neoclassical synthesis, of Walrasian equations covering microeconomics and Keynesian geometry taking care of macro.

Aiding and abetting the conquest of economics by the new neoclassical synthesis was the celebrated article by Milton Friedman in 1953, "The Methodology of Positive Economics," which quickly swept the board, sending Robbins's *Nature and Significance* unceremoniously into the dustbin of history.[16] For three decades, secure and unchallenged, the Friedman article remained virtually the only written portrayal of official methodology for modern economics.

It should be noted that, as in the triumph of the Keynesian revolution and many other conquests by various schools of economics, the Friedman article did not win the hearts and minds of economists in the pattern of what we might call the Whig theory of the history of science: by patient refutation of competing or prevailing doctrines. As in the case of the Mises-Hayek business-cycle theory dominant before Keynes's *General Theory*, the Robbins book was not refuted; it was simply passed over and forgotten. Here the Thomas Kuhn theory of successive paradigms is accurate on the sociology or process of economic thought, deplorable as it might be as a prescription for the development of a science. Too often in philosophy or the social sciences, schools of thought have succeeded each other as whim or fashion, much as one style of ladies' hemlines has succeeded

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[15]Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (London: Macmillan, [1932] 1935).

[16]Milton Friedman, "The Methodology of Positive Economics," in Friedman, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953).

another. Of course, in economics as in other sciences of human action, more sinister forces, such as politics and the drive for power, often deliberately skew the whims of fashion in their own behalf.

What Milton Friedman did was to import into economics the doctrine that had dominated philosophy for over a decade, namely logical positivism. Ironically, Friedman imported logical positivism at just about the time when its iron control over the philosophical profession in the United States had already passed its peak. For three decades, we have had to endure the smug insistence on the vital importance of empirical testing of deductions from hypotheses as a justification for the prevalence of econometric models and forecasting, as well as a universal excuse for theory being grounded on admittedly false and wildly unrealistic hypotheses For neoclassical economic theory clearly rests on absurdly unrealistic assumptions, such as perfect knowledge, the continuing existence of a general equilibrium with no profits, no losses, and no uncertainty, and human action being encompassed by the use of calculus that assumes infinitesimally tiny changes in our perceptions and choices.

In short, this formidable apparatus of neoclassical mathematical economic theory and econometric models, all rests, from the Misesian point of view, upon the treacherous quicksand of false and even absurd assumptions. This Austrian charge of falsity and unreality, if noticed at all, was for decades loftily rebutted by pointing to Friedman's article and asserting that falsity of assumptions and premises do not matter, so long as the theory "predicts" properly. In its founding years in the early 1930s, the Econometric Society emblazoned on its escutcheon the motto, "Science is prediction," and this was the essence of the Friedman-derived defense of neoclassical theory. Austrians such as Mises and Hayek replied that the disciplines of human action are not like the physical sciences. In human affairs, there are no laboratories where variables can be controlled and theories tested, while (unlike the physical sciences) there are no quantitative constants in a world where there is consciousness, freedom of will, and freedom to adopt values and goals and then to change them. These Austrian contentions were dismissed by neoclassicals as simply posing a greater degree of difficulty in arriving at the human sciences, but not in offering a troublesome difference in kind.

The neoclassical synthesis, however, began, in the early l970s, to lose its power either to understand or to predict what was going on

in the economy. The inflationary recession that first appeared dramatically in the 1973–74 contraction put an end to a thirty-five-year period of arrogant and unquestioned hegemony by the Keynesian wing of the neoclassical synthesis. For Keynesian theory and policy rested on the crucial assumption that inflationary recession simply cannot happen. At that point, Friedmanite monetarism came to the fore, but monetarism has now come a cropper after making a rapid series of disastrously wrong predictions from the beginning of the Reagan era until the present. But he who lives by prediction is destined to die by prediction.

In addition to these failures of Keynesianism and monetarism, the blunders and errors of econometric forecasting have become too notorious to ignore, and a wealthy and supremely arrogant profession, using ever higher-speed computer models, seems to enjoy less and less ability to forecast even the immediate future. Even governments, despite the assiduous attention and aid of top neoclassical economists and forecasters, seem to have great difficulties in forecasting *their own* spending, much less their own incomes, let alone the incomes or spending of anyone else.

Amid these failures, there has been a chipping away at the neoclassical formalism of Walrasian microeconomics, sometimes by disillusioned leaders operating from within this ruling paradigm.

As a result of these problems and failures, the last ten or fifteen years has seen the development of a classic Kuhnian "crisis situation" in the field of economics. As the positivist neoclassical orthodoxy begins to crumble, competing paradigms have emerged. Sparked also by Hayek's receipt of a Nobel Prize in 1974, Austrian or Misesian economics has enjoyed a revival since then, with numerous Austrians teaching in colleges in the United States and Britain. Recently there have even emerged five or six Austrian graduate programs or centers in the United States.

In a crisis situation, of course, the bad jostles the good in the new atmosphere of epistemological and substantive diversity. No one ever guaranteed that if a hundred flowers should bloom, that they would all be passing fair. On the left, the nontheory of institutionalism has made a bit of a comeback, jostled by "post-Keynesians" (inspired by Joan Robinson) and "humanistic" neo-Marxists who have substituted a vague adherence to "decentralization" and protection of all animal and vegetable life forms for the rigors of the labor theory of value.

Which brings us back to hermeneutics. For in this sort of atmosphere, even the underworld of hermeneutics will vie for its day in the sun. Probably the most prominent hermeneutical economist in the United States is Donald McCloskey, who calls his viewpoint "rhetoric" and whose attack on truth occurs in the name of rhetoric and of the eternal hermeneutical conversation.[17] McCloskey, unfortunately, follows the modern path of rhetoric run hog-wild and divorced from a firm anchor in truth, overlooking the Aristotelian tradition of "noble rhetoric" as the most efficient way of persuading people of correct and true propositions. For Aristotelians, it is only "base" rhetoric that is divorced from true principles.[18] McCloskey is now organizing a center for rhetorical studies at the University of Iowa, which will organize volumes on rhetoric in a number of diverse disciplines.

Much as I deplore hermeneutics, I have a certain amount of sympathy for McCloskey, an economic historian who endured years as a drill instructor and cadre leader in the Friedman-Stigler Chicago School's positivist ranks. McCloskey is reacting against decades of arrogant positivist hegemony, of an alleged "testing" of economic theory that never really takes place, and of lofty statements by positivists that "I do not understand what you *mean*," when they know darn well what you mean but disagree with it, and who use their narrow criteria of meaning to dismiss your argument. In this way, the positivists for a long while were able to read virtually all important philosophical questions out of court and consign them to the despised departments of religion and *belles lettres*. In a sense, the rise of hermeneutics is those departments' revenge, retorting to the positivists that if "science" is only the quantitative and the "testable," then we shall swamp you with stuff that is *really* meaningless.

It is more difficult to excuse the path traveled by the major group of hermeneuticians in economics, a cluster of renegade Austrians

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[17]Donald N. McCloskey, *The Rhetoric of Economics* (Madison: University of Wisconsin Press, 1985). For a comprehensive Misesian critique of McCloskey's work, see the book review essay by Hans-Hermann Hoppe, "In Defense of Extreme Rationalism: Thoughts on Donald McCloskey's *The Rhetoric of Economics*," *Review of Austrian Economics* 3 (1989): 179–214.

[18]Cf. Richard M. Weaver, *The Ethics of Rhetoric* (Chicago: University of Chicago Press) and Larry Arnhart, *Aristotle on Political Reasoning: A Commentary on "The Rhetoric"* (DeKalb: Northern Illinois University Press, 1981).

and ex-Misesians gathered in the Center for Market Processes at George Mason University. The spiritual head of this groupuscule, Don Lavoie, has reached the pinnacle of having his photograph printed in his magazine *Market Process* talking to the great Gadamer.[19] Lavoie has organized a Society for Interpretive Economics (*interpretation* is a code word for hermeneutics) to spread the new gospel, and has had the effrontery to deliver a paper entitled "Mises and Gadamer on Theory and History," which, as a colleague of mine has suggested, is the moral equivalent of my writing a paper entitled "Lavoie and Hitler on the Nature of Freedom."

It must be noted that nihilism had seeped into current Austrian thought before Lavoie and his colleagues at the Center for Market Processes embraced it with such enthusiasm. It began when Ludwig M. Lachmann, who had been a disciple of Hayek in England in the l930s and who had written a competent Austrian work entitled *Capital and Its Structure* in the 1950s, was suddenly converted by the methodology of the English economist George Shackle during the 1960s.[20] Since the mid-1970s, Lachmann, teaching part of every year at New York University, has engaged in a crusade to bring the blessings of randomness and abandonment of theory to Austrian economics. When Lavoie and his colleagues discovered Heidegger and Gadamer, Lachmann embraced the new creed at the 1986 first annual (and, if luck is with us, the last annual) conference of the Society of Interpretive Economics at George Mason University. The genuine Misesian creed, however, still flourishes at the Ludwig von Mises Institute at Auburn University and in its publications: *Free Market, Mises Review,* and the *Quarterly Journal of Austrian Economics*, which in its first issue included a critique of a quasi-hermeneutical book by two ex-Misesians who claim to have discovered the key to economics in the works of Henri Bergson.[21]

One of the main motivations of the ex-Misesian hermeneuticians is that their horror of mathematics, to which they react as to

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[19]*Market Process* 4 (Fall, 1986): 16.

[20]Ludwig M. Lachmann, *Capital and Its Structure* (London: London School of Economics, 1956). The later, post-Shackelian or nihilist Lachmann may be found in his "From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society," *Journal of Economic Literature* 54 (1976).

[21]Thus, see Charles W. Baird, "*The Economics of Time and Ignorance*: A Review," *Review of Austrian Economics* 1 (1987): 189–223.

the head of Medusa, leads them to embrace virtually any ally in their struggle against positivism and neoclassical formalism. And so they find that, lo and behold, institutionalists, Marxists, and hermeneuticians have very little use for mathematics either. But before they totally embrace the desperate creed that the enemy of my enemy is necessarily my friend, our Market Process hermeneuticians should be warned that there may be worse things in this world than mathematics or even positivism. And second, that in addition to Nazism or Marxism, one of these things may be hermeneutics.

And just as Professor McCloskey's history may serve as a partial mitigation of his embrace of hermeneutics, we may go further back and mitigate the sins of the logical positivists. For, after all, the positivists, much as they may be reluctant to admit it, also did not descend upon us from Mount Olympus. They grew up in old Vienna, and they found themselves in a Germanic world dominated by protohermeneutical creeds such as Hegelianism as well as by the young Heidegger, who was even then making his mark. After reading and listening to dialectics and protohermeneutics day in and day out, after being immersed for years in the gibberish that they were told constituted philosophy, is it any wonder that they—including for our purposes Popper as well as Carnap, Reichenbach, Schlick, et al.—should finally lash out and exclaim that the whole thing was meaningless or that they should cry out for precision and clarity in language? Is it also any wonder that the nascent positivists, like McCloskey a half-century later, should go too far and throw out the philosophic baby with the neo-Hegelian bathwater?

In the peroration to his paean to hermeneutical economics, ex-Misesian Richard Ebeling proclaims: "Man loves to talk about himself."[22] But in rebuttal I point to the sage words of the American cultural and political satirist Tom Lehrer. In the 1960s, Lehrer noted that "a lot of people are whining about their 'inability to communicate.'" "It seems to me," Lehrer added, "that if you are unable to communicate, the *least* you can do is to shut up." That, alas, is something that Ebeling and his hermeneutical colleagues have not yet learned to do.

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[22]Richard M. Ebeling, "Hermeneutics and the Interpretive Element in the Analysis of the Market Process," Center for Market Processes Working Paper (Fairfax, Va.: Department of Economics, George Mason University, 1985), p. 45. Cf. Frankfurt, "On Bullshit," p. 100.

Section Two

The Austrian School

9

New Light on the Prehistory of the Austrian School

The most notable development in the historiography of the Austrian School in the post-World War II era has been the drastic reevaluation of what might be called its prehistory and, as a corollary, a fundamental reconsideration of the history of economic thought itself. This reevaluation may be summarized by briefly outlining the orthodox pre-war paradigm of the development of economic thought before the advent of the Austrian School. The Scholastic philosophers were brusquely dismissed as medieval thinkers who totally failed to understand the market, and who believed on religious grounds that the just price was one that covered either the cost of production or the quantity of labor embodied in a product. After briefly outlining the bullionist and anti-bullionist discussion among the English mercantilists and lightly touching on a few French and Italian economists of the eighteenth century, the historian of economic thought pointed with a flourish to Adam Smith and David Ricardo as the founders of economic science. After some backing and filling in the mid-nineteenth century, marginalism, including the Austrian School, arrived in another great burst in the 1870s. Apart from the occasional mention of one or two English precursors of the Austrians, such as Samuel Bailey in the early nineteenth century, this completed the basic picture. Typical was the encyclopedic text of Lewis Haney: the Scholastics were described as medieval, dismissed as hostile to trade, and declared believers in the labor and cost-of-production theories of the just price.[1] It is no wonder that in

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[1]Lewis H. Haney, *History of Economic Thought*, 4th ed. (New York: Macmillan, 1949), pp. 106–08.

his famous phrase, R.H. Tawney could call Karl Marx "the last of the Schoolmen."[2]

The remarkably contrasting new view of the history of economic thought burst upon the scene in 1954 in the monumental, though unfinished, work of Joseph Schumpeter.[3] Far from mystical dunderheads who should be skipped over to get to the mercantilists, the Scholastic philosophers were seen as remarkable and prescient economists, developing a system very close to the Austrian and subjective-utility approach This was particularly true of the previously neglected Spanish and Italian Scholastics of the sixteenth and seventeenth centuries. Virtually the only missing ingredient in their value theory was the marginal concept. From them filiations proceeded to the later French and Italian economists. In the Schumpeterian view, the English mercantilists were half-baked, polemical pamphleteers rather than essential milestones on the road to Adam Smith and the founding of economic science. In fact, the new view saw Smith and Ricardo, not as founding the sciences of economics, but as shunting economics onto a tragically wrong track, which it took the Austrians and other marginalists to make right. Until then, only the neglected anti-Ricardian writers kept the tradition alive. As we shall see, other historians, such as Emil Kauder, further demonstrated the Aristotelian (and hence Scholastic) roots of the Austrians amidst the diverse variants of the Marginalist School. The picture is almost the reverse of the earlier orthodoxy.

