only recently become clear, through the insights of Professor Salerno, precisely *why* Mises was right, and also how the Misesian message was systematically distorted, from the 1930s until recent years, by F.A. Hayek and his followers. For Hayek and the Hayekians, obsessed with the alleged "problem of knowledge," have systematically misinterpreted Mises as maintaining solely that the Socialist Planning Board, facing the uncertainty of a dynamic economy, lacks the knowledge enabling it to plan the production and allocate the resources of a socialist economy. In contrast, the market economy, through its price signals, conveys that needed knowledge from and to the various participants in the market economy.

Mises, while not disputing the importance of knowledge and its dissemination through the price system, was, however, arguing a totally different point. From 1920 on, he reasoned as follows: *assume* the best for the Social Planning Board. Assume that, by some magical process, it has been able to discover and *know* absolutely all the value-scales of consumers, all technological methods, and compile an inventory of all resources. Suppose, then, Mises says, we grant total knowledge of all these data to the Socialist Planning Board. It *still* will not be able to calculate, still will not be able to figure out costs and prices, particularly of land and capital goods, and therefore will not be able to allocate resources rationally. The real problem of the Planning Board, then, the major thing denied that Board by absence of a market, is not knowledge but economic calculation.[34]

Thus, to Hayek, *if* the Planning Board could by some magic know, as people come to know through the market, consumer values, technologies, and resources, it could rationally plan and allocate resources fully as well as the market. As usual for Hayek and the Hayekians, the argument for the free market and against statism rests only on an argument from ignorance. But to Mises, the problem for the Planning Board is not knowledge but calculability. As Salerno puts it, the knowledge conveyed by present (or "immediate past") prices rests on values, techniques, and resources of the immediate past. But what acting man is interested in, especially the entrepreneur in committing resources into production and future sale, is

[34]For a survey and discussion of the arguments in the socialist calculation debate, see Rothbard, "The End of Socialism and the Calculation Debate Revisited," pp. 51–76.

future prices and future costs. The entrepreneur, who commits present resources, does so because he *appraises*—anticipates and estimates future prices—and allocates resources accordingly. It is, then, the *appraising entrepreneur*, driven by his quest for profits and for avoidance of losses, who can calculate and appraise because a genuine price system exists in the means of production, in land and capital goods, that is, a system of exchanges of privately-owned capital resources. Only such a pricing system allows for calculation.

Salerno points out that for Mises, *knowledge* and *appraisal* on the market are complementary, and have very different natures and functions. Knowledge is an *individual* process, by which each individual entrepreneur learns as much as he can about the largely qualitative nature of the market he faces, the values, products, techniques, demands, configurations of the market, and so on. This process necessarily goes on only in the minds of each individual. On the other hand, the prices provided by the market, especially the prices of means of production, are a *social* process, available to all participants, by which the entrepreneur is able to appraise and estimate future costs and prices. In the market economy, qualitative knowledge can be transmuted, by the free price system, into rational economic calculation of *quantitative* prices and costs, thus enabling entrepreneurial action on the market. As Salerno notes: "competition therefore acquires the characteristic of a quintessentially social process, not because its operation presupposes knowledge discovery [as with Hayek-Kirzner], which is inescapably an individual function, but because, in the absence of competitively determined money prices for the factors of production, possession of literally all the knowledge in the world would not enable an individual to allocate productive resources, economically within the social division of labor."[35]

In short, the entire Hayekian emphasis on ignorance and "knowledge" is misplaced and misconceived. The purpose of human action is not to "know" but to employ means to achieve goals. As Salerno perceptively summarizes Mises's position:

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[35]Salerno, "Postscript: Why a Socialist Economy is 'Impossible'," in Ludwig von Mises, Economic Calculation in a Socialist Commonwealth (Auburn, Ala.: Ludwig von Mises Institute, 1990), pp. 60–61. Also see Rothbard, "The End of Socialism and the Calculation Debate Revisited," pp. 51–71.

> The price system is not—and praxeologically cannot be—a mechanism for economizing and communicating the knowledge relevant to production plans [the Hayekian position]. The realized prices of history are an accessory of appraisement, the mental operation in which the faculty of understanding is used to assess the quantitative structure of price relationships which corresponds to an anticipated constellation of economic data. Nor are anticipated future prices tools of knowledge; they are instruments of economic calculation. And economic calculation is not the means of acquiring knowledge, but the very prerequisite of rational action within the setting of the social division of labor. It provides individuals, whatever their endowment of knowledge, the indispensable tool for attaining a mental grasp and comparison of the means and ends of social action.[36]

Mises's own avowal of the roots of his inquiry into the socialist problem has, until recently, been overlooked in the story of the social calculation debate. It has generally been assumed, understandably, that Mises's 1920 article arose solely out of curiosity about the arrival of socialism with the advent of the Bolshevik Revolution.

Actually, the main impetus for the study, as Mises has revealed, was the work he did on his monumental *Theory of Money and Credit* (1912). In the process of accomplishing the feat of integrating the theory of money into general marginal utility theory (deducing macro from micro, as it would now be put), Mises realized that, contrary to the earlier Austrians, the market does not impute *values* directly from consumer preferences to productive factors. Value-scales or preferences, Mises realized, were purely ordinal, a matter of choosing or setting aside; whereas market money prices were quantitative and cardinal. Only *money prices* can be imputed and not values directly. It was in ruminating on the ways and means that the market turns the qualitative into the quantitative that Mises arrived at his insight into the reasons that calculation under socialism would be "impossible."[37]

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[36]Joseph T. Salerno, "Ludwig von Mises as Social Rationalist," *Review of Austrian Economics* 4 (1990): 44. Also see ibid., pp. 26–54. These two profound and subtle articles by Salerno are indispensable to the entire Mises vs. Hayek discussion.

[37]Mises says in his memoirs:

Until the recent rehabilitation and new explanation of Mises's position on socialist calculation by Professor Salerno, Mises's viewpoint had been systematically obscured by modern Austrians as well as by non-Austrians in the debate. Thus, Professor Karen Vaughn, in a Hayekian summary of the calculation debate in the early 1980s, does not even mention Mises's profound contributions in *Human Action*. In an earlier paper, Vaughn did even more: she actually sneered that "Mises's so-called final refutation in *Human Action* is mostly polemic and glosses over the real problems."[38]

Professor Israel Kirzner, on the other hand, takes a diametrically opposite view: that the greatness of the Mises position in *Human Action* is that it joins Hayek in taking a "dynamic" view of the socialist problem, as against the "static" view in Mises's classic 1920 article. In reality, Mises's position was equally "dynamic" or "static" throughout; he simply elaborated his older position in *Human Action*. Actually, as Salerno points out, the "later" Mises, in *Human Action* explicitly *denies* that the key to the calculation problem under socialism is

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> They [the socialists] failed to see the very first challenge: How can economic action that always consists of preferring and setting aside, that is, of making unequal valuations, be transformed into equal valuations, by the use of equations? Thus the advocates of socialism came up with the absurd recommendation of substituting equations of mathematical catallactics, depicting an image from which human action is eliminated, for the monetary calculation in the market economy. (Ludwig von Mises, *Notes and Recollections* [Spring Mills, Penn.: Libertarian Press, 1978], p. 112)

Also see the discussion in Murray N. Rothbard, *Scholar, Creator, Hero* (Auburn, Ala.: Ludwig von Mises Institute. 1988), pp. 35–38, and especially, Rothbard, "The End of Socialism and the Calculation Debate Revisited," pp. 64–65. Also see Mises, *Human Action*, pp. 327–30, p. 696; Salerno, "Mises as Social Rationalist," pp. 39–40, and Salerno, "Why a Socialist Economy is 'Impossible," pp. 60–61.

[38]Dr. David Gordon has pointed out to me that, just as Mises showed, by his regression theorem, that money can only arise on the market out of a non-monetary good under barter, so money on the market is needed to transform ordinally ranked subjective values into money prices which are indispensable for imputations of productivity and for economic calculation by entrepreneurs.

that "all human action points to the future and the future is always uncertain." This is the Hayek-Kirzner way of conceiving the problem, since, outside of static equilibrium and in a dynamic, changing world, knowledge of the future is always uncertain. But no, says Mises, socialism suffers from

> quite a different problem. . . . We do not deal with the problem of whether or not the [socialist] director will be able to anticipate future conditions. What we have in mind is that the director cannot calculate from the point of view of his own present value judgments and his own present anticipation of future conditions, whatever they may be. If he invests today in the canning industry, it may happen that a change in consumers' tastes . . . will one day turn his investment into a malinvestment. But how can he find out today how to build and equip a cannery most economically?
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> Some railroad lines constructed at the turn of the century would not have been built if the people had at that time anticipated the impending advance of motoring and aviation. But those who at the time built railroads knew which of the various possible alternatives for the realization of their plans they had to choose from the point of view of their appraisements and anticipations and of the market prices of their day in which the valuations of the consumers were reflected. It is precisely this insight that the [socialist] director will lack. He will be like a sailor on the high seas unfamiliar with the methods of navigation.[39]

Reason: Exchange, Intention, and Design

At the core of the constellation of crucial differences between the Misesian and Hayekian paradigms is their respective attitudes toward human reason. Man, affirms Mises after Aristotle, is the uniquely rational animal; reason is man's unique and essential instrument to find out what his needs and preferences are, and to discover and employ the means to achieve them. Mises's stress on

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[39]Mises, *Human Action*, p. 700. Also see Rothbard, "The End of Socialism and the Socialist Calculation Debate Revisited," pp. 67–68; and Israel M. Kirzner, "The Economic Calculation Debate: Lessons for Austrians," *Review of Austrian Economics* 2 (1988): 1–18. Kirzner's error seems to be tied to his non-Misesian view of the entrepreneur: not as an appraiser of prices and costs, but as someone who is alert to uncertain knowledge of the future.

action, on acting man, therefore necessarily stresses the vital importance of human reason. Misesian Man acts, and therefore consciously selects goals, and decides how to pursue them.

Hayek's entire work, on the contrary, is devoted to a denigration of human reason. As David Gordon has pointed out, Hayek virtually assumes that human beings act *unconsciously*—of course, a contradiction in terms—and therefore that they neither know nor think nor choose. Therefore, their actions do not require understanding; hence Hayek's emphasis that the best that can be done is rely on a blind and unconscious adherence to evolved rules.[40]

Thus, Mises's view of why men participate in the basic form of market interaction-exchange, which also implies participating in the social division of labor. Harking back to the insight of the Scholastics, beginning at least with the great fourteenth-century French philosopher and scientist John Buridan, Mises saw that a man participates in an exchange because he sees that he will benefit more from the good or service received, than the good or service he has to give up. Here is the root of the basic subjective-utility, or Austrian, insight: men engage in exchange because and only because they subjectively prefer what they will receive in exchange to what they give up. Hence, also, Mises's conclusion on how to preserve and maintain the great *oecumene,* the mighty network, or system, of voluntary, mutually beneficial exchanges that constitute the free-market economy: The mass of the public must learn, must be educated to understand, the vast importance of maintaining and preserving that free market from aggression and coercive interference. They must understand that on preserving and expanding that market network, or oecumene, depends the flourishing and prosperity of the human race: whereas interference with that network can only lead to world-wide misery and impoverishment.[41] It is not, of course, that Mises believes that men will always listen to reason, or follow its dictates; it is simply that, insofar as men act at all, they are capable of following reason, and that pursuing such a course is literally the last best hope for mankind.