It is not the purpose of this paper to dwell on Schumpeter's deservedly well-known work, but rather to assess the contributions of writers who carried the Schumpeterian vision still further and who remain neglected by most economists, possibly from a failure to match Schumpeter in constructing a general treatise. The best development of the new history must be sought in fugitive articles and brief pamphlets and monographs.

The other relatively neglected contributions began contemporaneously with Schumpeter. One of the most important, and probably

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[2]R.H. Tawney, *Religion and the Rise of Capitalism* (New York: New American Library, 1954), pp. 38–39.

[3]Joseph A. Schumpeter, *A History of Economic Analysis* (New York: Oxford University Press, 1954).

the most neglected, was *The School of Salamanca* by Marjorie Grice-Hutchinson, who suffered in the economics profession from being a professor of Spanish literature. Moreover, the book bore the burden of a misleadingly narrow subtitle: *Readings in Spanish Monetary Theory*.[4] In fact, the book was a brilliant discovery of the pre-Austrian subjective-value-and-utility views of the late sixteenth-century Spanish Scholastics. But first Grice-Hutchinson showed that the works of even earlier Scholastics as far back as Aristotle contained a subjective-value analysis based on consumer wants alongside the competing objective conception of the just price based on labor and costs. In the early Middle Ages, Saint Augustine (354–430) developed the concept of the subjective-value scale of each individual. By the High Middle Ages, the Scholastic philosophers had largely abandoned the cost-of-production theory to adopt the view that the market's reflection of consumer demand really sets the just price. This was particularly true of Jean Buridan (1300–1358), Henry of Ghent (1217–1293), and Richard of Middleton (1249–1306). As Grice-Hutchinson observed:

> Medieval writers viewed the poor man as consumer rather than producer. A cost-of-production theory would have given merchants an excuse for overcharging on the pretext of covering their expenses, and it was thought fairer to rely on the impersonal forces of the market which reflected the judgment of the whole community, or, to use the medieval phrase, the "common estimation." At any rate, it would seem that the phenomena of exchange came increasingly to be explained in psychological terms.[5]

Even Henry of Langenstein (1325–1383), who of all the Scholastics was the most hostile to the free market and advocated government fixing of the just price on the basis of status and cost, developed the subjective factor of utility as well as scarcity in his analysis of price. But it was the sixteenth-century Spanish Scholastics who developed the purely subjective and pro-free-market theory of value. Thus, Luis Saravía de la Calle (c. 1544) denied any role to cost in the determination of price; instead the market price, which is the just

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[4]Marjorie Grice-Hutchinson, *The School of Salamanca: Readings in Spanish Monetary Theory, 1544–1605* (Oxford: Clarendon Press, 1952).

[5]Ibid., p. 27.

price, is determined by the forces of supply and demand, which in turn are the result of the common estimation of consumers on the market. Saravía wrote that, "excluding all deceit and malice, the just price of a thing is the price which it commonly fetches at the time and place of the deal." He went on to point out that the price of a thing will change in accordance with its abundance or scarcity. He proceeded to attack the cost-of-production theory of just price:

> Those who measure the just price by the labor, costs, and risk incurred by the person who deals in the merchandise or produces it, or by the cost of transport or the expense of traveling . . . or by what he has to pay the factors for their industry, risk, and labor, are greatly in error, and still more so are those who allow a certain profit of a fifth or a tenth. For the just price arises from the abundance or scarcity of goods, merchants, and money . . . and not from costs, labor, and risk. If we had to consider labor and risk in order to assess the just price, no merchant would ever suffer loss, nor would abundance or scarcity of goods and money enter into the question. Prices are not commonly fixed on the basis of costs. Why should a bale of linen brought overland from Brittany at great expense be worth more than one which is transported cheaply by sea? . . . Why should a book written out by hand be worth more than one which is printed, when the latter is better though it costs less to produce? . . . The just price is found not by counting the cost but by the common estimation.[6]

Similarly the Spanish Scholastic Diego de Covarrubias y Leiva (1512—1577) a distinguished expert on Roman law and a theologian at the University of Salamanca, wrote that the "value of an article" depends "on the estimation of men, even if that estimation be foolish." Wheat is more expensive in the Indies than in Spain "because men esteem it more highly, though the nature of the wheat is the same in both places." The just price should be considered not at all with reference to its original or labor cost but only with reference to the common market value where the good is sold, a value, Covarrubias pointed out, that will fall when buyers are few and goods are abundant and that will rise under opposite conditions.[7]

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[6]Luis Saravia de la Calle, *Instrucción de mercaderes* (1544), in Grice-Hutchinson, *School of Salamanca*, pp. 79–82.

[7]Ibid., p. 48.

The Spanish Scholastic Francisco García (d. 1659) engaged in a remarkably sophisticated analysis of the determinants of value and utility. The valuation of goods, Garcia pointed out, depends on several factors. One is the abundance or scarcity of the supply of the goods, the former causing a lower estimation and the latter an increase. A second is whether buyers or sellers are few or many. Another is whether "money is scarce or plentiful," the former causing a lower estimation of goods and the latter a higher. Another is whether "vendors are eager to sell their goods." The influence of the abundance or the scarcity of a good brought García almost to the brink, but not over it, of a marginal utility analysis of valuation.

> For example, we have said that bread is more valuable than meat because it is more necessary for the preservation of human life. But there may come a time when bread is so abundant and meat so scarce that bread is cheaper than meat.[8]

The Spanish Scholastics also anticipated the Austrian School in applying value theory to money, thus beginning the integration of money into general value theory. It is generally believed, for example, that in 1568 Jean Bodin inaugurated what is unfortunately called the application of supply-and-demand analysis to money. Yet he was anticipated twelve years earlier by the Salamanca theologian the Dominican Martin de Azpilcueta Navarro (1493–1576), who was inspired to explain the inflation brought about by the importation of gold and silver by the Spaniards from the New World. Citing previous Scholastics, Azpilcueta declared that "money is worth more where it is scarce than where it is abundant." Why? Because "all merchandise becomes dearer when it is in great demand and short supply, and that money, in so far as it may be sold, bartered, or exchanged by some other form of contract, is merchandise and therefore also becomes dearer when it is in great demand and short supply." Azpilcueta noted that

> we see by experience that in France, where money is scarcer than in Spain, bread, wine, cloth, and labor are worth much less. And even in Spain, in times when money was scarcer, saleable goods and labor were given for very much less than after the discovery of

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[8]Francisco García, *Tratado utilisimo y muy general de todos los contractos* (1583), in Grice-Hutchinson, *School of Salamanca*, pp. 104–05.

> the Indies, which flooded the country with gold and silver. The reason for this is that money is worth more where and when it is scarce than where and when it is abundant.[9]

Furthermore, the Spanish Scholastics went on to anticipate the classical-Mises-Cassel purchasing-power parity theory of exchange rates by proceeding logically to apply the supply-and-demand theory to foreign exchanges, an institution that was highly developed by the early modern period. The influx of specie into Spain depreciated the Spanish escudo in foreign exchange, as well as raised prices within Spain, and the Scholastics had to deal with this startling phenomenon. It was the eminent Salamanca theologian the Dominican Domingo de Soto (1495–1560) who in 1553 first fully applied the supply-and-demand analysis to foreign exchange rates. De Soto noted that

> the more plentiful money is in Medina the more unfavorable are the terms of exchange, and the higher the price that must be paid by whoever wishes to send money from Spain to Flanders, since the demand for money is smaller in Spain than in Flanders. And the scarcer money is in Medina the less he need pay there, because more people want money in Medina than are sending it to Flanders.[10]

What de Soto was saying is that as the stock of money increases, the utility of each unit of money to the population declines and vice versa; in short, only the great stumbling block of failing to specify the concept of the marginal unit prevented him from arriving at the doctrine of the diminishing marginal utility of money. Azpilcueta, in the passage quoted above, applied the de Soto analysis of the influence of the supply of money on exchange rates, at the same time that he set forth a theory of supply and demand in determining the purchasing power of money within a country.

The de Soto-Azpilcueta analysis was spread to the merchants of Spain by the Dominican friar Tomás de Mercado (d. 1585), who in 1569 wrote a handbook of commercial morality in Spanish, in contrast to the Scholastic theologians, who invariably wrote in Latin. It

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[9]Martín de Azpilcueta Navarro, *Comentario resolutorio de usuras* (1556), in Grice-Hutchinson, *School of Salamanca*, pp. 94–95.

[10]Domingo de Soto, *De Justitia et Jure* (1553), in Grice-Hutchinson, *School of Salamanca*, p. 55.

was followed by Garcia and endorsed at the end of the sixteenth century by the Salamanca theologian the Dominican Domingo de Bañez (1527–1604) and by the great Portuguese Jesuit Luís de Molina (1535–1600). Writing near the turn of the century, Molina set forth the theory in an elegant and comprehensive manner:

> There is another way in which money may be worth more in one place than in another; namely, because it is scarcer there than elsewhere. Other things being equal, wherever money is most abundant, there will it be least valuable for the purpose of buying and comparing things other than money.
>
> Just as an abundance of goods causes prices to fall (the quantity of money and number of merchants being equal), so does an abundance of money cause them to rise (the quantity of goods and number of merchants being equal). The reason is that the money itself becomes less valuable for the purpose of buying and comparing goods. Thus we see that in Spain the purchasing-power of money is far lower, on account of its abundance, than it was eighty years ago. A thing that could be bought for two ducats at that time is nowadays worth 5, 6, or even more. Wages have risen in the same proportion, and so have dowries, the price of estates, the income from benefices, and other things.
>
> We likewise see that money is far less valuable in the New World (especially in Peru, where it is most plentiful), than it is in Spain. But in places where it is scarcer than in Spain, there will it be more valuable. Nor will the value of money be the same in all other places, but will vary: and this will be because of variations in its quantity, other things being equal. . . . Even in Spain itself, the value of money varies: it is usually lowest of all in Seville, where the ships come in from the New World and where for that reason money is most abundant.
>
> Wherever the demand for money is greatest, whether for buying or carrying goods, . . . or for any other reason, there its value will be highest. It is these things, too, which cause the value of money to vary in course of time in one and the same place.[11]

The outstanding revisionist work on the economic thought of the medieval and later Scholastics is that of Raymond de Roover.

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[11]Luís de Molina, *Disputationes de Contractibus* (1601), in Grice-Hutchinson, *School of Salamanca*, pp. 113–14; Tomás de Mercado, *Tratos y contratos de mercaderes* (1569), ibid., pp. 57–58 and Domingo de Bañez, *De Justitia et Jure* (1594), ibid., pp. 96–103.

Basing his work in part on the Grice-Hutchinson volume, de Roover published his first comprehensive discussion in 1955.[12] For the medieval period, de Roover particularly pointed to the early fourteenth-century French Ockhamite Scholastic Jean Buridan and to the famous early fifteenth-century Italian preacher San Bernardino of Siena (1380–1444). Buridan insisted that value is measured by the human wants of the community of individuals and that the market price is the just price. Furthermore, he was perhaps the first to make clear in a pre-Austrian manner that voluntary exchange demonstrates subjective preference, since he stated that the "person who exchanges a horse for money would not have done so, if he had not preferred money to a horse."[13] He added that workers hire themselves out because they value the wages they receive higher than the labor they have to expend.[14]

De Roover then discussed the sixteenth-century Spanish Scholastics, centered at the University of Salamanca, the queen of the Spanish universities of the period. From Salamanca the influence of this school of Scholastics spread to Portugal, Italy, and the Low Countries. In addition to summarizing Grice-Hutchinson's contribution and adding to her bibliography, de Roover noted that both de Soto and Molina denounced as "fallacious" the notion of the late thirteenth-century Scholastic John Duns Scotus (1308) that the just price is the cost of production plus a reasonable profit; instead that price is the common estimation, the interaction of supply and demand, on the market. Molina further introduced the concept of

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[12]Raymond de Roover, "Scholastic Economics: Survival and Lasting Influence from the Sixteenth Century to Adam Smith," *Quarterly Journal of Economics* 69 (May 1955): 161–90; reprinted in de Roover, *Business, Banking, and Economic Thought* (Chicago: University of Chicago Press, 1974), pp. 306–35.