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[40]See in particular, David Gordon, "The Origins of Language: A Review," *Review of Austrian Economies* 2 (1989): 245–51.

[41]On Mises on the indispensable role of reason in exchange, and the contrast with Hayek, see the illuminating article by Salerno, "Ludwig von Mises as Social Rationalist," pp. 26–54.

One of the remarkable features of Hayek's character was his deviousness in expressing any disagreement with his old friend and mentor. Thus, it was only five years after Mises's death, on the occasion of writing a Foreword to the new edition of Mises's Socialism, that Hayek was able to express his harsh disagreement with Mises's rationalist view of why men exchange. Mises had written that he "regards all social cooperation [exchange] as an emanation of rationally recognized utility, in which all power is based on public opinion." But now, in his Foreword written after Mises's death, Hayek writes: "I had always felt a little uneasy about that statement of basic philosophy, but only now can I articulate why I was uncomfortable with it." Hayek then adds patronizingly:

> The extreme rationalism of this passage, which as a child of his time he could not escape from, and which he perhaps never fully abandoned, now seems to me factually mistaken. It certainly was not rational insight into its general benefits that led to the spreading of the market economy.[42]

But the point of Mises's "extreme" passage is this: for each particular exchange, each individual only participates in it because he acts consciously, and his reason tells him that he will be better off from making this exchange than from not making it. He will benefit from what

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[42]Ludwig von Mises, *Socialism: An Economic and Sociological Analysis* (1936; Indianapolis, Ind.: Liberty Fund, 1981), p. 418; F.A. Hayek, "Foreword," in *Socialism*, p. xxiii. Also see Peter G. Klein, "Introduction," *The Fortunes of Liberalism: The Collected Works of F.A. Hayek* (Chicago: University of Chicago Press, 1992), vol. 4, pp. 12–13; Hayek, *Fortunes of Liberalism*, p. 142.

Hayek's deviousness while Mises was alive may be seen in his 1937 article, "Economics and Knowledge," which marked his turn from a Misesian to a Popperian methodology (that of his old Viennese friend Karl Popper); apparently, the article was meant as an oblique attack on Mises for his allegedly Walrasian-neoclassical approach, and meant as a way to subtly shift Mises to an empiricist, Popperian approach. So oblique was the article, however, that Mises himself misinterpreted it as a Misesian attack on the neoclassicals, and current historians and scholars of the Austrian School are split on what Hayek's article *really meant*. It is interesting to note that what Hayek really meant about very many things is virtually a cottage industry for doctoral students, whereas it is rare that people have to puzzle over what Mises "really meant." See Klein, "Introduction," pp. 10–41.

he receives compared to what he gives up, and he will do better than from any other alternative exchange. All that this reasoning implies is conscious action. As for the free market economy in general, Mises's theory of government reflects the keen insight of David Hume: that no government, however powerful or coercive, can, in the long run, rule by force alone; that since force, in the long run, lies with the majority of the ruled rather than with the minority of the ruling elite, to maintain their rule the ruling elite must persuade the majority to give it their support. In other words, in the long run, ideas held by the people rule, for good or for ill. Ideas trump brute force. Far from being unrealistic "extreme rationalism," the remarkable internal collapse of Communist rule in the Soviet Union and Eastern Europe has borne dramatic testimony to the truth of Mises's position.[43]

In the passage in which he deprecates Mises's position, however, Hayek comes up with no counter-argument of his own. If "rational" ideas—in the sense of consciously-held rather than necessarily correct ideas—do not account for the adoption of a market economy, as well as the swing away from it in the twentieth century, what in the world does? Hayek hints that man "chooses" the market economy "only in the sense that he has learned to prefer something that already operated." Again, Hayek stresses blind habit or custom. Clearly habit plays a role, but if that were all, what accounts for the twentieth-century shift away from the market economy, and, finally, for the internal collapse of the Communist politico-economic system? Hayek's emphasis on unconscious habit or rule-following thus leaves out critical parts of the answer: such as (a) how do these rules or institutions get adopted in the first place; and (b) how do they ever change, often suddenly? To fall back, as Hayek does, on "evolution" as the sole

[43]There has been general agreement that Mises's claim of the "impossibility" of socialism has been vindicated, with panels at annual economics meetings devoted to the theme of "Mises was Right." See among others, Stephen Boehm, "The Austrian Tradition: Schumpeter and Mises," in *Neoclassical Economic Theory, 1870 to 1930*, K. Hennings and W. Samuels, eds. (Boston: Kluwer Academic Publishers, 1990), p. 231. There has been no recognition, however, of the Communist collapse vindicating Mises's position on the long-run dominance of the ideas of the public in government.

answer to the first question not only misapplies the very concept of evolution, which requires the existence of genes and mutations; it also fails spectacularly to account for sudden changes in those rules or in society's acceptance of them. Most glaringly, Hayek's implicit assumption of human unconsciousness violates the basic fact which we all know from our own experience as axiomatic: that human beings are indeed conscious, and that they therefore act and choose rather than move or "are moved" in an unconscious, robotic, or unmotivated manner.[44]

Hayek presents three crucial concepts as ways of highlighting his reliance on human blindness and irrationality: "spontaneous order"; the "*unintended* consequences of human action"; and the product of "human action, but not human design."

We need not tarry on the phrase "spontaneous order," except to note that the word "spontaneous," once again, connotes lack of thought, activity that is not consciously chosen, but rather purely reflexive and tropistic. It would have been far more accurate to use a term such as "voluntary," which would at least focus on voluntarily chosen, rather than coerced, actions.

The latter two concepts, of course, are simply variants of each other. All actions have consequences; and Hayek is anxious to

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[44]How to reconcile Hayek's dominant "anti-rationalist" position with another strain in his thought: the power of ideas in the long-run to effect social change, and his call for a "trickle-down" strategy of converting top scholars and philosophers to classical liberal views, who will in turn eventually convert lesser professors, who will in turn convert general intellectuals, journalists, and "dealers in second-hand ideas?" See, in particular. Hayek's "The Intellectuals and Socialism," first published in the *University of Chicago Law Review* 16 (Spring, 1949), and reprinted in Hayek, *Studies in Philosophy, Politics, and Economics* (Chicago: University of Chicago Press, 1967), pp. 178–94.

There are, it seems, three possible ways to explain this anomaly. First, that it is characteristic of Hayek's intellectual inconsistency and muddle. Second, that it still reflects the more rationalist Hayek I, since it was written in the 1940s, and before the development of his "evolutionary" position. And third, that Hayek sees the only role of ideas as a minority intellectual elite being able to rise above the general torpor and unconsciousness—but that the very best the elite can do is to urge everyone, including themselves, to follow evolved rules blindly.

emphasize, at every turn, the alleged importance of the unintended rather than intended consequences, thus showing the trivial importance of conscious human action. Humans may act in some sense, but their conscious actions are unimportant, since they do not bring about desired, "designed," or intended effects. Mises's analysis, on the contrary, rests squarely upon the Aristotelian insight into action, in which they are shown to be *intentional*, thinking and action always being guided toward an object. People act all the time, in a large number of respects; we assume that, most, or almost all of the time, people's actions bring about their *intended* results. If they did not, the people would not continue to repeat them. Hayek's own emphasis on habit or custom, indeed, proves the Aristotle—Mises rationalist point: for the habitual repetition means that these actions have repeatedly been successful in bringing about a person's goals. Thus, if someone lives in Long Island, and every morning takes a train to Penn Station, and then a bus to his job, reversing the process in the evening, his success in grasping cause-and-effect relations and in bringing about his intended consequences leads him to keep repeating these activities.

Furthermore, since all human actions are goal-directed, are *intentional*, if we do not absolutely know whether or not a person intended the consequences of his actions, we have to *presume* that he did, unless it can be demonstrated otherwise. Obviously, if a business investor or speculator has suffered losses, these losses were not intended, but apart from such cases the presumption must stay with intention.[45]

Perhaps the best case for stress on unintended consequences comes from analyzing the motive of exchange on the free market and was best expressed in the famous quote from *The Wealth of Nations*:

> It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their

[45]Owing to the income tax code, the losses may well have been intended, in order to reduce one's level of taxable income. But in that case, detailed investigation into the facts would overturn the common-sense presumption that losses would not be intended from the start.

> self-love, and never talk to them of our own necessities but of their advantages.[46]

To translate this passage into our current concerns: the butcher and the baker's actions result in the *intended* consequences of yielding them a profit, but, more importantly for society, they result in the *unintended* consequences of benefiting consumers, indeed society as a whole, in the most efficient possible manner.

This is surely an important and valid point, so far as it goes. But, we might wonder: why the rush to *celebrate* unintended consequences? Wouldn't it have been better if these pro-consumer or pro-general standard of living consequences had been understood and *intended* by the actors as well? To put it another way: the butcher, baker, and so on desire and intend the consequences of their production yielding them a satisfying profit. But suppose that they are informed, by economists and others, that their actions *also* have the effect of helping the rest of society and the general standard of living? Wouldn't they *then* come to intend this general welfare as well, even

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[46]Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Campbell and A. Skinner, eds. (Indianapolis, Ind.: Liberty Classics, 1981), vol. 1, pp. 26–27. It should be noted that Smith was anti-rationalist as well, if for rather different reasons. Smith was concerned to purge economic theory of all subjective utility considerations, so he had to discard mutual benefit as the reason for exchange. Indeed, in contrast to Mises's insight that the division of labor (the base of exchange) stems from the diversity and inequality of talents and interests among men, Smith maintained that all people and children are originally almost totally the same, and that the existing division of labor and of occupation willy-nilly pushes them into specialization and differences of interest. As Smith puts it: "the very different genius which appears to distinguish men of different professions . . . is not . . . so much the cause, as the effect of the division of labor."

If for Smith, the diversity and inequality of talent is not the root cause of the division of labor but the effect, what in the world is the root cause? Smith, like many social scientists who do not know the cause of a human phenomenon, falls back on some sort of built-in "instinct": or, as he put it, "a certain propensity in human nature" which has no regard for utility, but is instead, "a propensity to truck, barter, and exchange one thing for another," ibid., pp. 25, 28. Or, as Smith rather absurdly put it: "without disposition to truck, barter, and exchange, every man must have procured to himself every necessary and convenience of life which he wanted," ibid., p. 29.

conceding that their own self-interest would still be their primary goal? Wouldn't they be likely, at the very least, to feel better and happier about their own activities, knowing now that they benefit the body of consumers as well as themselves? How could such knowledge *hurt*?

It might be countered that the butcher and baker might well feel better; but apart from that, knowledge of the unintended consequences would have no effect upon their concrete actions on the market. But, on the contrary, knowledge that they are helping the general welfare might well affect their operations rather strongly. Consider the following case: a brilliant entrepreneur is engaged in productive activities. But he has absorbed the general cultural position that by maximizing his profits he is in some way injuring his fellow man. As a result, to assuage his conscience, he deliberately takes actions that will lower his profits—not eliminate them altogether, but lower them from what he considers to be an "extreme" or even "unconscionable" height.

The entrepreneur then reads Mises or some other hard-core free-market economist or journalist. He learns, to his amazement and relief, that the greater the amount of his profits the *more* he is helping consumers, society as a whole, and his fellow man. Happily, he casts off the guilt that had been plaguing him and changes his actions to engage in a happy and welfare-enhancing maximization of profits.

This is surely not an outlandish case, and it shows why it is better to shed light, to replace ignorance by knowledge, and thereby to show the entrepreneur all the foreseeable consequences of his actions. His actions will now be adjusted to the fact that all their consequences are conscious and intentional. Not only is there nothing wrong with this process, but the life of the entrepreneur and of society will both be improved. Hayek to the contrary notwithstanding, knowledge remains better than ignorance.[47]

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[47]There is another point: for any particular butcher or baker, the outside observer—the outside economist or social scientist—does not really *know* if he has been enlightened by Misesian or other free-market writers, or not. The observer may have his suspicions, but suspicions are not knowledge. Ironically, for Hayek or Hayekians to assume without evidence that all butchers, bakers, and so on are ignorant of free-market theory is to arrogantly claim knowledge that they do not, in fact ultimately cannot, have. Perhaps it is the Hayekians, not the Misesians, who suffer from *hubris*.

And finally, there is another vitally important point, which ties back into the argument about how an exchange economy, the free market economy, must be established and sustained. For spreading knowledge of the happy though currently unintended consequences of their actions may not only alter the actions of unintended consequences; they might imbue the mass of the public, regardless of their occupation, with an appreciation of the enormous benefits of the free-market lattice-work throughout society, and of the horrendous consequences of government interference in that web of the free-market economy. To educate in order to make currently unintentional consequences intentional may well be the only possible route to the salvation of mankind. Truth, understanding, reason, is surely the way to save the free market, not urging blind submission to rules that might not even be appropriate to a market economy.

Another grave problem with the Hayekian doctrine is that the spontaneous order design concept not only exalts blind rules and unconscious action in the market economy; it lets the State off the hook as well. For this emphasis means that not only market actions with beneficent consequences but also State actions with evil consequences are equally unconscious. This means that State acts, instead of being the result of conscious lobbying and the seeking of subsidy and special privilege, simply grew "spontaneously," like Topsy. No one is to blame for State actions: no motives, no goals, no lobbying, no self-seeking exploitation of taxpayers or competitors. Just as John R. Seeley, in his apologetics for the British empire, claimed it did not expand consciously but only "in a fit of absence of mind," so the Hayekian mindset, applied to State action, removes guilt or even understanding from analysis of the historical process.

Letting evil off the hook was indeed the origin of Hayek's cherished unintended consequences, or human action-not-human design concept. Hayek points out that Adam Ferguson, sociologist and old friend and colleague of Adam Smith in the eighteenth century Scottish Enlightenment, coined the concept "the result of a human action, but not the execution of any human design."[48] What Hayek does not tell us, however, is that Ferguson did not originally employ

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[48]F.A. Hayek, "The Results of Human Action but not of Human Design," in *Studies in Philosophy, Politics, and Economics*, p. 96.

the concept to analyze the market, or language, or any similar social process. As a young Presbyterian minister, Ferguson, along with his friend, the Reverend Alexander Carlyle, was reeling from the shock of the near-triumph of the Catholic Jacobite Rising of 1745, in which the Jacobites conquered Scotland, and were finally defeated by the Hanoverian troops in northern England. Ferguson and the others were confronted with this grave theological problem: how could God permit the evil Catholics to come so near to triumph? They concluded that while the Catholics, of course, were consciously evil, pursuing evil goals, they were unconsciously being used by God for his own good purposes: namely, to shake the Presbyterian Church of Scotland—God's Church—out of its lethargy, and to renew its devotion to its true purposes. In short, all events in human history, even if seemingly motivated by evil, are all *unconsciously* working toward good. Out of apparent evil, good: that is God's Providential plan. This truly dangerous doctrine leads straight, of course, to the Whig Theory of History: that whatever is, is right; and that which was, was right. Everything in history moves toward the good, is progressive; there can be no evil or wrong turn in history.[49]

In short: Hayek returns, with a burst, to the Whig theory of history and to a conservatism that justifies all institutions as "evolved," as part of some presumably beneficent pattern, even though God has now dropped out of the picture. Not only Hayek was influenced deeply by Ferguson; so too was a young graduate philosophy student at the University of Tübingen, G.W.F. Hegel, and his colleagues. Hegel systematized the Ferguson insight into his "dialectic," by which history, through its "cunning of reason," moves inexorably according to its divine plan: always bringing good, and a higher stage, out of apparent evil and conflict. Karl Marx, as a Left Hegelian, was to atheize that dialectic. Hayek is in odd, and not particularly wise, company.[50,51]

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[49]See the illuminating work by Richard B. Sher, *Church and University in the Scottish Enlightenment* (Princeton, N.J.: Princeton University Press, 1985), pp. 40–44.

[50]On Hegel and Marx, see Murray N. Rothbard, "Karl Marx: Communist as Religious Eschatologist," *Review of Austrian Economics* 4 (1990): 132–38.

In his incisive contrast of Mises's "social rationalism" with Hayek's irrationalist emphasis on "spontaneous order," Professor Salerno trenchantly points out that in the Misesian view, man cannot rely on spontaneous "unintended" consequences for successful social change. On the contrary, if men fail to understand rationally the destructive consequences of State intervention, that is, they fail to understand the beneficence of the free market economy, they are likely to wreck the *oecumene,* destroy capitalism, and return the economy to poverty and barbarism. The division of labor and human prosperity, then, necessarily rest on adoption by the public of the ideology of *laissez-faire*. If they adopt interventionism, on the other hand, the resulting "social maladjustment, which is inspired by fallacious ideology, carries in its wake the possibility of social disintegration and is more likely the greater the degree to which the consequences of human actions are unintended, or to use Mises's term, "unwitting." Salerno continues, following Mises, that "to the extent that social norms, policies, and institutions are 'undesigned,' are not completely and correctly thought out in advance and accounted for in a logically consistent ideology, to that extent does the continued existence of society become problematic." But then, "if social disintegration may occur 'spontaneously,' due to an ignorance of the remoter consequences of social action, social progress can only be assured by the widespread adoption of an ideology of social life which consciously and correctly accounts for these consequences. This ideology is [*laissez-faire*] liberalism."[52]

Ignorant and "spontaneous" action, then, is far more likely to be like a child's or a savage's destruction of fine china than providing a beneficent and flourishing market economy. Directly contrasting Mises and Hayek, Salerno concludes that

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[51]Hayek's praise of the common law as spontaneous and undesigned overlooks the fact that individual judges were consciously discovering, elaborating and applying fundamental legal principles. Reason and design were therefore dominant in common law. The fact that this reason and these laws were not imposed by a sovereign State but elaborated out of long-held legal principles is not relevant to Hayek's claim.

[52]Joseph T. Salerno, "Ludwig von Mises as Social Rationalist," *Review of Austrian Economics* 4 (1990): 50–51.

> the rationalist [Misesian] view of social evolution, therefore, is not one of placid and automatic improvement insured by "unintended" consequences, "undesigned" institutions, "tacit" knowledge and "natural selection" of rules of conduct. Social rationalism implies, instead, that human history is the outcome of a conflict between ideologies, which are consciously formulated and adopted by reasoning human beings. Whether an epoch is characterized by social progress, social retrogression, or even social disintegration depends upon which particular ideologies have become current and which individuals have attained ideological "might" defined by as "the power to influence other people's choices and conduct."[53]

It would seem that the most plausible case for Hayek's spontaneous, anti-rational anti-design theory of social life is the advent and development of language. Surely, language, at least, grew like Topsy, and was not rationally created? But, in an instructive essay, David Gordon has shown that recent research has plausibly resurrected the eighteenth-century Enlightenment view of Condillac, as well as of Thomas Reid and Lord Monboddo, that language was consciously created, out of gesture, and, Gordon adds, that gesture was reinforced by play. Gordon also points out that the Enlightenment view was driven out of circulation by the German Romantics, led by Johann Christian Herder, who were concerned to establish their bizarre view that German is the "highest" language by maintaining that it could only have emerged from the ineffable, unconscious, and noble German soul.[54,55]

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[53]Ibid., p. 52.

[54]David Gordon, "The Origins of Language: A Review," pp. 245–51. Gordon particularly discusses two recent works: G.A. Wells, *The Origins of Language* (Peru, Ill.: Open Court, 1987), and J.N. Hattiangadi, *How is Language Possible?* (Peru, Ill.: Open Court, 1987). Also see Hans Aarsleff, *From Locke to Saussure* (Minneapolis: University of Minnesota Press, 1982), for a critical view of the German Romantics on language.

[55]In addition, the Erlangen School of philosophy has emphasized the origin of mathematics and physics in the conscious apprehension of, for example, length, or numbers, in real world objects. See Paul Lorenzen, *Constructive Philosophy* (Amherst: University of Massachusetts Press, 1987).

Similar to the language question is the odd view that folk poetry or music was not consciously created by individuals, but grew unconsciously out of the wisdom of the folk. See H.L. Mencken, "Folk-Literature, a

Salerno also adds the important point taken from Mises that even language contains an important ideological, and hence conscious, component. Salerno quotes from Mises's *Theory and History* that language is "the precipitate of a people's ideological controversies, of their ideas concerning issues of pure knowledge and religion, legal institutions, political organizations, and economic activities. . . In learning their meaning the rising generation are initiated into the mental environment in which they have to live and to work. This meaning of the various words is in continual flux in response to changes in ideas and conditions." Some entire languages, notably modern Gaelic and secular Hebrew, were even deliberate creations and recreations out of ideological will and determination.[56]

It is instructive to contrast the twists and turns of error and fallacy in Hayek's concept of *unintended* consequences, including its paean to ignorant and unconscious action, with Mises's superficially similar but very different stress on *remote or unseen* consequences of human action. For, rather than Hayek's relying on spontaneity, or glorifying unconscious action and its unintended consequences, Mises was urgently concerned to have everyone grasp and *understand* the remote and unseen consequences of their actions, a grasp which they can only attain by means of reason, in this case by praxeological reasoning.