[13]Ibid., p. 309.

[14]Raymond de Roover, "Joseph A. Schumpeter and Scholastic Economics," *Kyklos* 10 (1957): 128. De Roover traced the concept of mutual benefit as exhibited in exchange back to Aquinas, who wrote that "buying and selling seem to have been instituted for the mutual advantage of both parties, since one needs something that belongs to the other, and conversely" (ibid.).

competition by stating that competition among buyers will drive prices up, while a scarcity of purchasers will pull them down.[15]

In a later article, de Roover elaborated on his researches into the Scholastic theory of the just price. He found that the orthodox view of the just price as a station-in-life, cost-of-production price was based almost solely on the views of fourteenth-century Viennese Scholastic Henry of Langenstein. But Langenstein, de Roover pointed out, was a follower of the minority views of William of Ockham and outside the dominant Thomist tradition; Langenstein was rarely cited by later Scholastic writers. While some of their passages are open to a conflicting interpretation, de Roover demonstrated that Albertus Magnus (1193–1280) and his great pupil Thomas Aquinas (1226–1274) held the just price to be the market price. In fact, Aquinas considered the case of a merchant who brings wheat to a country where there is a great scarcity; the merchant happens to know that more wheat is on the way. May he sell his wheat at the existing price, or must he announce to everyone the imminent arrival of new supplies and suffer a fall in price? Aquinas unequivocally answered that he may justly sell the wheat at the current market price, even though he added as an afterthought that it would be more virtuous of him to inform the buyers. Furthermore, de Roover pointed to the summary of Aquinas's position by his most distinguished commentator, the late fifteenth-century Scholastic Thomas de Vio, Cardinal Cajetan (1468–1534). Cajetan concluded that for Aquinas the just price is "the one, which at a given time, can be gotten from the buyers, assuming common knowledge and in the absence of all fraud and coercion."[16]

The cost-of-production theory of just price held by the Scotists was trenchantly attacked by the later Scholastics. San Bernardino of Siena, de Roover pointed out, declared that the market price is fair regardless of whether the producer gains or loses, or whether it is

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[15]De Roover, *Business, Banking, and Economic Thought*, pp. 312–14. Elsewhere de Roover noted that the Scotists were a small minority among medieval and later Scholastics, whereas the Scholastics discussed here were in the mainstream of Thomist tradition.

[16]Raymond de Roover, "The Concept of the Just Price: Theory and Economic Policy," *Journal of Economic History* 18 (December 1958): 422–23.

above or below cost. The great early sixteenth-century jurist Francisco de Vitoria (c. 1480–1546), founder of the school of Salamanca, as well as his followers, insisted that the just price is set by supply and demand regardless of labor costs or expenses; inefficient producers or inept speculators must bear the consequences of their incompetence and poor forecasting. Furthermore, de Roover made clear that the general Scholastic emphasis on the justice of "common estimation" (*communis aestimatio*) is identical to "market valuation" (*aestimatio fori*), since the Scholastics used these two Latin expressions interchangeably.[17]

De Roover noted, however, that this acceptance of market price did not mean that the Scholastics adopted a *laissez-faire* position. On the contrary, they were often willing to accept governmental price fixing instead of market action. A few prominent Scholastics, however, led by Azpilcueta and including Molina, opposed all price fixing; as Azpilcueta put it, price controls are unnecessary in times of plenty and ineffective or positively harmful in times of dearth.[18]

In a comment on de Roover's paper, David Herlihy noted that, in the northern Italian city-states of the twelfth and thirteenth centuries, the birthplace of modern commercial capitalism, the market price was generally considered just because it was "true" and "real," if it was "established or utilized without deceit or fraud." As Herlihy summed it up, the just price of an object is its "true value as determined by one of two ways: for objects that were unique, by honest negotiation between seller and purchaser; for staple commodities by the consensus of the marketplace established in the absence of fraud or conspiracy."[19]

John W. Baldwin's definitive account of the theories of just price during the High Middle Ages of the twelfth and thirteenth centuries amply confirmed de Roover's revisionist insight. Baldwin pointed out that there were three important and influential groups of medieval writers: the theologians (whom we have been examining), the Roman lawyers, and the canon lawyers. For their part, the Romanists, joined

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[17]Ibid., p. 424.

[18]Ibid., p. 426.

[19]David Herlihy, "The Concept of the Just Price: Discussion," *Journal of Economic History* 18 (December 1958): 437.

by the canonists, held staunchly to the principle of Roman private law that the just price is whatever is arrived at by free bargaining between buyers and sellers.[20] Baldwin demonstrated that even the theologians of the High Middle Ages before Aquinas accepted the current market price as the just price.[21]

Several years later, de Roover turned to the views of the Scholastics on the broader issue of trade and exchange.[22] He conceded the partial validity of the older view that the medieval Church frowned on trade as endangering personal salvation; or rather that, while trade *can* be honest, it presents great temptation for sin. However, he pointed out that, as trade and commerce grew after the tenth century, the church began to adapt to the idea of the merits of trade and exchange. Thus, while it is true that the twelfth-century Scholastic Peter the Lombard (c. 1100–1160) denounced trade and soldiering as sinful occupations *per se*, a far more benevolent view of trade was set forth during the thirteenth century by Albertus Magnus and his student Thomas Aquinas, as well as by Saint Bonaventure (1221–1274) and Pope Innocent V (1225–1276). While trade presents occasions for sin, it is not sinful *per se*; on the contrary, exchange and the division of labor are beneficent in satisfying the wants of the citizens. Moreover, he early fourteenth-century Scholastic Richard of Middleton developed the idea that both the buyer and the seller gain by exchange, since each demonstrates that he prefers what he receives in exchange what he gives up. Middleton also applied this idea to international trade, pointing out that both countries benefit

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[20]John W. Baldwin, "The Medieval Theories of the Just Price," *Transactions of the American Philosophical Society* (Philadelphia: July 1959); see also the review of Baldwin by A.R. Bridbury, *Economic History Review* 12 (April 1960): 512–14.

[21]In particular, the theologians at the great center at the University of Paris in the early thirteenth century: Alexander of Hales and Aquinas's teacher, Albertus Magnus (ibid., p. 71). Baldwin further pointed out that theological treatment of such practical questions as the just price in the Middle Ages only began with the development of university centers at the end of the twelfth century (ibid., p. 9).

[22]Raymond de Roover, "The Scholastic Attitude toward Trade and Entrepreneurship," *Explorations in Entrepreneurial History* 2 (1963): 76–87; reprinted in de Roover, *Business, Banking, and Economic Thought*, pp. 336–45.

by exchanging their surplus products. Since the merchants and citizens of each country benefit, neither party is exploiting the other.

At the same time, Aquinas and other theologians denounced "covetousness" and love of profit, mercantile gain being only justifiable when directed toward the "good of others"; furthermore, Aquinas attacked "avarice" as attempting to improve one's "station in life." But, as de Roover pointed out, the great early sixteenth-century Italian Thomas Cardinal Cajetan corrected this view by demonstrating that, if this were true, every person would have to be frozen in his current occupation and income. On the contrary, asserted Cajetan, people with unusual ability should be able to rise in the world. In contrast to such northern Europeans as Aquinas, Cajetan was quite familiar with the commerce and upward social mobility in the Italian cities. Furthermore, even Aquinas explicitly rejected the idea that prices should be determined by one's station in life, pointing out that the selling price of any good tends to be the same whether the entrepreneur is poor or wealthy.

De Roover hailed the early fifteenth-century Scholastic San Bernardino of Siena as being the only theologian who dealt in detail with the economic function of the entrepreneur. San Bernardino wrote of the uncommon qualities and abilities of the successful entrepreneur, including effort, diligence, knowledge of the market, and calculation of risks, with profit on invested capital justifiable as compensation for the risk and effort of the entrepreneur. The acceptance of profit was immortalized in a motto in a thirteenth-century account book: "In the name of God and of profit."[23]

De Roover's final work in this area was a booklet on San Bernardino and his contemporary Sant' Antonino (1389–1459) of

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[23]De Roover, here and in his other writings, pointed to the great deficiency in Scholastic analysis of the market: the belief that any interest on a pure loan (a mutuum) constituted the sin of usury. The reason is that while the Scholastics understood the economic functions of risk and opportunity cost, they never arrived at the concept of time preference. On the Scholastics and usury, see the magisterial work of John T. Noonan, Jr., *The Scholastic Analysis of Usury* (Cambridge, Mass.: Harvard University Press, 1957); see also Raymond de Roover, "The Scholastics, Usury, and Foreign Exchange," *Business History Review* 41(1967): 257–71.

Florence.[24] In San Bernardino's views of trade and the entrepreneur, the occupation of trade may lead to sin, but so may all other occupations, including that of bishops. As for the sins of traders, they consist of such illicit activity as fraud, misrepresentation of products, the sale of adulterated products, and the use of false weights and measures, as well as keeping creditors waiting for their money after a debt is due. As to trade, there are several kinds of useful merchants, according to San Bernardino: importer-exporters, warehousemen, retailers, and manufacturers.

San Bernardino described the rare qualities and virtues that go into the making of successful businessmen. One is efficiency (*industria*), which includes knowledge of qualities, prices, and costs and ability to assess risks and estimate profit opportunities, which, he declared, "indeed very few are capable of doing." Entrepreneurial ability therefore includes the willingness to assume risks (*pericula*). Businessmen must be responsible and attentive to detail, and trouble and toil are also necessary. The rational and orderly conduct of business, also necessary to success, is another virtue lauded by San Bernardino, as are business integrity and the prompt settlement of accounts.

Turning again to the Scholastic view of value and price, de Roover pointed out that, as early as Aquinas, prices were treated as determined, not by their philosophic rank in nature, but by the degree of the usefulness or utility of the respective products to man and to human wants. As de Roover wrote of Aquinas, "These passages are clear and unambiguous; value depends upon utility, usefulness, or human wants. There is nowhere any mention of labor as the creator or the measure of value."[25] A century before the Spanish Scholastics and a century and a half before the sophisticated formulation of Francisco Garcia, San Bernardino had demonstrated that price is determined by scarcity (*raritas*), usefulness (*virtuositas*), and pleasurability or desirability (*compacibilitas*). Greater abundance of a good will cause a drop in its value and greater scarcity a rise. To

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[24]Raymond de Roover, *San Bernardino of Siena and Sant' Antonino of Florence: The Two Great Economic Thinkers of the Middle Ages* (Boston: Kress Library of Business and Economics, 1967).

[25]Ibid., p. 17.

have value, furthermore, a good must have usefulness, or what we may call "objective utility"; but within that framework, the value is determined by the *complicibilitas*, or "subjective utility," that it has to individual consumers. Again, only the marginal element is lacking for a full-scale pre-Austrian theory of value. Coming to the brink of the later Austrian solution to the classical economists' "paradox of value," San Bernardino noted that a glass of water to a man dying of thirst would be so valuable as to be almost priceless, but fortunately water, though absolutely necessary to human life, is ordinarily so abundant that it commands either a low price or even no price at all.

Correcting Schumpeter's ascription of the founding of subjective utility to Sant' Antonino and observing that he had derived it from San Bernardino, de Roover showed further that recent scholarship demonstrates that Bernardino derived his own analysis almost word for word from a late thirteenth-century Provençal Scholastic, Pierre de Jean Olivi (1248–1298). Apparently, Bernardino did not give credit to Olivi because the latter, coming from another branch of the Franciscan order, was at that time suspected of heresy.[26]

Turning to the concept of the "just price," de Roover made it clear that San Bernardino, following Olivi, held the price of a good or service to be "the estimation made in common by all the citizens of the community" This he held explicitly to be the valuation of the market, since he defined the just price as "the one which happens to prevail at a given time according to the estimation of the market, that is, what the commodities for sale are then commonly worth in a certain place."[27]

Wages were treated by the two Italian friars in the same manner as the prices of goods. For San Bernardino, "The same rules which apply to the prices of goods also apply to the price of services with the consequence that the just wage will also be determined by the forces operating in the market or, in other words, by the demand for labor and the available supply." An architect is paid more than a ditchdigger, asserted Bernardino, because "the former's job requires more intelligence, greater ability, and longer training and that, consequently, fewer qualify…. Wage differentials are thus to be explained

[26]On the originality of Olivi see ibid., p 19.

[27]Ibid., p. 20.

by scarcity because skilled workers are less numerous than unskilled and high positions require even a very unusual combination of skills and abilities."[28] And Sant' Antonino concluded that the wage of a laborer is a price which, like any other, is properly determined by the common estimation of the market in the absence of fraud.