Thus, the Misesian economist Henry Hazlitt, in his best selling *Economics in One Lesson*, makes the centerpiece of his book Frédéric Bastiat's "broken window fallacy."[57] A nasty kid hurls a rock and breaks a window. The immediate common-sense reaction is for the onlookers to deplore the action of the kid, and lament the fact that

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Review of Louise Pound, *Poetic Origins and the Ballad*," in *A Mencken Chrestomathy* (New York: Alfred A. Knopf, 1949), pp. 471–72. Writes Mencken: "German folksong, the loveliest in the world used to be credited to a mysterious native talent in the German yokelry, but scientific investigation reveals that some of the songs regarded as especially characteristic of the folk-soul were actually written by the director of music at the University of Tübingen, Professor Dr. Friedrich Silcher," ibid., p. 472. Also see Ludwig von Mises, *Theory and History*, pp. 188–89.

[56]Ibid., pp. 227–32; Salerno, "Mises as Social Rationalist," p. 53.

[57]Henry Hazlitt, *Economics in One Lesson* (New York: Harper and Bros., 1946).

the storekeeper will now have to pay a considerable amount of money to repair the window. But then comes the proto-Keynesian, the Broken Window Fallacy-monger, the second-level sophisticate sneering at the common herd. "No, no, you don't understand," he proclaims: "that kid's action is really good for the economy, because the storekeeper will now spend money on the glazier to repair the window, providing employment for the glazier's workers, and stimulating the economy. The common-sense view, as usual, is wrong." But then the economist, the Mises-Hazlitt-Bastiat economist, comes on the scene and rebuts the Broken Window Fallacy-monger. "No, this fool sees only the money that the storekeeper spends on the glazier. But what he does not see is far more important: the money the storekeeper would have spent, had he not suffered loss to his property, either on consumer goods, or on expanding his business. That unseen stimulus is lost. So: the storekeeper is worse off because of the kid's action, and the economy and society suffer." Common-sense is vindicated by the third-level farseeing economist. As in so many areas of political economy, we see an alliance on behalf of truth of the common-sense member of the public with the genuine economist, uniting against the sophistries of the second-level pseudo-intellectual and pseudo-economist.

Non-Misesian Macroeconomics: Genuine Money or Counterfeiting?

Professor Erich Streissler, in his discussion of the contributions of Menger and his students, stressed correctly that these were largely in microeconomics. But then he added that Menger "bequeathed to his school a peculiar horror of macroconomic concepts." Commenting on Streissler's paper, Professor Robert Hébert properly took Streissler to task, pointing in particular to Ludwig von Mises as the creator of a peculiarly Austrian form of macroeconomics, building macro concepts upon individualist micro foundations. In particular, Mises integrated monetary theory, and the theory of the value of money, into micro marginal utility, as well as supply and demand theory.[58] Hébert

[58]Erich Streissler, "Menger, Böhm-Bawerk, and Wieser: The Origins of the Austrian School," in *Neoclassical Economic Theory, 1870 to 1930*, K. Hennings and W. Samuels, eds. (Boston: Kluwer Academic Publishers, 1990), p. 170; Robert E. Hébert, "Commentary," ibid., pp. 190–200.

might have added that Mises then built upon that monetary theory in forging his masterful theory of the business cycle. In his early years Hayek (or Hayek I), elaborated upon Mises's cycle theory, in work which later won him the Nobel.[59] Surely, there are no fields that would now be considered more "macro" than monetary and business cycle theory.[60] And yet, Hayek II spent very little time in this area, and the Hayekians and Lachmannians none at all. Kirzner spends all of his time on micro and devotes none to the macro area. The same is true of all of the Lachmann followers, who have not so much bothered to refute the Misesian monetary or business cycle theory as they have ceased to refer to or deal with it.

The only Austrians who have dealt with money or business cycle theory, indeed, have been Misesians: among them, in the 1920s and 1930s, Hayek I, Fritz Machlup, Gottfried Haberler, and Lionel Robbins, and, in the years since World War II, Hazlitt, Salerno, Hoppe, Walter Block, and the present writer. The "honor" of macro-economic concepts, in fact, applies only to the various non-Misesians, who have no macro theory of any kind.[61]

There is one unfortunate exception to this rule. In 1976, after Hayek succumbed to *hubris* upon winning the Nobel Prize, he opened the Pandora's Box of money-crankism by offering a bizarre scheme for private competing currencies.[62] The only common point

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[59]In particular, F.A. Hayek, *Monetary Theory and the Trade Cycle* (1933; New York: Augustus M. Kelley, 1966), a translation of a book published in Vienna in 1929; and *Prices and Production* (London: Routledge and Kegan Paul, 1935).

[60]A case could easily be made that Böhm-Bawerk's superb capital-structure theory was "macro" as well as "micro."

[61]In his unpublished comment on my article on "Austrian Definitions of the Supply of Money" at the Windsor Castle Austrian conference in September 1976, indeed, Israel Kirzner took the nihilist line that it was impossible to define the supply of money, since it was an aggregative concept. It is, on the contrary, a happy aggregate of homogeneous units, whether of dollars or gold ounces. Murray N. Rothbard, "Austrian Definitions of the Supply of Money," in *New Directions in Austrian Economics*, Louis Spadaro, ed. (Kansas City: Sheed Andrews and McMeel, 1978), pp. 143–56; included in this volume as chapter 39.

[62]F.A. Hayek, *Denationalization of Money: The Argument Refined* (1976, 3rd ed.; London: Institute of Economic Affairs, 1990).

with his master Mises's view of money was narrowly political: both were opposed to Central Bank control of the money supply. But, apart from that, Hayek violated the rule for valid monetary theory that he himself had adumbrated as Hayek I: that it must, like Mises's theory, be deduced from, and therefore integrated with, a sound general micro theory.[63] Instead, Hayek's doctrine was totally cut off from general economic theory and from Mises's monetary theory as well.

Hayek's scheme of private individuals or banks issuing their own currencies—a scheme which he himself, in more sober moments, would have dismissed as absurdly "constructivist"—was not so much adopted as coming to serve as inspiration or jumping-off point for other money-crank schemes, which have proliferated ever since. They range from private currencies to schemes for private banks freely inflating credit on top of gold currency reserves. As these proposals have multiplied, however, gold has inevitably dropped out or been pushed out of the picture. Later plans range from banks inflating notes or deposits on top of Federal Reserve Notes even after the Fed has been abolished; gold being a mere shadow helping to prop up the system; and finally schemes where banks clear each others' notes indefinitely with no possibility of the poor public's being able to redeem its way out of bank money. Finally, standard or "high powered" money disappears altogether, and inflationary banks merely redeem their notes and deposits in the equally phony notes and deposits of other inflating banks."[64,65]

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[63]Thus, Hayek I wrote: For "Trade cycle theory . . . as for any other theory, there are only two criteria of correctness. Firstly, it must be deduced with unexceptionable logic from the fundamental notions of the theoretical system; and secondly, it must explain by a purely deductive method those phenomena with all their peculiarities which we observe in the actual cycles." F.A. Hayek, *Monetary Theory and the Trade Cycle*, pp. 32–33.

[64]Among the culprits are Lawrence White, George Selgin, Kevin Dowd, David Glasner, F. Capie, Leland Yeager, Robert Greenfield, and Richard Timberlake. Even Milton Friedman has lately defended bimetallism, thereby implicitly repudiating the correct monetarist analysis of that system. For critiques of some of these offerings, see Murray N. Rothbard, "The Myth of Free Banking in Scotland," *Review of Austrian Economics* 2 (1988): 229–45; included in this volume as chapter 46; Rothbard, "The Case for a Genuine Gold Dollar," in *The Gold Standard: Perspectives in the*

Money-crankism is a common phenomenon of the last two centuries and, as every professor of money and banking who has received lengthy and passionate letters written in crayon on the subject can attest, it always involves schemes for radical expansion of the supply of money. The proposed monetary inflation can either be governmental, or, if proposed by the libertarian-inclined, it can be private. Economically, it makes no real difference, except that empowering every private person to print as much money as possible would bring hyper-inflationary disaster even more quickly.

The first grave fallacy and departure from Misesian doctrine, committed by many of these schemes, not least by Hayek's, is to ignore the fundamental Regression Theorem, which Mises built as a logical law upon Carl Menger's historical insight. To function as a *money*, an entity *must* have emerged on the free market out of barter, as a particularly marketable commodity selected on the market as a medium for virtually all exchanges.[66] Nothing can be originally adopted as money by government fiat, or by some sort of social contract; it must originate as a strictly market phenomenon. Nothing can be adopted as a money, as a medium of exchange, unless it had

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Austrian School, Llewellyn H. Rockwell, Jr., ed. (1985; Auburn, Ala.: Ludwig von Mises Institute, 1992), pp. 1–17; included in this volume as chapter 41; and Rothbard, "Aurophobia: or, Free Banking on What Standard?," *Review of Austrian Economics* 6, no. 1 (1992): 97–108; included in the volume as chapter 47.

[65]This would be a "libertarian" version of the condition that Professor Paul Cantor, in his stimulating paper, points out: "That is what it meant to have a currency backed by gold—a paper/banknote was redeemable in terms of a real commodity, namely gold, something that had independent value. But in the modern era of fiat money, a banknote just represents another banknote. One dollar bill can merely be exchanged for another dollar bill, but such a transaction has no point anymore, once no real commodity backs the currency. In the modern paper money system, money does not represent anything outside itself; money only represents itself." Paul A. Cantor, "Hyperinflation and Hyperreality: Thomas Mann in Light of Austrian Economics," *Review of Austrian Economics* 7, no. 1 (1994): 3–29. Retired banker John Exter likes to refer to fiat money instruments as "IOU nothings."

[66]For a welcome appreciation of Mises's achievement, see Hébert, "Commentary," pp. 191–95.

a pre-existing purchasing-power as a non-monetary good. Even if Hayek were allowed to issue his proposed private tickets called *ducats* redeemable in nothing but other ducats—which I think he should legally be allowed to do—no one would accept it as money. It would only have a severely limited value as a curiosity, yet another monument to man's folly. All of the new currency plans, private or public, commit the same grave fallacy.

The other group of plans—which build private banking schemes upon existing currencies—at least do not violate the Regression Theorem. Instead, they take one step further than the State has done in recent centuries: build on pre-existing gold money by eventually converting paper tickets once redeemable in gold into fiat standards of their own. Unfortunately, as the Regression Theorem makes clear, once a paper ticket has won market acceptance by piggy-backing on gold as a redeemable ticket, the government can use its coercive powers to keep the paper in play indefinitely as irredeemable fiat money. The second group of pseudo-Austrian plans propose to construct inflationary private banking schemes on top of existing fiat paper, eventually even getting rid of standard paper money altogether.

Apart from the Regression Theorem, both sets of schemes would institute disaster on a large scale. There are two sets of fallacies committed by all of these proposals. Building on the insights of the Ricardians and the Currency School, as well as on continental monetary theory since the Scholastics, Mises demonstrated that, given the existence of money in the economy, every supply of money is optimal. In short, even though the value, or purchasing power, of money is, like all other goods or services, determined by its supply and demand, there is one crucial difference between money and all other goods. All other goods and services, whether consumer or producer goods or resources, help to alleviate natural scarcity; therefore, other things being equal, any increase in these goods is a net social benefit, easing natural scarcity. But that is not true for money, since the only function of money is to facilitate exchange, to furnish a general medium of exchange and hence a unit of economic calculation. But money performs such a function optimally and fully, regardless of the supply available. An increase in the quantity of money cannot alleviate scarcity and cannot provide a social benefit: it could only dilute the purchasing power of each money unit. An increase in supply can only dilute the exchange effectiveness of each dollar or franc or whatever is the monetary unit.

Any scheme for inflating the money supply, whether private or public, can only redistribute income and wealth, cripple or destroy the unit of calculation indispensable to a modern economy, weaken incentives to save, and generally cripple and eventually destroy the economic system.[67] The eventual end is hyperinflation and economic disaster.

The second basic problem is politico-economic. Any free-market economy must necessarily rest on devotion to the sanctity of private property. It is obvious that rampant theft or fraud can only gravely cripple property rights and the free, prosperous economy that emerges from them. For a free society to survive and flourish, property rights must be defended. Most of this defense must occur by incorporation of the supreme value of property rights into the value systems of the broad mass of the public. That can only be accomplished and sustained when the opinion and value molding groups and institutions in society: notably, intellectuals, academics, media, and churches—sustain and promote that value system. When they systematically fail to do so, as we have seen all too clearly in this century, we are all in deep trouble. The frontline of defense against what should generally be a minority of violators of property are the specific institutions of law, police, and courts. Regardless of how these institutions are set up and financed, their defense or protection function is extremely important.

Libertarians, in their zeal for privatizing government functions, tend to forget one vital truth: that *some* functions of government, such as the Internal Revenue Service or providing concentration camps for dissenters, deserve to be abolished rather than privatized. To put it another way: we must not forget that government is not the only organization that can and does commit crimes. Private persons and organizations, and not only governments, can and do commit robbery, assault, kidnapping, and murder. We must not forget that not *every* private action deserves our uncritical blessing. The relevance of this seemingly evident truth is that among the crimes private persons commit are fraud, embezzlement, and many forms of

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[67]If money consists of a precious metal, say gold, then while an increase in the supply of gold has no beneficial monetary effect in society, it does confer a benefit by decreasing the scarcity of gold for non-monetary uses, such as jewelry or dentistry.

theft. One of those forms is forgery, or counterfeiting, in which theft is committed by the forger or counterfeiter who corrupts the marketplace by passing off a fake as the real thing.

Counterfeiting of art despoils the buyers and owners of the art, as well as the painter or his estate, and the owners of the genuine article. But counterfeiting of money wreaks more general havoc. In a society where gold is the only form of money, a person can acquire gold in only three ways: (a) selling a good or service in exchange for a part of the existing gold stock; (b) receiving gold as a charitable gift or bequest; and (c) mining new gold out of the ground. All of these are productive ways of obtaining gold, whether it be through exchange, new gold production, or someone receiving a gift or inheritance granted by another person. But counterfeiting, for example, dressing a base metal to look like gold, despoils not only the particular seller but the entire market economy. The counterfeiter, so long as his crime is not detected, is able to extract unearned income and wealth from producers without their knowledge, to exploit the producers for his benefit, and to lower the purchasing power of the gold unit to everyone in society. But at least there is hope, when counterfeiting is illegal, that it will be discovered and rooted out and the culprits apprehended and stopped.

But when government or its creature, the Central Bank, becomes the legalized counterfeiter, the counterfeit is not only fully detected but hailed by public opinion, often guided and molded by the counterfeiters themselves, as wise economic statesmanship. Then, there is no way to guard the guardians, and the counterfeiter is turned loose to prey on society and inflate at will. The result will be a process of continuing and even accelerating monetary and therefore price inflation.

Such is roughly the course of modern monetary history, particularly in the twentieth century—a history of statism and volatile rates of debasement of the currency unit by the legalized counterfeiters. The result is a veritable and increasingly chaotic Age of Inflation. What is desperately needed is to abolish the counterfeiting. That was the proposal stemming from Mises's insight into the inevitably destructive effects of paper money and fractional reserve banking. Instead, what our pseudo-Austrian economists propose to do is not to abolish counterfeiting, but to privatize it—to open up the counterfeiting process to "free" private competition.

One of Mises's favorite quotes on money and banking was from Thomas Tooke: "free trade in banking is tantamount to free trade in swindling." Tooke and Mises, of course, were referring to fractional reserve banking, in which banks pledge to redeem on demand receipts to non-existent money in their vaults. These bank notes or deposits are just as much counterfeit as warehouse receipts to non-existent grain, fake receipts that look like genuine warehouse receipts to grain, which were loaned out by grain elevators until recent decades—until, that is, the practice of fractional-reserve issues of receipts in grain, was outlawed and cracked down on.

The champions of free competition in counterfeiting retort that this is simply the market at work, that the market registers a "demand" for more expanded credit, and that the private bankers, these Kirznerian entrepreneurs, are simply "alert" to such market demands. Well, of course, there is *always* a "demand" for fraud, and embezzlement, on the "market," and there will always be plenty of "alert" swindlers who are eager and willing to furnish a supply of these items. But if we define the "market" not simply as a supply of desired goods and services, but as a supply of such goods *within* a framework of inviolate property rights, then we see a very different picture. To paraphrase William Graham Sumner, when A supplies B with a good or service, that is a genuine and unexceptionable market transaction. A is supplying what B demands. But when A and B put their heads together to swindle C, D, and E, that is a horse of a very different color, and surely not a market transaction in the same voluntary sense.

Following a perceptive suggestion of Dr. David Gordon, let us examine a slightly different kind of fractional reserve banking. Instead of issuing deposits or notes which function like counterfeit warehouse receipts to cash, let us assume that these banks actually print dollar bills made up to look like the genuine article, replete with forged signatures by the Treasurer of the United States. The banks print these bills and lend them out at interest. If they are then criticized for what everyone would concede to be forgery and counterfeiting, why cannot these banks reply as follows: "Well, look, we have genuine, non-counterfeit cash reserves of 10 percent in our vaults. As long as people are willing to trust us, and accept these bills as equivalent to genuine cash, what is wrong with that? We are only engaged in a market transaction, no more no less so than any other fractional reserve banking." And what indeed is *wrong* about the statement that cannot be applied to any case of fractional reserve banking? If counterfeiting *per se* is deplorable and to be outlawed, then the same standards must be applied to its surrogate, fractional reserve banking, which is currently legal and which would run rampant in the "free-banking" heaven of our non-Misesian pseudo-Austrians. Conversely, these free-bankers must then be willing to accept the legality of every person and every bank issuing outright forgeries or counterfeits and simply printing paper dollar bills, which would not be illegal if some "reserve" or other in genuine bills were actually maintained. And if the free bankers must be willing to accept outright "free" counterfeiting of dollar bills, then they also must be willing to endorse its immediate consequences in wildly runaway inflation.

Monetary policy is evidently a strange field, for it is an area where no one, from the writers of crayoned letters on up to F.A. Hayek, seems to be afraid to engage in flights of Utopian fancy, or what Hayek would ordinarily deride as "constructivism." So I might as well do the same, with the important difference that my proposal lies within the strict bounds of property rights, genuine market commodity money, and Misesian monetary theory.

Ludwig von Mises saw that, once various marketable commodities are chosen on the market to be media of exchange and then to be general media of exchange termed "money," there is an inexorable market tendency for *one* commodity money to win out in each society. In every society where they were available, gold and silver soon became the only commodities that survived as moneys, with the relatively more abundant silver used as coins for smaller transactions and the relatively rare gold coins for larger transactions. In each society and country, gold and silver coins circulated at various units of weight determined by the market; generally, the unit of account, the unit used to calculate business accounts, profits or assets, as well as people's incomes, was the weight of gold or of silver, as denominated in the language of each country. As countries proliferated and discovered each other, the gold and silver coins of the various countries tended to exchange according to their precious metal content, for example, if the U.S. dollar was *defined* as 1/20 of a gold ounce, and the French franc at 1/100 of a gold ounce, then the "exchange rate" of dollars to francs would naturally be at the ratio of their respective weights: five francs to one dollar. Gold and silver ratios, on the other hand, would tend to be set on the market at the current ratio of the purchasing powers of gold and silver, as determined by the supplies of and demands for the two metals.

Over the centuries, however, governments have interfered with, and crippled, the natural process toward international metallic money. Governments seized the command post of the economy by nationalizing the coin minting function and then facilitated their own debasement of standards of weights of coin by shifting emphasis from the unit of gold or silver weight to *tale*, or the *name* itself. By shifting the monetary unit from, say, the dollar as 1/20 of a gold ounce to the dollar itself, the government could repeatedly debase, or lighten, the gold weights of the currency unit. The English "pound sterling," as its name indicates, used to be worth, indeed used to be defined as, one pound weight of silver; it has now been debased to approximately one half an ounce of silver. Almost as destructive, and facilitating the processes of debasement, was the insistence of most governments on fixing the exchange rate, that is, the price, of silver and gold, that is, instituting "bimetallism." This bimetallic fixed ratio, usually set initially at the ratio determined by world market prices, inevitably departed from it more strongly as time went on. Gresham's Law went into effect and caused sudden shortages of the artificially undervalued metal along with inflows and surpluses of the artificially overvalued one. In a truly free market, government would not fix exchange rates, but would allow countries and societies throughout the market to select media of exchange and units of account: this is what is called "parallel standards" of gold, silver, and possibly other metals, and what has also been called "free metallism."[68]

[68]On parallel standards, see Mises, *Theory of Money and Credit* (New Haven, Conn.: Yale University Press, 1951), pp. 179ff. On how they worked in medieval and early modern Europe and how bimetallism interfered with them, and provided occasions for debasement, see Luigi Einaudi, "The Theory of Imaginary Money from Charlemagne to the French Revolution," in *Enterprise and Secular Change*, F.C. Lane and J.C. Riemersma, eds. (Homewood, Ill.: Irwin, 1953), pp. 229–61. On "free metallism," see two works by William Brough, *Open Mints and Free Banking* (New York: Putnam, 1898), and *The Natural Law of Money* (New York: Putnam, 1894).