During and after the sixteenth century, the Roman Catholic church and Scholastic philosophy came under increasingly virulent attack, first from Protestants and then from rationalists, but the result was not so much to eliminate any influence of Scholastic philosophy and economics as to mask that influence, since their proclaimed enemies would often fail to cite their writings. Thus, the great early seventeenth-century Dutch Protestant jurist Hugo Grotius (1583–1645) adopted much of Scholastic doctrine, including the emphasis on want and utility as the major determinants of value, and the importance of the common estimation of the market in determining price. Grotius, in fact, explicitly cited the Spanish Scholastics Azpilcueta Navarro and Covarrubias. Even more explicitly following the Spanish Scholastics of the sixteenth century were the Jesuit theologians of the following century, including the highly influential Flemish Jesuit Leonardus Lessius (1554–1623), a friend of Luís de Molina, and the even more influential Spanish Jesuit Cardinal Juan de Lugo (1583–1660), whose treatise was originally published in 1642 and was reprinted many times in the next three centuries. Also explicitly following the Scholastics and the Salamanca School in the seventeenth century was the Genoese philosopher and jurist Sigismundo Scaccia (c. 1618), whose treatise was widely reprinted, as well as Antonio de Escobar (c. 1652), author of a moral manual.

To return to what would be the dominant Protestant trend for later economic thought, Grotius's legal and economic doctrines were followed closely in the later seventeenth century by the Swedish Lutheran jurist Samuel Pufendorf (1632–1694). While Pufendorf followed Grotius on utility and scarcity and the common estimation of the market in determining value and price, and while he certainly consulted the writings of the Spanish Scholastics, it is the rationalist Pufendorf who dropped all citations to these hated Scholastic influences upon his teacher. Hence, when Grotian doctrine was brought

[28]Ibid., pp. 23–24.

to Scotland by the early eighteenth-century professor of moral philosophy at Glasgow Gershom Carmichael (1672–1729), who translated Pufendorf into English, knowledge of Scholastic influences was lost. Hence, with Carmichael's great student and successor Francis Hutcheson, utility began to be weakened by labor and cost-of-production theories of value, until finally by the time Hutcheson's student Adam Smith (1723–1790) wrote the *Wealth of Nations*, pre-Austrian Scholastic influence had unfortunately dropped out altogether. Hence the view of Schumpeter, de Roover, and others that Smith and later Ricardo shunted economics onto a wrong track, which the later marginalists (including the Austrians) had to correct.

Scholastic doctrine had a more lasting influence on economists on the Continent, particularly in Catholic countries. Thus, the brilliant mid-eighteenth-century Italian the Abbé Ferdinando Galiani (1728–1787) is often credited by historians with inventing full-blown the concept of utility and scarcity as the determinants of price. No one wished to stress Scholastic writings in that rationalistic age, but strong Scholastic influence is detectable in Galiani's work, whose section on value even contains an explicit citation to the Salamanca Scholastic Diego Covarrubias y Leiva. Galiani's uncle Celestino, who brought up the youthful economist, had been professor of moral theology before becoming an archbishop and was therefore undoubtedly familiar with the Scholastic literature on the subject, which filled the Italian libraries of the eighteenth century. Galiani's contemporary Italian economist Antonio Genovesi (1712–1769) was also directly influenced by Scholastic thought; he had served as professor of ethics and moral philosophy at the University of Naples.

From Galiani the central role of utility, scarcity, and the common estimation of the market spread to France, to the late eighteenth-century French Abbé Etienne Bonnot de Condillac (1714–1780), as well as to that other great abbé Robert Jacques Turgot (1721–1781). Knowing only Galiani as his predecessor, Turgot echoed the Salamanca School in holding the prices of goods and the value of money, as the result of the "common estimation" of the market, to be built up out of the subjective valuations of individuals in that market. François Quesnay (1694–1774) and the eighteenth-century French physiocrats—often considered to be the founders of economic science—were also heavily influenced by the Scholastics, both in their natural law theory and their emphasis on consumption

and subjective value. Scholastic doctrine even appears in the fiercely anti-Catholic Encyclopédie, including the doctrine of natural law, as well as the analysis of price as determined by the current common estimation of the market. Even during the nineteenth century strong traces of Condillac and Turgot appear in Jean-Baptist Say (1767–1832), who upheld a utility model for the future.[29]

At about the same time as Schumpeter, Grice-Hutchinson, and de Roover published their researches, Emil Kauder set forth a similar revisionist viewpoint. Kauder traced the connection between the Scholastics and Galiani, first to the mid-sixteenth-century Italian politician Gian Francesco Lottini (1512–1572).[30] He showed that Lottini first worked out a rudimentary concept of time preference: that people estimate present wants higher than future. The next link was the late sixteenth-century Italian merchant Bernardo Davanzati (1529–1606), who applied subjective-value theory to money in 1588. Indeed, Schumpeter was soon to point out that Davanzati also solved the "paradox of value," that water is very useful but not valuable on the market because it is highly abundant. Whether or not Davanzati was influenced by San Bernardino is not known.[31] He was followed almost a century later by the Italian mathematics professor Geminiano Montanan (1633–1687). Galiani was then definitely influenced by Davanzati.

Kauder then developed in an original way the great contributions of Galiani. For not only did Galiani comprehensively set forth the familiar theory of utility and scarcity as determinants of price—which lacked only the marginal principle to arrive at the Austrian theory—but he also went on to apply the utility theory to the value of labor and other factors of production. For the value of labor is, in turn, determined by the utility and scarcity of the particular kind of

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[29]On the later influence of the Scholastics, see Schumpeter, *History of Economic Analysis*, pp. 94–106; Grice-Hutchinson, *School of Salamanca*, pp. 59–78; de Roover, *Business, Banking, and Economic Thought*, pp. 330–35; and de Roover, "Joseph A. Schumpeter and Scholastic Economics," pp. 128–29.

[30]Emil Kauder, "Genesis of the Marginal Utility Theory: From Aristotle to the End of the Eighteenth Century," *Economic Journal* 63 (September 1953): 638–50.

[31]Schumpeter, *History of Economic Analysis*, p. 300.

labor being considered. The highly skilled are paid much more than the common laborer, since nature produced only a small number of able men. But not only that; for Galiani it is not labor costs that determine value, but value—and consumer choice—that determines labor cost. Furthermore Galiani touched on a pre-Böhm-Bawerk, time-preference theory of interest, with interest being the difference between present and future money.[32] Turgot then anticipated the Austrians in applying Galiani's utility theory to a detailed analysis of isolated exchange. Turgot, furthermore, as Schumpeter pointed out, developed a time analysis of production and worked out a pre-Austrian general analysis of the law of eventually diminishing returns that was not to be matched until the end of the nineteenth century. Quite justly Schumpeter wrote that "it is not too much to say that analytic economics took a century to get where it could have got in twenty years after the publication of Turgot's treatise had its content been properly understood and absorbed by an alert profession."[33] Instead, as Kauder pointed out, it was left to Condillac to offer a last-ditch and neglected defense of Galiani's utility theory against the rising tide of British cost theory. In Condillac's trenchant phrase, "A thing does not have value because it costs, as people suppose; instead it costs because it has a value.[34]

In a fascinating companion article, Kauder speculated on the persistence of utility-and-subjective-value theory on the Continent, as compared to the rise and dominance of a quantity-of-labor-and-cost-of-production theory in Great Britain.[35] He was particularly intrigued by the fact that the pre-nineteenth-century French and Italian subjectivists were all Catholics (and, of course, he might have

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[32]Kauder, "Genesis of the Marginal Utility Theory," p. 645.

[33]Schumpeter, *History of Economic Analysis*, p. 249, see also ibid., pp. 259–61, 332–33.

[34]Emil Kauder, "Genesis of the Marginal Utility Theory," p. 647. Kauder and Schumpeter also noted the early eighteenth-century French mathematician Daniel Bernoulli (1738), who outside the stream of economic thought developed a mathematical version of the diminishing marginal utility of money (ibid., pp. 647–50; Schumpeter, *History of Economic Analysis,* pp. 302–05).

[35]Emil Kauder, "The Retarded Acceptance of the Marginal Utility Theory," *Quarterly Journal of Economics* 67 (November 1953): 564–75.

added the medieval and sixteenth-century Scholastics as well), while the British economists were all Protestants, or, more precisely, Calvinists. Kauder speculated that it was their Calvinist training that led John Locke and particularly Adam Smith to reject the Continental tradition (Smith knew Turgot and read Grotius) and to emphasize a labor theory of value. The Calvinists believed that work or labor was divine; could not this imprint have led Smith and the others to adopt a labor theory of economic value? Furthermore, Kauder pointed out that until the middle of the eighteenth century the French and Italian universities were dominated by Aristotelian philosophy, particularly as transmitted by the Jesuits and other religious orders. Kauder added that, in contrast to Calvinism, Aristotelian-Thomist philosophy did not glorify work or labor *per se* as divine; work may be necessary, but "moderate pleasure-seeking and happiness"—in short, utility—"form the center of economic actions." Kauder concluded that "if pleasure in a moderate form is the purpose of economics, then following the Aristotelian concept of the final cause, all principles of economics including valuation must be derived from it."[36]

Kauder admitted that his is a conjecture that cannot be proved and also that it does not particularly hold for the nineteenth century. However, he did offer an intriguing explanation for Alfred Marshall's failure to adopt the full marginal utility theory and, instead, his shunting aside of the theory in favor of a recrudescence of Ricardo's objective cost-of-production theory. That explanation lies in Marshall's undoubtedly strong Evangelical and Calvinist background.[37]

Finally, Emil Kauder convincingly demonstrated the direct influence of Aristotelian philosophy on the founders of the Austrian School and contrasted the result with the other marginalist schools of the late nineteenth century. First, in contrast to Jevons and Walras, who believed that economic laws are hypotheses dealing with social quantities, Carl Menger and his followers held that economics investigates, not the quantities of phenomena, but the underlying essences of such real entities as value, profit, and the other economic

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[36]Ibid., p. 569.

[37]Ibid., pp. 570–71. These two articles are essentially reprinted in Emil Kauder, *A History of Marginal Utility Theory* (Princeton, N.J.: Princeton University Press, 1965), pp. 3–29.

categories. The belief in underlying essences inherent in superficial appearances is Aristotelian, and Kauder pointed out that Menger studied and cited Aristotle extensively in his methodological work. He also noted the similarities discovered by Oskar Kraus between the Austrian and the Aristotelian theories of imputation. Kauder also pointed out that Menger applied the fundamental Aristotelian distinction between matter and form to economic theory: economic theory deals with the underlying form of events, while history and statistics deal with the concrete matter. The concrete historical cases are the exemplifications of general regularities, the Aristotelian matter that contains potentialities, while the economic laws "are the Aristotelian forms which actualize the potential, that is, they provide the laws and concepts valid for all times and places."[38]

Second, Menger held, in contrast to Jevons and Walras, that economic laws as expressed in mathematical equations are only arbitrary statements; on the contrary, genuine economic laws are "exact," in Menger's terminology meaning fixed laws that describe sequences invariable to time and place. Thus, Menger and the Austrians build up an "eternal structure of economics . . . stripped of all historical peculiarities." In short, Menger and, following him, Böhm-Bawerk were Aristotelian social ontologists, maintaining the absolute and apodictic reality of economic laws. Kauder perceptively pointed out that in contemporary economics, "only von Mises, the most faithful student of the three [Marginalist] pioneers, maintains the ontological character of economics laws. His theory of human action is a 'reflection about the essence of action.' Economic laws provide 'ontological facts.'"[39]

Finally, the Jevons-Walras mathematical method necessarily deals with "functions of interdependent phenomena," whereas, for Menger and the Austrians, economic laws are genetic and causal, proceeding from the utility and the action of the consumer to the market result. As Kauder put it:

> For Marshall, value and cost, supply and demand are interdependent factors whose functional connection can be explained in an

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[38]Emil Kauder, "Intellectual and Political Roots of the Older Austrian School," *Zeitschrift für Nationalökonomie* 17 (December 1957): 411–25.

[39]Ibid., p. 417.

> equation or a geometrical figure. For Wieser, Menger, and especially for Böhm-Bawerk the wants of the consumer are the beginning and the end of the causal nexus. The purpose and the cause of economic action are identical. There is no difference between causality and teleology, claims Böhm-Bawerk. He knew the Aristotelian origin of his argument.[40]

Kauder also pointed out that the characteristically Austrian method of proceeding with words from a Robinson Crusoe model and then proceeding step by step to a fully developed economy accords with the Aristotelian concept of entelechy, in which "the motion from the potentiality to the actualization determines not only the structure of the system but also the presentation of the thoughts."[41]

In attempting to explain the Austrian choice among all the marginalists for philosophical realism and social ontology, Kauder pointed to the late nineteenth-century influences on the Austrian intellectual climate of Aristotle, Thomas Aquinas, and other schools of realistic philosophy. Most influential was Aristotle, who was studied carefully down to the middle of the nineteenth century, and who was often taught in the secondary schools in Austria. And while realism gave way to empiricism in the Austrian School by the turn of the twentieth century, "the Viennese *Schottengymnasium*, the intellectual nursery of many famous Austrians including Wieser, required, even after 1918, the students to read Aristotle's metaphysics in the original Greek."[42] In contrast, of course, the influence of Aristotelian philosophy in Britain or even France during the nineteenth century was virtually nil.

In recent decades, the revisionist scholars have clearly altered our knowledge of the prehistory of the Austrian School of economics. We see emerging a long and mighty tradition of proto-Austrian Scholastic economics, founded on Aristotle, continuing through the Middle

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[40]Ibid., p. 418.