A genuine free market in money, then, would allow the market to select whatever metals it wishes as media of exchange and units of account, without government attempts to fix the exchange rates between them.[69]

But one would expect that the world free market, the mighty network of voluntary exchange that Mises called an oecumene, would, if unrestricted and given its head, move eventually toward one monetary metal.[70] And, whether it be one or two metals, the currency units would eventually transcend the independent or quasi-independent names given by states, to form a world-wide unity of simple units of weight. The entire world, we might expect, as state interference into the market *oecumene* disappears will speak and reckon no longer in "dollars," or "francs," or "marks," but only in gold ounces or gold grams. That sort of world was, indeed, the attainable dream of many of the economists and statesmen of the nineteenth century, the classic century of the gold standard. In a series of

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[69]Comparing the return to gold coin in Europe after half a millennium in the mid-thirteenth century, in Florence and in Genoa, Professor Lopez, a proud Genoese, writes:

> Florence, like most medieval states, made bimetallism and trimetallism [copper] a base of its monetary policy. . . . Genoa, on the contrary, in conformity with the principle of restricting state intervention as much as possible, did not try to enforce a fixed relation between coins of different metals . . . basically, the gold coinage of Genoa was not meant to integrate the silver and bullion coinages but to form an independent system. (Robert Sabatino Lopez, "Back to Gold, 1252," *Economic History Review* [April 1956]: 224.

[70]On Mises and the oecumene, Joseph T. Salerno, "Ludwig von Mises as Social Rationalist," pp. 26–54, esp. 27–36. Salerno writes of the Misesian oecumene,

> As the final and full fruition of social evolution driven by the cosmic ontological principle of division of labor, the "oecumene" embraces all of humanity cooperating in hyperspecialized production processes. At any point in history, the evolving oecumene is the "rational and intended" outcome of an intersubjective process, whose purpose is the amelioration of scarcity. It exists not as a thing unto itself, but as a complex of social relations which emerges from a common orientation of individual

international monetary conferences, which contrasted to twentieth-century ones by not seeking more global government monetary control but greater expression of a unified free market, there were attempts to reach this goal. The idea was first to adjust existing exchange rates slightly to make them multiples of one another, facilitating a phasing out of names and a growing use of explicit units of gold weight in every country. Unfortunately, the vexed silver problem obstructed any agreement, until of course World War I swept away any search for a genuine international metallic money.[71]

Since World War I, unfortunately, the quest for inter-central bank cooperation, for international monetary coordination, has been a search for a form of monetary internationalism diametrically opposed to the thrust of the nineteenth century. Instead of a search for a world money uncontrolled and unhampered by any State, we see repeated attempts to achieve a form of world governmental coordinated paper inflation. The ultimate Keynesian dream is moving ever closer: to establish a world economic government with a World Reserve Bank issuing a new world paper currency to be called the *bancor* after Keynes, the *unita* after Harry Dexter White, the *phoenix* after the London *Economist*, or whatever. Then, all nations of the world believe they could inflate together, keeping exchange rates fixed and also avoiding the kind of monetary reserve crisis that laid low the phony British-run "gold" standard of the late 1920s, as well as the phony "gold"-tainted Bretton Woods system after World War II. Then, there will be nothing to stop the smooth run of worldwide inflation—until, of course, the market takes the play away from the depreciating world paper currency and the world goes through the fearful holocaust of a worldwide runaway inflation.

> human actions, that is, to use the social division of labor as the means to attain individual goals. Because such relations thus emanate from the will, they must be daily affirmed and recreated in human thought and action. (Ibid., p. 31)

[71]See the detailed account in the much neglected work, Henry B. Russell, *International Monetary Conferences* (New York: Harper, 1898). Also see Frederick A.P. Barnard, *The Metric System of Weights and Measures* (New York: Columbia College, 1872), who treats the problem of international unification of monetary units in an appendix as a subset of the problem of unifying all metric measures.

But let us return from this grisly scenario to my projected and hoped-for worldwide free market, the interconnected and prospering *oecumene*. We can project what will happen to this market if it is allowed to evolve without government distortion or interference. We can project, then, a future worldwide free economy, using only metallic money, with the entire world using one unit of weight of gold as money, both as a medium of exchange and as a unit of account. All reckoning will take place in terms of gold ounces or grams, which cannot constitute the world stock of money. It is possible that silver will continue to be a metallic money for smaller denomination transactions, but we can imagine that the market's quest for efficiency will eventually lead to one metallic money. Money will then be fully private, with no government intrusion, for the gold will both be mined and minted by private firms. (There is no reason to assume that only government is qualified to mint coins. In fact, considering its record of continuing debasement, government is scarcely qualified to mint coins at all.)

A "free market" also means no government interference whatever in the economy. It means that private individuals and firms are free to earn money and profits, and that they are also free to lose. There can be no genuine freedom to choose without a corollary freedom to lose. No firm may be considered "too big to fail." And so a free market in money necessarily means the abolition of central banking and of so-called deposit "insurance." Banks must be free to fail.

Indeed, a "free market" necessarily implies total respect for and protection of private property. But this means that rights of private property must always be preserved. This implies not only a cracking down on assault and murder, but also on all forms of theft and fraud, including counterfeiting. Counterfeiting must be prosecuted fully by the law and, more than that, must be scorned and condemned by public opinion. As an advocate of 100 percent reserve banking, of full gold backing for all bank notes and deposits, I recognize that it would be difficult for government to police the banks, banks being notably ingenious in discovering market ways of getting around government regulations. One hundred percent banking must be enforced, not by administrative regulations, but by the legal system. While investigative snoops can hunt down counterfeit warehouse-receipts, it would be far simpler and more effective to crack down immediately and totally on any failure of a bank to pay in full on demand. First, as the Jacksonians wanted, but were never able to get through the Whig-dominated Congress in the late 1830s, at the first sign of such non-payment, the bank must be declared insolvent and its assets liquidated. But, second, these fractional-reserve bankers must be treated not as mere entrepreneurs who made unfortunate business decisions but as counterfeiters and embezzlers who should be cracked down on by the full majesty of the law. Forced repayment to all the victims plus substantial jail terms should serve as a deterrent as well as to mete out punishment for this criminal activity.

I envision the free-market world of the future, then, as one of purely metallic worldwide money. Increases of bank money will not be tolerated and will be treated as the counterfeiting and the invasion of property rights that they really are. The money supply, then, will grow only slowly, concomitant with the slow growth in the stock of the world's gold. The scourge of inflation will finally be lifted from the world; prices will fall, and the more productive the economy, and the more the increase in the supply of goods, the more prices will fall, the cost of living will decline, and the greater will be the increase in the standard of living for everyone. And without fractional reserve banking, there will be no more booms and busts, no more terrible malinvestments, distortions, and shocks of euphoria and distress brought about by business cycles. Investment will be limited to voluntary savings, and therefore there will be no periodic outbreaks of unsound investments that will have to be liquidated by recession. The world *oecumene* will at last be secured by the money required for freedom: a metallic money, produced by the market and the value of which is decided totally by the market and not at all by government.

Consumers and the economy will be immeasurably freer and sounder, and the only ones who will lose from the development of this market *oecumene* are the special interest groups who benefit from government and bank-controlled inflation and who constitute the ruling power elites in our increasingly state-dominated economy.

EPILOGUE: THE MODERN AUSTRIAN REVIVAL

Professor Karen Vaughn's brief history of the modern Austrian "revival" as a participant-observer is, first of all, a strictly biased account from the Hayekian/Lachmannian point of view. The Vaughn treatment is yet another variant of the Whig theory of the history of thought, this time from a Lachmannian perspective. Being Whiggish, Vaughn's history has to be fitted into the Procrustean mold of early fumblings, improvement, and, at each step of the way, onward and upward into the light, it begins then, in post-World War II America, with Mises as the admitted carrier of the Austrian tradition; to be improved upon and superseded by Hayek; and then finally, to be crowned by the upward march of nihilist Lachmannia, creative gropings by O'Driscoll and Rizzo, and finally even Lachmann's "narrow" destructionism surpassed by glimpses of a grand and noble new theory, emphasizing "biological evolution," and culminating in the work of several young graduate students of Professor Don Lavoie. In particular, the two works cited by Vaughn as blazing the path toward a grand new Austrian paradigm consist of two articles published in Lavoie's minor and now defunct journal, *Market Process*.

Professor Vaughn leaves out some significant facts from her starry-eyed account. One is that she herself was on the board of Lavoie's Center for the Study of the Market Process, and that she therefore was engaging in a certain amount of special pleading.

In any case: how did our Whiggish neo-Austrian fare in her attempt to capture the historical process, her form of institutionalist Austrianism? In short, how well did she predict the near-term Austrian future? The answer is: not very well. Professor Vaughn's article was written for a conference on the Austrian tradition in economics held in the spring of 1989. In the less than four years that have elapsed since then, the entire Austrian world has changed dramatically. Well, it is a fast-moving world out there, if not quite the "kaleidic" one perceived by Ludwig Lachmann. Since her article was written, the Lachmannian Society for Interpretive Economics, founded by Professor Lavoie, has come and gone, the journal *Market Process* has disappeared, and the Center for the Study of the Market Process has virtually left economics. My own prediction, I dare say better founded than Professor Vaughn's, is that, with the passing away of Professor Lachmann, and more particularly, the loss of interest in economics by its funding source, Lachmannia and the Lavoiean variants will quickly disappear from the scene. Not being a Whig historian, this development does not unsettle me in the least.[72]

[72]In her latest discussion of Austrian economics, Vaughn, while quietly and necessarily abandoning the Lavoiean project and dropping all references to it, is still searching for some mixture of "evolution" and institutionalism as the way out for Austrian economics. Karen I. Vaughn, "The Problem of Order in Austrian Economics: Kirzner vs. Lachmann," *Review of Political Economy* 4, no. 3 (1992): 251–74.