[41]Ibid.

[42]Ibid., p. 420; see also Kauder, *History of Marginal Utility*, pp. 90–100. On Menger as Aristotelian, also see Terence W. Hutchinson, "Some Themes from Investigations into Method," in *Carl Menger and the Austrian School of Economics*, J.R. Hicks and Wilhelm Weber, eds. (Oxford: Clarendon Press, 1973), pp. 17–20.

Ages and the later Italian and Spanish Scholastics, and then influencing the French and Italian economists before and up till the day of Adam Smith. The achievement of Carl Menger and the Austrians was not so much to found a totally new system on the framework of British classical political economy as to revive and elaborate upon the older tradition that had been shunted aside by the Classical School.

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The Present State of Austrian Economics

In the past two decades, there has been a seeming growth of methodological sophistication in the world of economics. Until the early 1970s, a blind Walrasian formalism held total sway in microeconomics, while a triumphant Keynesianism dominated macro, all held together by an unthinking and arrogant empiricist epistemology of logical positivism. The micro and macro synthesis of the neoclassical paradigm were both embodied and symbolized in the work of Paul Samuelson, while the positivist methodology was enshrined in the famed 1953 article of Milton Friedman and the later work of Mark Blaug.[1]

Since that point, however, the dominant positivist paradigm has been effectively overthrown, to be replaced by a bracing and near-chaotic Kuhnian "crisis situation" in the methodology of economics.

This paper was delivered at the Tenth Anniversary Scholars' Conference of the Ludwig von Mises Institute, October 9, 1992.

[1]For my purposes, I am ignoring the allegedly wide gulf between the earlier positivists with their "verifiability" criterion and the Popperites and their emphasis on "falsifiability." For those far outside the logical empiricist camp, this dispute has more of the appearance of a family feud than of a fundamental split in epistemology. The only point of interest here is that the Popperites are more nihilistic and therefore even less satisfactory than the original positivists, who at least are allowed to "verify" rather than merely "not falsify."

For a brilliant and incisive discussion and demolition of the logical empiricist contention on many levels, see David Gordon, *The Philosophical Origins of Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1993).

For the last two decades, a dozen, if not a hundred, schools of economic thought have been allowed to bloom. Unfortunately, however, the orthodox paradigms in macro and especially microeconomics are still dominant, although less aggressively held than before; the crisis situation in methodology has not yet been allowed to trickle down fully to the substantive bread-and-butter areas where economists, after all, earn their livelihood. If methodology is in ferment, however, the rest of the substantive fortress may soon follow.

The deterioration of the dominant neoclassical paradigm starting in the early 1970s has numerous causes. I would contend that the main cause was the abject collapse of the Keynesian System upon the emergence of the first major inflationary recession in 1973–74, an anomalous situation that has marked every recession since. The inflationary recession of the early 1970s[2] was a shock for two reasons: (1) in the Keynesian model, recessions are supposed to be due to underspending, and inflation to overspending; how then could both occur at the same time? And what can fiscal (or even monetary) policy do about it? and (2) intervention and statist planning of fiscal policy and "growth economics" in the 1960s was supposed to have eliminated business cycles forevermore, to bring us, in the naive jargon of the economic Establishment of that day: full employment without inflation. Business cycle courses were purged from graduate curricula; for if business cycles had been rendered obsolete, such courses would only be antiquarian studies of economic history. The severe inflationary recession of 1973–74, followed by a similar and even more severe recession of 1979–82, ended the myth of the disappearance of business cycles.[3] And if planning for growth was seen

[2]Actually, inflationary recession had first emerged during the 1933–37 inflationary boom, which took place within a deep depression. But since the origins of that depression, in 1929–33, were seemingly not inflationary, this episode was considered anomalous, and irrelevant to future cycles. In addition, prices first began to creep upward, but only slightly, during the 1957–58 recession, an overlooked but important harbinger of things to come. During 1966, there was a recession again without the usual price fall, but this was disregarded because the 1966 episode was not quite deep enough to meet the overly venerated National Bureau criteria for a recession. So the 1973–74 shock came like a bolt from the blue to the profession.

[3]We might even say of the business cycle as the great Etienne Gilson said about natural law: "the natural law always buries its undertakers."

to be flawed and even counter-productive, then perhaps government planning in general had severe problems; it was no coincidence, then, that the 1970s saw the resurgence of free-market economies and of free-market thinking among economists.

I contend, too, that the renaissance of Austrian economics beginning at about the same time was part and parcel of this general disillusion with both Keynesian economics and with government intervention, and part of a resurgence of free-market thinking. The Nobel Prize in economics granted to F.A. Hayek in 1974 has generally been credited with setting the spark for the Austrian revival, and there is much to be said for this thesis, especially considering the superstitious awe and veneration with which the Nobel Prize is regarded by the economics profession. But unless we really believe that the Swedish economists who award the Nobel annually are guided solely by divine inspiration, we must recognize that these gentlemen, too, reflect ideas current in the economics profession in Sweden and in Europe as a whole. After World War II, the Swedish profession, even more than their colleagues of other countries, was notoriously the home of Keynesianism and of econometrics; and the first Nobels, from 1969 through 1973, reflect that bias. It is no accident, then, that Hayek's Nobel prize in 1974, shared ironically with the leftist maverick Gunnar Myrdal, was the first one to be granted to a free-market economist.[4] It is also significant that the first free-market Nobel went to Hayek, not for his later vaporings in "spontaneous order," "knowledge," "evolution," and so on, for which he is unfortunately revered by most current Austrians, but instead for his elaboration of the Misesian business cycle theory which had been prominent in Britain in the 1930s, only to be swept away, in the late 1930s, by its great enemy, the Keynesian Revolution. To grant the first free-market Nobel to the antipode of Keynesian macro-theory cannot be considered a coincidence: it symbolized the end of the unquestioned dominance of the Keynesian-statist paradigm in economics.[5]

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[4]Previous Nobels had been granted to: Keynesian econometricians Ragnar Frisch and Jan Tinbergen, Paul Samuelson, national income statistician Simon Kuznets, Kenneth Arrow and John R. Hicks, and input—output planner Wassily W. Leontief.

[5]Some of us harbor the suspicion that it is no coincidence that Hayek received the prize precisely in 1974, the year after the death of his great

The Austrian revival starting in 1974 has now lasted long enough and taken hold firmly enough to enjoy the luxury of its first published historian, who places central emphasis on the week-long South Royalton, Vermont, Austrian conference in the summer of 1974. Professor Karen Vaughn was a youthful participant, now turned participant-observer, at this conference, but unfortunately her account of that conference and of the revival generally is both biased and totally unsatisfactory. One of the minor purposes of this paper, in the course of a critique of that revival and of the current state of Austrian economics, is to analyze and correct the Vaughn record.[6]

Paradigms and the Whig Theory of the History of Science

One of the most welcome aspects of the methodological ferment of the past twenty years has been the overthrow of the once-dominant "Whig" notion of the history of a scientific discipline: that it proceeds, onward and upward in linear fashion, testing hypotheses, accumulating knowledge, and discarding the dross, so that scientific knowledge embodied in the latest textbooks and journal articles at point t is always and necessarily greater than at point t-1. This means that since the scientific discipline always knows more, say in 1983 than in 1971 or 1962, that there is no point in reading any part of the discipline except the latest textbooks and journal articles. Oh, there could be an antiquarian point, in 1992, to reading 1956 physics or chemistry, to find out about the history of the earlier period, or to examine how a science grew, or how scientists influenced each other, but there is nothing to learn substantively about the discipline from reading older chemistry or physics.

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mentor, the founder of Austrian business cycle theory, Ludwig von Mises. The Swedish economics profession might have become partially liberated by 1974, but surely not liberated enough to grant the prize to as consistent and uncompromising an ideological and methodological "extremist" as Ludwig von Mises.

[6]Karen I. Vaughn, "The Mengerian Roots of the Austrian Revival," in *Carl Menger and His Legacy in Economics*, Bruce J. Caldwell, ed., Annual Supplement to Vol. 22 of *History of Political Economy* (Durham, N.C.: Duke University Press, 1990): 395–405.

But this sort of naively optimistic view has been rendered obsolete by the brilliant "paradigm" analysis of Thomas Kuhn, who shows that this fanciful tale is far from the truth, even in the physical sciences. Even if we are less relativist than Kuhn, and believe that later paradigms are usually superior to—closer to the truth than—earlier ones, there still can be a severe loss of knowledge in discarding earlier paradigms. At the very least, then, there can well be substantive knowledge gained by exploring earlier paradigms. If this is true even in the physical sciences, *a fortiori* it is even more true in the nonexperimental disciplines such as philosophy and economics, where because of gross error, accident, or ideological or political bias, a later paradigm may well be inferior to earlier ones. There should not even be a presumption, much less a guarantee, of the later the better in the history of economic thought.

And yet, observers of the current Austrian School, as well as participants in it, have unwittingly and unthinkingly returned to Whig habits of thought when discussing or evaluating contributions of the Austrian School. They have unthinkingly assumed that the later the better, that is, that simply because, for example, the works of Don Lavoie or Ludwig M. Lachmann came later in time than those of Ludwig von Mises, that they must be better, or to put it differently, that these later contributions must constitute "development" and "growth" in the field. And yet, if later is not necessarily better, then the new may not at all constitute "growth"; newer may, in fact, constitute error and degeneration from an originally correct paradigm. But if the newer is not necessarily better, it follows that it might even be worse. And if a newer contribution is worse, and there is degeneration, then there must be some criterion or standard of truth with which to compare these temporally different contributions. On the other hand, if we take the fashionably nihilist view and claim that there is no truth, that anything, any methodology, goes, then it follows that contribution A can never be better or worse than contribution B, and then there can be no judgments of merit at all, regardless of the date of the contribution. Indeed, the entire scholarly enterprise may as well be abandoned.

To show how this inconsistency works: Professor Vaughn is horrified because a new work, in 1985, purportedly in Austrian economics, by O'Driscoll and Rizzo was severely criticized by other Austrians. She writes: "By the time of its completion, the book [by

O'Driscoll and Rizzo] broke new ground in developing a coherent Austrian paradigm," and adds: "and consequently was criticized by many Austrians who 'knew' it wasn't faithful to Austrian principles." But does this mean that Vaughn's conception of the scholarly dialogue is that every new book, *because* new, must be above criticism, and that any criticism is somehow illegitimate? Is *that* the way she conceives of the search for truth? And what if the book is *actually* (a) fallacious to the core, and (b) totally violates Austrian principles? Are critics supposed to fall silent, because "Austrian principles" are to enjoy a definition so elastic that anyone should be allowed to call himself an "Austrian" without being subject to criticism or challenge?[7]

It is the contention of this paper, indeed, that several different and clashing paradigms have been allowed to develop and fester, all in the name of "Austrian economics"; that a great deal of confusion and incoherence have resulted; and that this coexistence of contradictory doctrine and proliferation of clutter should be brought to an end. In short, the rubble of Austrian economics must be cleared at last, the turgid undergrowth hacked away, Austrian doctrine re-clarified and truth enshrined, and the proliferation of error and fallacy swept away.

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[7]Vaughn, "Mengerian Roots," p. 401*n*. Also see ibid., p. 397*n*. Amusingly enough, Vaughn talks repeatedly of the O'Driscoll-Rizzo volume "garnering so much criticism" from Austrians without citing the major, indeed the only, place such criticism appeared: the devastating review by Professor Charles W. Baird, "*The Economics of Time and Ignorance*: A Review," *Review of Austrian Economics* 1 (1987): 189–206.

The Economics of Time and Ignorance was a fortunately short-lived attempt to replace the Misesian paradigm with Bergsonian irrationalism; its rapid demise was assured by its demolition by Professor Baird. In the course of writing that work, Professor Rizzo, the philosophical leader of the duo, was moving visibly away from the Misesian paradigm. In a Mises centennial volume edited by Israel Kirzner, Rizzo first flirted with the then-fashionable philosophy of science of Imre Lakatos as a replacement for praxeology; in a postscript written a mere six months after the text, Rizzo announced another radical change of mind even further away from Mises. The final result in 1985 was the Bergsonian dead-end. See Mario J. Rizzo, "Mises and Lakatos: A Reformulation of Austrian Methodology," in *Method, Process, and Austrian Economics*, Israel M. Kirzner, ed. (Lexington, Mass.: Lexington Books, 1982), pp. 53–73.

The New Methodology and the Burgeoning of "Austrian" Fallacies

Part of what has happened to Austrian economics since 1974 was inevitable. Along with growth and flourishing, in numbers of economists, students, and contributions, there is bound to be a proliferation of error and of false leads and byways. That, in a sense, is a healthy development in the history of a science, but *only* if there are corrective forces who will periodically clear the underbrush and sweep away the rubble. That task has unfortunately not yet been done, although part of this necessary process has already begun.[8]

The idea of correction and demolition of error does not sit well with the now reigning paradigm in the epistemology of economics. The Old Methodology, dominant until the 1970s was frankly prescriptive, setting up criteria for valid and invalid theory. The problem with the Old Methodology was not that it presumed to methodological truth and validity, nor that it passed judgment on various methods and theories in economics, but that its criteria were systematically wrong: it was trapped by what Professor Mirowski calls "physics envy" to ape the assumed methodology of physics in the disciplines of human action. The problem with the Old Methodology (dominant until the 1970s) was not that it was prescriptive, but that its prescriptions were dead wrong. Unfortunately, in overturning the tyranny of the Old Methodology, the successful rebels focused not on the invalidity of the prescription but on the fact that any prescriptions were set forth at all. And so the prescriptive baby was thrown out with the positivist bathwater—to be replaced by the New Methodology of anything goes, of allowing all flowers, including noxious weeds, to bloom. The New Methodologists habitually deny that for them "anything goes," but that is precisely what their proclaimed mission—to *understand* and clarify all theories, but never to judge or

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[8]See, for example, the demolitions of the fortunately short-lived "hermeneutical tendency" in Austrian economics, by David Gordon, *Hermeneutics vs. Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1986); Hans-Hermann Hoppe, "In Defense of Extreme Rationalism: Thoughts on Donald McCloskey's *The Rhetoric of Economics*," *Review of Austrian Economics* 3 (1989): 179–214; and Murray N. Rothbard, "The Hermeneutical Invasion of Philosophy and Economics," *Review of Austrian Economics* 3 (1989): 45–59; included in this volume as chapter 8.

denounce them—amounts to. Clearly, the New Methodology is all too congruent with our New Age.[9]

There are two grievous and unwitting contradictions involved in this argument by our New anti-prescriptive Methodologists. In the first place, as we have pointed out in the case of Professor Vaughn, there is a glaring though unacknowledged bit of *prescription*: the Whig view that newer is necessarily better, a view that sits peculiarly in a system that offers no criteria for validity and no suggestion that there is any process or mechanism for learning about or adopting such criteria if they *did* exist. But there is also a deeper contradiction. For the New Methodologists are saying that it is *wrong* for economic methodology to be prescriptive, that it is only right for methodology to describe or clarify within each paradigm. But in that case, the New Methodologists are being very prescriptive indeed: they are saying that it is wrong or bad to say that any methodology is wrong or bad; but what argument, then, do they offer for *their* prescriptiveness? Various old methodological schools, be they positivists, Austrians, or institutionalists, have offered various concrete arguments for their particular prescriptions: for their view that their particular methodologies are right or correct, and the others wrong. But the New Methodologists offer *no argument whatsoever* for their own, sweeping, hidden prescriptiveness: that all prescriptions (except their own) are necessarily bad or incorrect. In short, the New Methodologists offer no argument for their anything-goes prescription—all they have to offer is the *mood* of the moment, of the contemporary culture: the absurd, self-contradictory mood of our "therapeutic," psycho-babbling, anti-"judgmentalist" culture. To state this fact is to reveal the absurd, counter-intuitive, anti-rational, fashionable mood of the New Methodologists—a mood that offers no, and is subject to no, argument, and is therefore simply not to be taken seriously.

My contentions are: that the correct Austrian paradigm is and can only be the Misesian, that is, the paradigm of Misesian *praxeology*; that the competing Austrian paradigms, in particular the

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[9]For an incisive discussion of the Old and the New Methodologies, by one of the leading purveyors of the New, see Bruce J. Caldwell, "The Trend of Methodological Thinking," *Ricerche Economiche* 43 (January/June 1989): 8–20.

fundamentally irrational "evolved rules," "knowledge," "plans," and "spontaneous order" paradigm of Hayek and the more extreme "ultra-subjectivist" or nihilist paradigm of Lachmann, have both been fallacious and pernicious; that, as we shall see below in discussing the history of the modern Austrian revival as a *movement*, for various reasons the Misesian paradigm was almost totally cast aside and forgotten; but that now it is resurgent and rapidly becoming dominant and even triumphant within Austrian economics. And in the nick of time. The strong implication of Vaughn and of other anti-Misesian critics is that Misesians simply want Austrian economics to be static, to repeat endlessly Mises's words and ideas by rote. Not so; that this is untrue may be seen in numerous creative developments and advances in Misesian economics over the past thirty years: in particular my own earlier work in monopoly theory, theory of rent, welfare economics, government and the economy, and theory of property rights[10] and more recently by the work of Hans-Hermann Hoppe in the praxeological method, comparative economic systems, taxation, and a praxeological theory of rights; and by the work of Joseph T. Salerno in Mises vs. Hayek on reason, free exchange, and socialist calculation; and of Salerno on the work of Hutt and market coordination of prices as against the Hayekian "coordination of plans." All this, as well as the recent work in the philosophical background of Austrian economics by Barry Smith and David Gordon, are notable and creative advances in developing, elaborating, and making more consistent and hard-edged, the original Misesian paradigm.[11] In addition, there are the papers delivered at this conference,

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[10]Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles*, 2 vols. (1962; Los Angeles: Nash, 1970); Rothbard, *Power and Market: Government and the Economy* (1970; Kansas City: Sheed Andrews and McMeel, 1977); and Rothbard, *Toward a Reconstruction of Utility and Welfare Economics* (1956; New York: Center for Libertarian Studies, 1977); included in this volume as chapter 17.

[11]See, among others, Hans-Hermann Hoppe, *Praxeology and Economic Science* (Auburn, Ala.: Ludwig von Mises Institute, 1988); Hoppe, *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (Boston: Kluwer, 1988); Hoppe, *The Economics and Ethics of Private Property* (Boston: Kluwer, 1993); Joseph T. Salerno, "Postscript: Why Socialist Economy is 'Impossible,'" in *Ludwig von Mises, Economic Calculation in the Socialist Commonwealth* (1920; Auburn, Ala.: Ludwig von Mises Institute, 1990), pp. 51–71;

as well as literally dozens of other contributions in the *Review of Austrian Economics* and elsewhere on numerous aspects of theory, method, history, and policy.

The desideratum is not to keep Austrian economics static; that can never be true of a growing and developing science. The desideratum is creative advance *within* the correct Misesian paradigm, as well as guarding against degeneration of the discipline into fallacy and error.

Misesian Praxeology versus Competing Paradigms

It has unfortunately become habitual in summing up Austrian economics, or the Austrian paradigm, to present it as an unconnected grab-bag of separate principles, a laundry-list of various separate traits: In particular, "subjectivism"; "market process" or disequilibrium processes as against equilibrium or end-states; market coordination of plans; methodological individualism; stress on the "unintended consequences" rather than the *intended* consequences of human action; and writing in "literary" style or ordinary language rather than in formal mathematics. As we shall see, this emphasis on the unconnected laundry-list leads almost inevitably into gross error, for it leads to a one-sided overvaluation and therefore mis-emphasis on such particular traits as "subjectivism," "market process," or unintended consequences, thereby unfortunately denigrating such *other* crucial elements of Austrianism as objective reality and its laws, the end-state or equilibrium goals implicit in all human action, and the exercise of reason and therefore the *intended* consequences of such action.

If for no other reason, this disparate laundry-list of Austrian traits should be swept away with one mighty slash of Occam's Razor. For all of them can be integrated into, encompassed by, and deduced from, one central core concept: the Misesian concept of *praxeology*.

Salerno, "Ludwig von Mises as Social Rationalist," *Review of Austrian Economics* 4 (1990): 26–54; Salerno, "Commentary: The Concept of Coordination in Austrian Macroeconomics," in *Austrian Economics*, Richard Ebeling, ed. (Hillsdale, Mich.: Hillsdale College Press, 1991), pp. 325–43; Barry Smith, "Austrian Economics and Austrian Philosophy," *Austrian Economics: Historical and Philosophical Background*, W. Grassl and Barry Smith, eds. (New York: New York University Press, 1986), pp. 1–36; and Gordon, *Philosophical Origins of Austrian Economics*.

The word praxeology means precisely what its etymology says: the *logic* of (human) *action*. All of economic theory can be deduced from the central axiom that human beings *act*—that they pursue means in order to arrive at ends.[12] One of Mises's central achievements was to realize that this was the methodology of the best economic theory before him, to be the first to systematize that methodology, and then to be the first to construct the entire edifice of economic theory in accordance with this praxeological prescription. Correct theory is based on the true and unrefutable axiom that human beings act, and proceeds by deducing the logical—and therefore true—implications from that formal fact.[13]

Armed with the central core of praxeology, of the implied logic of the existence of human action, let us examine each of the alleged Austrian traits as set forth by non-Misesian Austrians (Hayekians and others).

Subjectivism

Subjectivism stems from the important point that individuals value only subjectively: that goods and resources are evaluated by individual minds, for example, by consumers, and that prices of goods and services are determined only by relative valuations of those goods by all individuals in the market. It is true, also, that Mises helped to purge economics of continuing vestiges of faulty objective value theories, from Ricardian cost and labor-pain theories preserved by Marshall, to the current pretensions to employ and even measure such invalid concepts as objective "social costs," objective "costs and benefits," and objective, measurable "transaction costs." All these concepts are illegitimate.

But, with the shunning and neglect of Mises and praxeology (shunned rather than consciously argued with or refuted), recent Austrian paradigms have allowed "subjectivism" to run riot: to extend from legitimate subjective value theory to a virtual denial of

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[12]The deduction is also aided by a few subsidiary axioms: such as the basic fact that human beings require leisure.

[13]For a statement of praxeology and the construction of an edifice of economic theory according to the praxeological method, see Ludwig von Mises's monumental work *Human Action* (1949, 3rd rev. ed.; Chicago: Henry Regnery, 1963). Also Rothbard, *Man, Economy, and State*.

the objective existence of the real world, of the objective laws of cause and effect, and of the objective validity of deductive logic. In value theory, the non-Misesians, especially the Lachmannians, neglect or deny the objective fact that physical objects are being produced, exchanged, and evaluated, albeit that they are subjectively evaluated by acting individuals.[14] Lachmannians and other pseudo-Austrians must be confronted with the fact that individual human beings exist, that their actions exist, and that the world of which they are a part also exists.

Knowledge and Uncertainty

Intimately connected with the question of subjectivism is the problem of knowledge and uncertainty. Neoclassical economics has locked itself into the absurd view that everyone in the market—consumers, producers, and firms—have *perfect* knowledge: that demands, supplies, costs, prices, products, technologies, and markets are known fully to everyone, or to all relevant individuals. This absurd assumption can only begin to be defended on the positivist, or Friedmanite, view that it is all right to incorporate gross error into one's assumptions so long as correct "predictions" can be made. In the praxeological view, however, quantitative predictions can *never* be made; in fact, it becomes necessary to guard against including error in the chain of axioms and propositions, which must be true at every step of the way. In recent years, the rational expectations theorists have compounded this absurdity even further by claiming that "the market"—as some reified all-knowing entity—has absolute knowledge not only of all present conditions, but also of all *future* demands, costs, products, and technologies: so that the *market* is omniscient about the future as well as the present.[15]

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[14]I find it helpful to regard the market demand-and-supply curves as interactions of a vertical line of an existing stock of things, goods, or resources, being evaluated by a falling demand curve comprised of aggregates of individual ordinal value or preference scales, marked of course by diminishing utility of each unit as the supply of a good increases. The intersection of the vertical supply (or stock) line with the falling demand curve determines the day-to-day market equilibrium price.

[15]More strictly, the rational expectation theorists claim that the *market* has absolute knowledge of the "probability distributions" of all future

The Misesian praxeological view, in contrast, is that knowledge of the present, much less of the future, is never perfect, and that the world in general, and the market in particular, are eternally marked by uncertainty. On the other hand, man obtains knowledge, which one hopes increases over time, of natural laws, and of the laws of cause and effect, which enable him to discover more and better ways of mastering nature and of bringing about his goals ever more effectively. As for uncertainty, it is the task of the entrepreneur to meet that uncertainty by assuming risks, in search of profit and of avoiding loss.[16]

Hence, to the praxeologist, Misesian Man faces the world emphatically knowing some things about his world and not knowing others. He knows absolutely that he and the world, including other people and resources, exist; he knows that natural laws and the laws of cause and effect exist; and that such knowledge cumulates over time. His technological knowledge of what goods will satisfy his wants and of how to acquire them continually increases. And yet he lives in a world of uncertainty, of uncertain future demands, resources, products, prices and costs, all problems which entrepreneurs tackle. Over time, entrepreneurs who are successful in bearing risks and forecasting their particular future will earn profits and expand

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events, any errors being purely random. But this only compounds the problem since the concept of "probability distribution" can only be used for events that are homogeneous, random [path-independent], and infinitely replicable. But the events in the world of human action are almost exactly opposite: they are almost all heterogeneous, not random [path-dependent] and hardly replicable at all. Furthermore, even in the highly unlikely event that these conditions *did* apply, class probabilities could not at all be used to explain or predict events, which is what we face in human life. See Mises, *Human Action*, pp. 106–15; and Richard von Mises, *Probability, Statistics, and Truth* (1928, 2nd ed.; New York: Macmillan, 1957).