Let us return to Professor Vaughn's history of the Austrian revival. In order to praise the later developments, she is forced to disparage the earlier ones, particularly the noble struggle of Ludwig von Mises and even more those of us who have continued in the older and therefore allegedly discredited Misesian paths. Part of her form of Whig mythology is that Hayek must be painted as far superior to Mises. So we have Mises grudgingly hailed as single-handedly preserving the Austrian School in the United States in the 1940s, 50s, and 60s. She disparages Mises as an outsider to academia, as not being able to secure an official teaching position because of his "outspoken antistatist views," and because of his unfortunate "emphatic style." She is forced to admit that while Hayek, whom she claims to be "ultimately . . . more important in shaping the Austrian revival," actually emigrated to the United States in the 1940s, and while Hayek taught at the same time at the University of Chicago, it was unaccountably "his older colleague Mises who was responsible for bringing Austrian economics to America."[73]

What she fails to mention, since it would correct her deprecation of Mises, is that Hayek too, despite his definitely *un*emphatic style, could not find an official academic post in the United States, and that *his* salary, too, was financed by the William Volker Fund, the same organization that financed Mises's professorial post because it "knew of [Mises's] lifelong antistatist fight." The Volker Fund financed Hayek's professorial position for the same reason.

Moreover, the reason why Hayek did not help spark an Austrian revival in the United States, despite his years of teaching at Chicago, is that Hayek was not the sort of teacher to ignite or inspire student interest. Hayek was barred from teaching economics at the University of Chicago by the economics department, and so he had to teach at the Committee on Social Thought, a charmingly interdisciplinary graduate department, but whose PhDs, being outside orthodox department lines, were not exactly designed for scholarly careerism. But more important than that: Hayek did not have the personality as a teacher to inspire students or disciples. Unlike Mises, who was unfailingly charming and devoted to spurring productivity among his

[73]Vaughn, "Mengerian Roots," p. 396.

students, Hayek was cool and aloof, only answering specific questions put to him by his doctoral students, and never engaging them in conversation or discussion. Hence, Hayek did not help spark an Austrian revival. Also, as Vaughn briefly admits, Hayek had not yet come up with his "evolutionary" and other philosophic studies. His first alleged masterwork, *The Constitution of Liberty*, published in 1960, was political philosophy rather than economics, and it was a political philosophy that properly carried no weight, being generally demolished by such Austrian critics as his student Ronald Hamowy.

Finally, Hayek retired from the University of Chicago in 1961, and since Chicago refused to pay him a pension since it had never paid him a salary, Hayek was forced to leave the United States and go to Germany, where be was able to draw a salary at the University of Freiburg. From 1961 on, Hayek no longer resided in the United States, and this important fact, curiously omitted from Vaughn's account, played an important role in Hayek's not being central to the Austrian revival which Vaughn dates from the South Royalton Conference in 1974.[74] As Vaughn points out, Hayek's coincidental receiving of the Nobel prize later in the fall of 1974 clearly ignited a general and continuing interest in and study of Hayek and the entire Austrian tradition.

Historical accuracy compels me to take up Professor Vaughn's comparative treatment of Professor Kirzner and myself, undoubtedly the two most productive American students of Mises, both of whom had published important Austrian works before the South Royalton year of 1974. I, she says, was "Mises's faithful interpreter to the radical libertarian fringe . . . young people, many of them free-market radicals who had discovered the work of Mises and who had listened to the Austrian folklore at Murray Rothbard's knee."[75] So here I am, in Professor Vaughn's account, a preacher of Misesian folklore to youthful free-market libertarians. In the meanwhile, while I was dispensing Misesian folklore to bedazzled youth, what was Professor

[74]Vaughn attributes the alleged neglect of Hayek at the South Royalton conference to the fact that I "did not think much of Hayek's politics or economics." Very true, except that I had no control over the papers of the two other major participants: Israel Kirzner and Ludwig M. Lachmann. Vaughn, "Mengerian Roots," p. 402*n*.

[75]Ibid., p. 399.

Kirzner doing? He, "against overwhelming odds, attempted to carry on Mises's work in the context of the mainstream academic community."[76]

There are two fundamental flaws with Vaughn's historical account, convenient though it may be for her own Whiggish folklore of Up from Mises to Lachmann and Lavoie. One is, that I too, was an academic. At the time of South Royalton, I was a professor of economics at the Polytechnic Institute of Brooklyn; perhaps, bedazzled youth that she may have been at the time, she did not realize that I was not a full-time folklorist. The second deals with Professor Kirzner's role. While Kirzner is a distinguished scholar and contributor to the Austrian tradition, even though he too has strayed from Mises in later years, he was scarcely, at that point, a heroic struggler for Austrianism against its academic enemies. In fact, Israel Kirzner kept a very low Austrian profile at New York University. I myself became friendly with someone who had received a PhD under Kirzner in the late 1960s, and he had no idea whatever what Austrian economics was or that his doctoral mentor was connected with it.

Vaughn mentions that the Institute for Humane Studies sponsored the week-long scholarly Austrian conference at South Royalton, as well as two others in the next two years, one at the University of Hartford, which she does not name, and one at Windsor Castle, England; important volumes of papers emerged from both the South Royalton and Windsor Castle conferences.

But then Vaughn does not raise the question: what in the world happened to these annual high-level scholarly conferences, that did so much to advance the Austrian School's discipline and interest in Austrian economics? What happened is that these conferences disappeared, since the major funding source, whom I refer to as The Donor, shifted his focus of interest. The shift was away from Misesian radicalism and consistency, both in Austrian economics, notably praxeology, and in political economy, in the form of consistent *laissez-faire*. By the late 1970s, The Donor decided that what Vaughn refers to as Mises's "outspoken antistatist views" and "emphatic style" were too candid and uncompromising to be palatable to the Powers That Be or respectable to other funding sources, the federal

[76]Ibid.

government, or the leaders of academia. For all of these reasons, The Donor, followed by the eager recipients of his largess, decided to set up moderate think tanks for public policy and to dilute Austrian economics to become respectable and non-threatening to academia. In academia, he thereby encouraged various outreaches: to Marxists, to hermeneuticians and deconstructionists, indeed to anyone and everyone put off by Ludwig von Mises's intransigent devotion to truth and to liberty. Hence, no more scholarly Austrian conferences, but only fellowships and programs promoting non- or anti-Misesian views in the name of Austrian economics.

If Professor Vaughn were *really* interested in chronicling a battle for Austrian truth "against overwhelming odds," she would ponder the tremendous achievement of Llewellyn H. Rockwell, Jr., in founding the Ludwig von Mises Institute ten years ago. For Lew Rockwell founded the Institute with no endowment, no pledges, no Big Daddy. All he had was the gleam of a lifelong idea: to found an institute dedicated to Ludwig von Mises and promoting the Misesian paradigm in Austrian economics. In fact, Big Daddy, the aforesaid Donor, was furious at Rockwell's plan to found the Mises Institute, and had the unmitigated gall to "order" him not to do so. When Lew went ahead despite this order, The Donor engineered a determined boycott, both of the Institute, and of the later establishment of the only scholarly Austrian journal, *The Review of Austrian Economics*.

There is good news to report at this Tenth Anniversary Conference of the Mises Institute. In the first place, this scholarly conference in Austrian economics continues the Windsor Castle tradition; let us hope it is the first of many. And second, The Donor has lost interest in Austrian economics and in ideology. The Mises Institute's stunningly successful summer conference, its "Mises University," is just about the only instructional summer conference remaining in Austrian economics. And as we have developed more and more outstanding Misesians, the Misesian paradigm has not only revived as a result of the Mises Institute's success: it is now virtually the only paradigm left in the field. Instead of the Whiggish history of a straight line onward and upward from Mises to the students of Lavoie, what we have is a three phase history, a zig-zag history of clashing paradigms and ideologies. The first phase was The Revival, beginning in the summer and fall of 1974 with the South Royalton Austrian conference and the award to Hayek of the Nobel Prize; but this expansion phase ended sometime in the late 1970s, after Windsor Castle, and was succeeded by Phase II, a decline and degeneration of Austrian economics away from the Misesian paradigm and into various fallacious variants and deviations. But then, as the Mises Institute got under way in the 1980s, Phase III, the Renaissance, developed, culminating in the recent successes of the Mises Institute, the pull-out from the field by The Donor, and the subsequent triumphal restoration of the Misesian paradigm. The difference from the late 1970s is that the Misesian paradigm is now established on a higher level than two decades ago; not only are there far more younger Misesians, and bound to be still more in the years ahead; not only are the "middle generation" of renegade anti-Misesians fading away, but of course Misesians have learned more in these two decades, ever honing and sharpening our Misesian knowledge in the course of waging struggles against these deviations and fallacies.

And so the truly good news of this Tenth Anniversary Conference of the Mises Institute is that I stand here, and the conference itself bears witness, to proclaim victory, to announce, at long last, the triumph of the Misesian paradigm in the Austrian home that Mises himself created. The great Ludwig von Mises could ask for no greater tribute.

11

Ludwig von Mises and the Paradigm for Our Age

Unquestioningly the most significant and challenging development in the historiography of science in the last decade is the theory of Thomas S. Kuhn. Without defending Kuhn's questionable subjectivist and relativistic philosophy, his contribution is a brilliant sociological insight into the ways in which scientific theories change and develop.[1] Essentially, Kuhn's theory is a critical challenge to what might be called the "Whig theory of the history of science." This "Whig" theory, which until Kuhn was the unchallenged orthodoxy in the field, sees the progress of science as a gradual, continuous, ever-upward process; year by year, decade by decade, century by century, the body of scientific knowledge gradually grows and accretes through the process of framing hypotheses, testing them empirically, and discarding the invalid and keeping the valid theories. Every age stands on the shoulders of and sees further and more clearly than every preceding age. In the Whig approach, furthermore, there is no substantive knowledge to be gained from reading, say, nineteenth-century physicists or seventeenth-century astronomers; we may be interested in reading Priestley or Newton or Maxwell to see how creative minds work or solve problems, or for insight into the history of the period; but we can never read them to learn something about science which we didn't know already. After all, their contributions are, almost by definition, incorporated into the latest textbooks or treatises in their disciplines.

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[1]Philosophically, Kuhn tends to deny the existence of objective truth and therefore denies the possibility of genuine scientific progress. Thomas S. Kuhn, *The Structure of Scientific Revolutions*, 2nd ed. (Chicago: University of Chicago Press, 1970).

Many of us, in our daily experience, know enough to be unhappy with this idealized version of the development of science. Without endorsing the validity of Immanuel Velikovsky's theory, for example, we have seen Velikovsky brusquely and angrily dismissed by the scientific community without waiting for the patient testing of the open-minded scientist that we have been led to believe is the essence of scientific inquiry.[2] And we have seen Rachel Carson's critique of pesticides generally scorned by scientists only to be adopted a decade later.

But it took Professor Kuhn to provide a comprehensive model of the adoption and maintenance of scientific belief. Basically, he states that scientists, in any given area, come to adopt a fundamental vision or matrix of an explanatory theory, a vision that Kuhn calls a "paradigm." And whatever the paradigm, whether it be the atomic theory or the phlogiston theory, once adopted the paradigm governs all the scientists in the field without being any longer checked or questioned—as the Whig model would have it. The fundamental paradigm, once established, is no longer tested or questioned, and all further research soon becomes minor applications of the paradigm, minor clearing up of loopholes or anomalies that still remain in the basic vision. For years, decades or longer, scientific research becomes narrow, specialized, always within the basic paradigmatic framework.