[16]Mises incorporated into his praxeology the useful Knightian distinction between insurable *risk* (such as lotteries, gambling on roulette), and uninsurable (because heterogeneous, not random, and not replicable) *uncertainty*, which the entrepreneur bears and for which he earns profit or suffers loss. See Mises, *Human Action*, pp. 289–94. Also see Mises's neglected essay, "Profit and Loss," Ludwig von Mises, *Planning for Freedom and other Essays and Addresses* (South Holland, Ill.: Libertarian Press, 1952), pp. 108–30.

their operations, while poor risk-bearers and forecasters will suffer losses and necessarily shrink their field of activity. Hence, entrepreneurs will tend to be kept on their toes and be successful in most of their forecasts.

The important point in relation to economic theory is that Misesian Man knows the body of economic laws that Misesians have built up; these laws, while absolute, are qualitative and *ceteris paribus* in their nature and cannot themselves forecast the future. Such forecasting can only be an entrepreneurial art, quantitative forecasts that can be helpfully guided though not determined by qualitative praxeological laws. These forecasts must also be guided by insight, by *Verstehen*, into present and future conditions and into the values, preferences, and changing habits of other human actors.

Suppose, for example, that Misesian Man, as forecaster, is trying to estimate how prices in general will behave in the next few years. He is armed with an absolutely true (as Mises would say, *apodictic*), qualitative, law of praxeological economic theory: that if the money supply increases, and people's demand for money remains the same, prices will rise. But, to forecast, he must go beyond such economic laws, and try to estimate: (a) how much, if at all, money will increase in the near future; (b) what will happen to the demand for money; and (c) what, then, will happen to general prices—considering also what is likely to happen to the supply of goods. Misesian Man knows a lot; but he does not know everything and he must try to estimate the future, given various quantitative and qualitative estimates of change. To show the absurdity of the neoclassical (monetarist subdivision) pretension of attempting to establish "scientific" quantitative laws between the money supply and prices, in estimating the course of the money supply in the near future, a person must try to figure out the psychology of, the ideas held by, and the political influence upon, the Federal Reserve Board.

But contrast to this "moderate" uncertainty of Misesian Man, the plight of Lachmannian Man, subject to Lachmann's radical uncertainty and nihilism. Professor Lachmann's favorite mantra, which he would repeat at every opportunity, and which I hold to be the key to his thought, was the following: "the past is, in principle, absolutely knowable; the future is absolutely unknowable." Since the future, for Lachmann, is absolutely unknowable, Lachmannian Man knows no economic law, no law of cause and effect, qualitative or

quantitative. In fact, he can have no *Verstehen* into patterns that are likely to occur in the future. At every moment of succeeding time, Lachmannian Man steps into a trackless void.[17]

Since there are no laws of cause and effect in human action, Lachmannian Man would not be able to take the first step in figuring out what is happening, or likely to happen, with prices. Money? Prices? They can have no relation into the future, qualitative or quantitative, which means they are not causally related at all.

Once again, the Lachmannites have no real arguments in escalating from moderate to absolute uncertainty; they apparently think that repetition suffices for argument. It seems clear to me, on the contrary, that the entire Lachmannian paradigm is nonsense. Putting aside Lachmann's overweighing of the absolute unknowability of *the past* (Do we really *know* with certainty why Caesar crossed the Rubicon?), I know many things about the future with absolute certainty: I know with absolute certainty, for example, that I will never be elected president of the United States. I know, with even greater certainty, if possible, that I will never be named King of England. I submit that I am far more certain about these future events than I am of the reason that Lenin, at Finland Station, was the only Bolshevik to see that skipping several important stages could lead to a successful revolution in Russia.[18]

Since Lachmann denies the possibility of knowing the future at all, and therefore of any economic law, qualitative as well as quantitative, Lachmann and his followers inevitably become mere institutionalists, mere historians of the record of man's past economic activities. Mises

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[17]When pressed, Lachmann, fortunately for Lachmannian Man, conceded that this total ignorance does *not* apply to the laws of the physical world; Lachmannian Man is fortunate that he can rely, *inter alia*, on the law of gravity. It is only laws and patterns in the human sphere that cannot exist for him.

[18]Lachmann's weasel-worded disclaimer, knowable "in principle," is scarcely enough to salvage his naively optimistic view of our knowledge of the past. *In principle*, how can we figure out why Lenin saw something in the Russian concatenation of events that none of the other Bolsheviks, even with very similar world-outlooks, could then see? At bottom, individual uniqueness, whether the uniqueness of the entrepreneur, the inventor, the forecaster of events or the creator, cannot be "explained" in determinist fashion.

would have called Lachmann and the Lachmannians, as he called all other institutionalists, "anti-economists," that phrase meant not merely as an epithet, but also as a deadly accurate summation of what they are about. Since the Lachmannians are opposed to even the possibility of economic theory, they must be set down as no longer economists at all. *Faute de mieux*, I suppose they could be called "historians" except (a) they do very little actual historical work, and (b) as Mises has made clear in his fundamental though much-neglected *Theory and History*[19] to be a good historian you have to be able to use causal theories from various disciplines to help explain unique historical events, and the tools of economic law are indispensable parts of any genuine historian's armamentarium.[20] In a sense, Lachmannians and other institutionalists function as professional anti-economists and "meta-historians," expending their energies denouncing economics and urging other economists to act as historians.[21]

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[19]See Ludwig von Mises, *Theory and History* (1957; Auburn. Ala.: Ludwig von Mises Institute, 1985).

[20]Ludwig M. Lachmann had been a student of Hayek at the London School of Economics in the 1930s and his writings were generally Misesian until the mid-1970s, when he became converted to the nihilism of his old friend and fellow-Hayek student, the Englishman G.L.S. Shackle. Thus, see Lachmann's appreciative review of Mises's *Human Action*, "The Science of Human Action," *Economica* 18 (November 1951): 412–27. Lachmann's outstanding achievement was his Misesian *Capital and Its Structure* (London: London School of Economics, 1956) which, presumably for that reason, is never cited by modern Lachmannians. The watershed date for announcing his conversion to Shackleinism was Ludwig M. Lachmann, "From Mises to Shackle: An Essay on Austrian Economics and the Kaleidic Society," *Journal of Economic Literature* 14 (March 1976): 54–62.

[21]An amusing but instructive event occurred on the occasion of the conference of American Austrians at Windsor Castle in the summer of 1976. Under the good offices of Professor Stephen C. Littlechild of the University of Birmingham, a kind of summit conference was arranged so that some of the American Misesians could meet the English Subjectivist School, as the Shackleians call themselves. The eminent Subjectivists at the meeting included the *doyen* of that school, Shackle himself, as well as Terence W. Hutchison, Jack Wiseman, and Brian Loasby. At one point, the Subjectivists were lamenting that they could not offer a program of graduate economics courses as alternatives to the neoclassical paradigm, since all

Knowledge and the Role of the Entrepreneur

If Lachmannian Man knows nothing, his brother Hayekian Man (the third major paradigm within modern Austrian economics), is better off, but not by very much. Hayek is obsessed by Man's allegedly pervasive and systemic ignorance. Indeed, Hayek's virtually lone argument against government intervention and against socialism is that government planners can know nothing. Since reason can play little or no role in man's affairs, government, or man through government, does not even know enough to establish general legal or constitutional rules for society. These general rules can only emerge from the blind, unconscious forces of "evolution"—the evolved rules that the later, post-Misesian Hayek, (in Hutchison's felicitous term, Hayek II as compared to the Misesian Hayek I) wishes us to worship and follow blindly lest we perish.[22] For Hayekian Man, however, there is a way out: even though he knows virtually nothing, he can painfully learn *through* the processes of the free market, just as in law or constitutions, he can learn to accept the "evolved" rules. In contrast, Misesian Man can not only know and learn, he can do so by exercising his unique human power of *reason*; and *reason*—the body of praxeologically-deduced economic theory—can and does tell him that the market economy works extremely well, while government planning and socialism cannot work at all. Misesian Man knows the virtues of the free market and the devastating flaws of socialism by using his reason. In the case of general rules, Misesian Man would think it absurd to accept all rules simply because they are there, without also correcting them by use of his reason.

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they had produced were a few critical essays but no substantial body of economic theory. I replied in some surprise that there was indeed a great deal of systematic Austrian literature available, including works by Mises, the early Hayek, and my own work, in addition to volumes of Böhm-Bawerk and Frank A. Fetter, among others. The blank looks of incomprehension on the faces of the distinguished Subjectivists were a revelation of the enormous extent of the inherent gulf between Shackleian Subjectivists and Misesians.

[22]Since there can be nothing in social life corresponding to the biological gene, the use of the term "evolution" by Hayek and others to describe historical change simply serves to drape the mantle of pseudo-science upon such change and to smuggle in an unacknowledged and unsupported value-judgment (supported only by the alleged benevolence and necessity of the "evolutionary" process) to sanctify such rules.

The respective attitudes toward human knowledge and human capacity help account for the enormous differences in the various paradigms on the crucial role of the entrepreneur in the market. For Neoclassical Man, there is no need for an entrepreneur, since all men know everything about the market, its past and its future, perfectly; and all curves are tangent, and all things at rest, in the Never-Never Land of long-run general equilibrium. Austrians, in contrast, place great stress on the dynamic role of the entrepreneur, but their visions of that role are very different.

Hayekian Man, the Hayekian entrepreneur, starts by knowing nothing, but he painfully learns about the world and the market *through* the "signals" of the price system. Hayek, and Professor Israel Kirzner after him, habitually speak of the market, of competition on the market, as a "discovery process." In contrast to Lachmann, who thinks there can be no knowledge of the world out there to learn, Hayek-Kirzner see a world of knowledge out there, with the unconscious forces of the market supplying man with that knowledge, through market price and profit-and-loss signals. The Hayek-Kirzner entrepreneur, indeed, is strangely passive; he scarcely acts like an entrepreneur at all. He risks nothing, and he really knows nothing, except what the signals of the price-system teach him, as he and the market economy wend their way toward general equilibrium. In his elaboration of the Hayekian theme, Kirzner sees the only function of the entrepreneur, and his only necessary quality, to exercise "alertness": to catch the market signals earlier than the next guy. In Kirzner's favorite metaphor, a $10 bill lies on the ground. Many people do not see that bill; but the entrepreneur is more alert than his fellows, and so he is the first to see, and to snatch that bill. Superior alertness, alertness to the truth out there, accounts for entrepreneurial profits.

There are many problems with the Kirznerian schema. If superior alertness accounts for entrepreneurial profits, what in the Kirznerian world can account for entrepreneurial losses? The answer is nothing. And yet the crucial aspect of entrepreneurship is that stressed by Mises: that the entrepreneur *takes risks*, that he can make profits by risking resources and through superior forecasting of the future, while suffering losses from inferior forecasting. Yet, there are neither risks nor uncertainty of the future in the Kirznerian world. Kirznerian Man faces not the future but the present; he owns no capital

resources and so he risks no losses; he simply sees present truth before others and alertly possesses it.

In the Misesian world, in contrast, the entrepreneur is not passive but extremely active.[23] He takes risks, and attempts to forecast the future; he grapples with uncertainty. The most important Misesian entrepreneurs, the driving force of the economy, are the capitalist-entrepreneurs, those who own or partially own capital resources and risk them in projects hoping for future returns. And, in the area of knowledge, as professor Salerno has perceptively pointed out, Misesian Man knows a lot about his part of the market—not just prices, but all the *qualitative* knowledge that must also go into production and into risky ventures: the sort of customers he will have, the sort of products they will want, where to buy raw materials and how to transform them, and so on—that is, all the *particular* knowledge that Hayek has talked about in other contexts. The free price-system is vital to the entrepreneur but it is not, as in Hayek-Kirzner, his only source of knowledge.[24]

The Misesian entrepreneur, then, is not a passive, if alert, recipient of "knowledge" provided by the price system. He is a knowledgeable, active, risking, forecasting, man using the price system as an indispensable guide to enable him to *calculate* his costs, and to estimate his future revenues and profits.

As for Lachmannian Man, the entrepreneur may exist, but he loses all significance. In contrast to the Hayek-Kirznerian man, he cannot learn from market signals because he cannot know anything

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[23]For a critique of Kirznerian alertness, see Murray N. Rothbard, "The End of Socialism and the Calculation Debate Revisited," *Review of Austrian Economics* 5, no. 2 (1991): 67; included in this volume as chapter 45. Also see Rothbard, "Professor Hébert on Entrepreneurship," *Journal of Libertarian Studies* 7 (Fall, 1985): 281–85. The latter article was a comment on a paper by Professor Robert Hébert, both written for a tricentennial conference on Cantillon in August 1980. Hébert's discussion on Kirzner's view of entrepreneurship is in Robert F. Hébert, "Was Richard Cantillon an Austrian Economist?," ibid., pp. 272–75. For a further comment on Kirzner and on my paper, see Robert F. Hébert and Arthur N. Link, *The Entrepreneur Mainstream Views and Radical Critiques* (New York: Praeger, 1982), pp. 95–99.

[24]See below, the section on Knowledge and Socialist Calculation.

anyway, even through price signals. Lachmannian Man is totally bereft of knowledge, and his Man in the market economy is scarcely better off than, or knows more than, the Lachmannian socialist planner.[25]

Market Process and Equilibrium

While the neoclassicist believes, or affects to believe, that the market economy is always in a state of general long-run equilibrium, Austrian economics, from Menger on, indeed from Cantillon on, has concentrated not on equilibrium but on the process by which the market moves toward it. The real world, the day-to-day world of markets, is one where the market is always moving toward equilibrium but never attaining it, since the determinants of market activity: values, resources, technologies, knowledge, products, and so on, are always changing. The Austrians, therefore, concentrate on market processes rather than on the final equilibrium state.

But in contrast to Mises, the Lachmannians, in particular, have thrown out final equilibrium altogether. They regard the entire concept as meaningless. Instead, they virtually use the phrase "market process" as a shibboleth, thereby throwing out not only equilibrium,

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[25]Alexander Gray's hilarious and perceptive strictures on Ricardo's argument against government intervention apply a fortiori to the free-market Lachmannians:

> Such is the Ricardian scheme of distribution; in place of the old harmony of interest, he has placed dissension and antagonism at the heart of things. . . . Gone is the large-hearted optimism of Adam Smith, transmuted into a pessimism that will not be comforted. Yet Ricardo remains immovably non-interventionist. . . . In a world of Ricardian gloom one might ask why there should not be interference. An optimist carolling that God's in His Heaven and that all is right with enlightened self-interest has a right to nail the laissez-faire flag to the mast, but a pessimist who merely looks forward to bad days and worse times ought not in principle to be opposed to intervention, unless his pessimism is so thorough-going as to lead to the conviction that, bad as all diseases are, all remedies for all diseases are even worse. (Alexander Gray, *The Development of Economic Doctrine* [1931; London: Longman, 1980], pp. 171–72)

but the baby of economic theory itself along with the neoclassical bathwater. It is impossible to engage in economic theorizing without employing what Mises called "imaginary constructions" or "thought experiments" (*Gedankenexperimenten*) which function as the praxeologist's unique substitute for the laboratory experiments of the physical sciences. In the laboratory, the scientist holds all other variables constant, while he examines the effect of changing one variable upon another. Since human beings cannot be "held constant," the praxeologist does so in "thought experiments," by means of the famed *ceteris paribus* clause. It is through such reasoning that the economic theorist concludes, for example, that an increase in the supply of money, the demand for money being held constant, will be bound to lower the value (purchasing power) of the monetary unit. In short, the economic theorist postulates an equilibrium, then mentally changes one variable, say the supply of money, keeps all other relevant variables constant, and examines the effect on prices in general. Refusing to employ equilibrium concepts is necessarily destructive of all economic theory or economic law.

Ceteris paribus constructions can and do embody reality and economic truth even if the *specific* constructions are not "realistic" in the sense that they are not happening at that particular moment in time. These theories and laws are realistic because they are deduced from the fundamental and absolutely true axiom of human action, that people continually *act* by employing means to try to achieve goals. The laws of monetary theory, for example, that an increase in the supply of money, given the demand for money, will lead to a fall in the value of the monetary unit, are eternally and "apodictically" true, regardless of time and place, provided, of course, that money is being used in the economy. Even if there were no money in the world today, or, more specifically, no monetary inflation, the law or construction in question would still be *true*, only presently not applicable. It is the task of the economic historian or forecaster to *apply* the theory of monetary inflation to any economy where such inflation may exist.[26]

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[26]In his sympathetic discussion of praxeology, Patrick J. O'Sullivan asserts that Mises, as an a priorist, believed that since the fundamental axiom of action is a priori to experience, that the deduced laws are simply true, whereas Hayek and Robbins, believing that the axioms are empirically

Mises put it this way:

> The specific method of economics is the method of imaginary constructions. . . . An imaginary construction is a conceptual image of a sequence of events logically evolved from the elements of action employed in its formation. It is a product of deduction, ultimately derived from the fundamental category of action, the act of preferring and setting aside. . . . Their function is to serve man in a scrutiny which cannot rely upon his senses. . . . The main formula for designing imaginary constructions is to abstract from the operation of some conditions present in actual action. Then we are in a position to grasp the hypothetical consequences of the absence of these conditions and to conceive the effects of their existence. Thus we conceive the category of action by constructing the image of a state in which there is no action [final equilibrium], either because the individual is fully contented and does not feel any uneasiness or because he does not know any procedure from which improvement in his well-being [state of satisfaction] could be expected.[27]

Furthermore, by tossing out equilibrium concepts altogether, and in concentrating only on "market processes," Lachmannians and other non-Misesian Austrians fail to realize that they thereby give up any chance of understanding those "processes" themselves. For these "processes" are really human actions which, unlike the mere motions of stones or atoms, are necessarily purposive and goal-oriented. Therefore, every action on the market must already imply the goal, or end-state, of that action.[28] The action, or "process," already implies the equilibrium state, even if that state is never fully reached.

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derived, believed that the laws had to be consciously *applied* to empirical states of affairs where the conditions hold. But the need for applicability is maintained by Mises as well as the others, and that need is not related to the philosophic status of the fundamental axioms. Thus, while the basic laws of human action can only be applied to those empirical worlds where *human beings exist*, more narrowly deduced laws, such as the laws of monetary theory, can only be applied *to those empirical societies where money is in use*. See Patrick J. O'Sullivan, in *Ricerche Economiche* 43 (January/June, 1989).

[27]Mises, *Human Action*, pp. 236–37.

[28]Professor Hans-Hermann Hoppe illuminated this point in his lecture on monetary theory at the Ludwig von Mises Institute conference on the Federal Reserve at Jekyll Island, in May 1992.

Once again, a crucial difference is the abandonment, by non-Misesians, of the Misesian concept of *action*—action that is necessarily goal or end-state directed, and that is purposive, active, and risktaking. Instead of "equilibrium," these Lachmannians speak of "processes," which connote impersonal motions and mechanisms rather than the conscious choices of persons engaging in goal-directed activity.[29,30] We have seen, in contrast, that equilibrium constructions are indispensable for all *ceteris paribus* economic thinking, for analyzing actions, and for demonstrating the direction in which the economy is necessarily tending. As Mises indicated in the above quote, final equilibrium is also necessary for analyzing the emergence of profit-and-loss in an uncertain world; for such positive or negative returns would not exist in a world of certainty and changeless final equilibrium. The final equilibrium construct also enables the economist to distinguish short-run entrepreneurial profit-and-loss from returns brought about by time-preference, embodied in the "natural" rate of interest, returns which would still continue to exist in a world of certainty and equilibrium.

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[29]The use of "market process" as a mantra was demonstrated by Professor Don Lavoie, a former Misesian who became a Lachmannian and even a "hermeneutician," based on the fashionable Continental philosophy of Heidegger and his student Gadamer. Lavoie established a Center for the Study of Market Processes (CSMP) at George Mason University, and in 1983 the Center established a periodical, *Market Process*. Ludwig Lachmann's major work as a Lachmannian was his volume, *The Market as an Economic Process* (Oxford: Basil Blackwell, 1986). Later, Lavoie organized a Society for Interpretative Economics, which managed to hold one meeting before it folded. It should come as no surprise that Professor Lachmann gave the keynote address at that meeting.

Professor Vaughn concluded her 1990 article on the Austrian revival by hailing the Lavoiean market process approach as the wave of the Austrian future, a view possibly reflecting her position as a board member of the Center. Unfortunately for her prediction, the CSMP minus Professor Vaughn, has now transformed itself into a very different center dedicated to a certain kind of managerial scheme unrelated to economics, let alone to Austrianism or its concerns. Vaughn, "Mengerian Roots," pp. 403–04.

[30]Kirzner, too, has succumbed, naming his latest collection of essays, *The Meaning of Market Process* (New York: Routledge, 1992).

Meanwhile, in contrast to the Lachmannians, the Hayekians have preserved the concept of equilibrium, and the view that entrepreneurs are always moving the economy in an equilibrating direction. But the Hayekians, who include Kirzner, are waging the battle on empiricist rather than praxeological grounds. In other words, the Hayekians claim that the entrepreneurs, in the process of learning from market signals, are in fact moving the economy toward equilibrium. The Lachmannians, of course, claim that entrepreneurs can learn nothing, and that therefore the economy is either moving away from equilibrium, or else in no particular direction. The battle between the two, therefore, is over empirical estimates over rates of speed: the Hayekians claiming that entrepreneurs are learning at a faster pace from the price signals than data are changing, thereby moving the economy toward equilibrium. The Lachmannians, on the other hand, claim that data are changing faster than people can learn (assuming they can learn at all), and that therefore the economy, in fact, is moving away from equilibrium. The dispute is a mere empirical one over rates of speed of change: a dispute which, in the nature of things, can never be resolved.

For the Misesian, on the other hand, the entire dispute is misconceived. The logic of the situation demonstrates that man always acts by using reason to improve his lot; so that his action is always "rational," that is, his actions are always beneficial, always necessarily equilibrating *ex ante*. And the market mechanism is also such that forecasts tend, in general, to pan out as true, so that ex ante decisions become validated *ex post*. But choice, and action, are always *ex ante*, and *ex ante* action on the market is always equilibrating. And *ex ante* considerations are what count in analyzing and explaining human action.[31]

Coordination: of Plans or Prices?

Wrapped up in its faulty conception of equilibrium is the Hayekian shibboleth about the alleged market function of "coordi-

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[31]For an exposition of action on the market as always equilibrating out of the very nature and logic of action, and for a critique of the empiricists on this issue, see George A. Selgin, *Praxeology and Understanding: An Analysis of the Controversy in Austrian Economics* (Auburn, Ala.: Ludwig von Mises Institute, 1990).

nation of plans." The concept is not to be discovered in Mises, and for good reason. In the first place, in final equilibrium, in the evenly rotating economy toward which the economy tends but never reaches because of continually changing data, there is no change in the endless round and so no change is expected. All subject "plans" are therefore brought into equilibrium, or coordinated, by definition, in final equilibrium. But while Hayekians and Lachmannians quarrel about whether or not people learn from experience and whether the market is equilibrating and coordinating, the entire controversy is misconceived. For while in non-existing final equilibrium plans are coordinated by definition, why should we expect that outside of equilibrium plans, which are necessarily variable and subjective, will *ever* be "coordinated," or brought into equality? In fact, we can say that, given basic data—values, resources, technology—there is far less reason to think that plans will be coordinated than that the market tends toward equilibrium.

Suppose, for example, that we can say that the capital value of a certain firm, in final equilibrium, will be $100 million, based on future returns and the rate of interest, and that therefore, given 1 million shares of outstanding stock of the firm, the "equilibrium" stock price is $100. But even if the data are given or frozen, and we can say that the stock price is tending toward $100, there is no reason to assume that, short of the actual final equilibrium state, that all market participants' plans will be "coordinated" to understand that the equilibrium price is going to be $100. Until the end, there can and will be individuals with varying expectations, bulls and bears, and share price volatility until the final state of rest is reached. In short, while all action is equilibrating by its nature, and the market tends to equilibrium if data are frozen, subjective plans will *never* be "coordinated" until final equilibrium arrives. And since that final state of rest, given the nature of man and of the world, can *never* come to pass, the entire concept of "coordination of plans" should be tossed out as unhelpful, misleading, and false.

But does this mean that the market never "coordinates," that we may never speak of coordination on the market? On the contrary, as Professor Salerno has recently shown, coordination occurs effectively, *and every day*, through the entire price system. Professor Salerno has performed the signal service of reviving William H. Hutt's theory of price coordination and demonstrating that this Huttian concept is

essentially the Misesian view.[32] Not in the Never-Never Land of final equilibrium, but every day in markets, in day-to-day equilibrium, the price system coordinates prices, including wage rates and the prices of other productive factors, so that there is never any shortage or unsold surplus. From day-to-day, then, there may, for various reasons, be *misallocations* of resources, but never shortages and surpluses, so long as prices are free to move.

Suppose, for example, a typical misallocation of agricultural resources takes place during a war. A country gets into war, supplies of agriculture from other areas are cut off, and there is a great increase in demand for the country's agriculture. Food and farm prices rise and farm production expands. Then, when the war is over, the agricultural expansion is seen to be excessive for peacetime, and food and farm prices and wage rates fall. *Even though* there is now "too much" food and too many resources in agriculture to be sustained in peacetime, if prices are free to fall, there is no unsold surplus, either in produce or in labor employment. Even though wartime demand has caused too many resources to move into agriculture, the free price system continues to *coordinate*—to make sure that there are, nonetheless, no shortages or surpluses in the agricultural sector. In the longer run, of course, the losses in agriculture and the especially low wage rates there, will induce resources to move out of agriculture and into other areas, so that prices and wages will move toward equilibrium in all areas. But *at each stage* of the process, the price system coordinates successfully.[33]

Knowledge and Socialist Calculation

It is now universally acknowledged that Ludwig von Mises, allegedly the loser in the famous socialist calculation debate that he launched in 1920, was really right: clearly, socialism cannot calculate, it cannot run a complex modern economic system. But it has

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[32]Salerno, "Commentary: Concept of Coordination," pp. 325–45.

[33]For a brilliant discussion of price and wage consideration, and the contrast with Keynesian assumptions, see William H. Hutt, *The Keynesian Episode: A Reassessment* (Indianapolis, Ind.: Liberty Press, 1979), pp. 135–77, esp. 137–40, 150ff. Also see the earlier W.H. Hutt, *Keynesianism—Retrospect and Prospect* (Chicago: Henry Regnery, 1963), pp. 53–81, esp. 54ff.