But then, gradually, more and more anomalies pile up; puzzles can no longer be solved by the paradigm. But the scientists do not give up the paradigm; quite the contrary, increasingly desperate attempts are made to modify the particulars of the basic theory so as to fit the unpleasant facts and to preserve the framework provided by the paradigm. Only when anomalies pile up to such an extent that the paradigm itself is brought into question do we have a "crisis situation" in science. And even here, the paradigm is never simply discarded until it can be replaced by a new, competing paradigm which appears to close the loopholes and liquidate the anomalies. When this occurs, there arrives a "scientific revolution," a chaotic period

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[2]On the sociology of the reception of Velikovsky in the scientific community, see Alfred de Grazia, "The Scientific Reception Systems," in *The Velikovsky Affair*, Alfred de Grazia, ed. (New Hyde Park, N.Y.: University Books, 1966), pp. 171–231.

during which one paradigm is replaced by another, and which never occurs smoothly as the Whig theory would suggest. And even here, the older scientists, mired in their intellectual vested interests, will often cling to the obsolete paradigm, with the new theory only being adopted by the younger and more flexible scientists. Thus, of the co-discoverers of oxygen in the late eighteenth century, Priestley and Lavoisier, Joseph Priestley never, till the day he died, conceded that he had in fact discovered oxygen; to the end he insisted that what he had discovered was merely "dephlogisticated air," thus remaining within the framework of the phlogiston theory.[3]

And so, armed with Kuhn's own paradigm of the history of scientific theories, which is now in the process of replacing the Whig framework, we see a very different picture of the process of science. Instead of a slow and gradual upward march into the light, testing and revising at each step of the way, we see a series of "revolutionary" leaps, as paradigms displace each other only after much time, travail, and resistance. Furthermore, without adopting Kuhn's own philosophical relativism, it becomes clear that, since intellectual vested interests play a more dominant role than continual open-minded testing, it may well happen that a successor paradigm is less correct than a predecessor. And if that is true, then we must always be open to the possibility that, indeed, we often know less about a given science now than we did decades or even centuries ago. Because paradigms become discarded and are never looked at again, the world may have forgotten scientific truth that was once known, as well as added to its stock of knowledge. Reading older scientists now opens up the distinct possibility that we may learn something that we haven't known—or have collectively forgotten—about the discipline. Professor de Grazia states that "much more is discovered and forgotten than is known," and much that has been forgotten may be more correct than theories that are now accepted as true.[4]

If the Kuhn thesis is correct about the physical sciences, where we can obtain empirical and laboratory tests of hypotheses fairly easily, how much more must it be true in philosophy and the social sciences, where no such laboratory tests are possible! For in the disciplines

[3]Kuhn, *The Structure of Scientific Revolutions*, pp. 53–56.

[4]De Grazia, "The Scientific Reception Systems," p. 197.

relating to human action, there are no clear and evident laboratory tests available; the truths must be arrived at by the processes of introspection, "common sense" knowledge, and deductive reasoning, and such processes, while arriving at solid truths, are not as starkly or compellingly evident as in the physical sciences. Hence, it is all the more easy for philosophers or social scientists to fall into tragically wrong and fallacious paradigms and thus to lead themselves down the garden path for decades, and even centuries. For once the sciences of human action adopt their fundamental paradigms, it becomes much easier than in the physical sciences to ignore the existence of anomalies, and therefore easier to retain erroneous doctrines for a very long time. There is a further well-known difficulty in philosophy and the social sciences which makes systematic error still more likely: the infusion of emotions, value judgments, and political ideologies into the scientific process. The angry treatment accorded to Jensen, Shockley, and the theorists of inequalities of racial intelligence by their fellow scientists, for example, is a case in point. For underlying the bulk of the scientific reception of Jensen and Shockley is that even if their theories are true, they should not say so, at least for a century, because of the unfortunate political consequences that may be involved. While this sort of stultifying of the quest for scientific truth has happened at times in the physical sciences, it is fortunately far less prevalent there; and whatever the intellectual vested interests at stake, there was at least no ideological and political buttressing for the phlogiston theory or the valence theory in chemistry.

Until recent decades, philosophers and social scientists harbored a healthy recognition of vast differences between their disciplines and the natural sciences; in particular, the classics of philosophy, political theory, and economics were read not just for antiquarian interest but for the truths that might lie there. The student of philosophy read Aristotle, Aquinas, or Kant not as an antiquarian game but to learn about answers to philosophical questions. The student of political theory read Aristotle and Machiavelli in the same light. It was not assumed that, as in the physical sciences, all the contributions of past thinkers have been successfully incorporated into the latest edition of the currently popular textbook; and it was therefore not assumed that it was far more important to read the latest journal article in the field than to read the classical philosophers.

In recent decades, however, the disciplines of human action—philosophy and the social sciences—have been frantically attempting to ape the methodology of the physical sciences. There have been many grave flaws in this approach which have increasingly divorced the social sciences from reality: the vain substituting of statistics for laboratory experimentation, the adoption of the positivistic hypothesis-testing model, the unfortunate conquest of all of the disciplines—even history, to some extent—by mathematics, are cases in point. But here the important point is that in the aping of the physical sciences, the social disciplines have become narrow specialties; as in the physical sciences, no one reads the classics in the field or indeed is familiar with the history of the discipline further back than this year's journal articles. No one writes systematic treatises anymore; systematic presentations are left for jejune textbooks, while the "real" scholars in the field spend their energy on technical minutiae for the professional journals.

We have seen that even the physical sciences have their problems from uncritical perpetuation of fundamental assumptions and paradigms; but in the social sciences and philosophy this aping of the methods of physical science has been disastrous. For while the social sciences were slow to change their fundamental assumptions in the past, they were eventually able to do so by pure reasoning and criticism of the basic paradigm. It took, for example, a long time for "marginal utility" economics to replace classical economics in the late nineteenth century, but it was finally done through such fundamental reasoning and questioning. But no systematic treatise—with one exception to be discussed below—has been written in economics, not a single one, since World War I. And if there are to be no systematic treatises, there can be no questioning of the fundamental assumptions; deprived of the laboratory testing that furnishes the ultimate checks on the theories of physical science and now also deprived of the systematic use of reason to challenge fundamental assumptions, it is almost impossible to see how contemporary philosophy and social science can ever change the fundamental paradigms in which they have been gripped for most of this century. Even if one were in total agreement with the fundamental drift of the social sciences in this century, the absence of fundamental questioning—the reduction of every discipline to narrow niggling in the journals—would be cause for grave doubts about the soundness of the social sciences.

But if one believes, as the present author does, that the fundamental paradigms of modern, twentieth-century philosophy and the social sciences have been grievously flawed and fallacious from the very beginning, including the aping of the physical sciences, then one is justified in a call for a radical and fundamental reconstruction of all these disciplines, and the opening up of the current specialized bureaucracies in the social sciences to a total critique of their assumptions and procedures.

Of all the social sciences, economics has suffered the most from this degenerative process. For economics is erroneously considered the most "scientific" of the disciplines. Philosophers still read Plato or Kant for insights into truth; political theorists still read Aristotle and Machiavelli for the same reason. But no economist reads Adam Smith or James Mill for the same purpose any longer. History of economic thought, once required in most graduate departments, is now a rapidly dying discipline, reserved for antiquarians alone. Graduate students are locked into the most recent journal articles, the reading of economists published before the 1960s is considered a dilettantish waste of time, and any challenging of fundamental assumptions behind current theories is severely discouraged. If there is any mention of older economists at all, it is only in a few perfunctory brush strokes to limn the precursors of the current Great Men in the field. The result is not only that economics is locked into a tragically wrong path, but also that the truths furnished by the great economists of the past have been collectively forgotten by the profession, lost in a form of Orwellian "memory hole."

Of all the tragedies wrought by this collective amnesia in economics, the greatest loss to the world is the eclipse of the "Austrian School." Founded in the 1870s and 1880s, and still barely alive, the Austrian School has had to suffer far more neglect than the other schools of economics for a variety of powerful reasons. First, of course, it was founded a century ago, which, in the current scientific age, is in itself suspicious. Second, the Austrian School has from the beginning been self-consciously philosophic rather than "scientistic"; far more concerned with methodology and epistemology than other modern economists, the Austrians arrived early at a principled opposition to the use of mathematics or of statistical "testing" in economic theory. By doing so, they set themselves in opposition to all the positivistic, natural-science-imitating trends of this century. It meant, furthermore, that Austrians continued to write fundamental treatises while other economists were setting their sights on narrow, mathematically oriented articles. And third, by stressing the individual and his choices, both methodologically and politically, Austrians were setting themselves against the holism and statism of this century as well.

These three radical divergences from current trends were enough to propel the Austrians into undeserved oblivion. But there was another important factor, which at first might seem banal: the language barrier. It is notorious in the scholarly world that, "language tests" to the contrary notwithstanding, no American or English economists can really read a foreign language. Hence, the acceptance of foreign-based economics must depend on the vagaries of translation. Of the great founders of the Austrian School, Carl Menger's work of the 1870s and 1880s remained untranslated into English until the 1950s; Menger's student Eugen von Böhm-Bawerk fared much better, but even his completed work was not translated until the late 1950s. Böhm-Bawerk's great student, Ludwig von Mises, the founder and head of the "neo-Austrian" School, has fared almost as badly as Menger. His classic *Theory of Money and Credit*, published in 1912, which applied Austrian economics to the problems of money and banking, and which contained the seeds of a radically new (and still largely unknown) theory of business cycles, was highly influential on the Continent of Europe, but remained untranslated until 1934. By that time Mises's work was to be quickly buried in England and the United States by the fervor of the "Keynesian Revolution," which was at opposite poles from Mises's theory. Mises's book of 1928, *Geldwerstabilisierung und Konjunkturpolitik*, which predicted the Great Depression on the basis of his developed business cycle theory, remains untranslated to this day. Mises's monumental systematic treatise, *Nationalökonomie*, integrating economic theory on the grounds of a sound basic epistemology, was overlooked also from its being published in 1940, in the midst of war-torn Europe. Again its English translation as *Human Action* (1949) came at a time when economics had set its methodological and political face in a radically different direction, and therefore Mises's work, as in the case of other challenges to fundamental paradigms in science, was not refuted or criticized but simply ignored.

Thus, while Ludwig von Mises was acknowledged as one of Europe's most eminent economists in the 1920s and 30s, the language barrier shut off any recognition of Mises in the Anglo-American world until the mid-1930s; then, just as his business cycle theory was beginning to achieve renown as an explanation for the Great Depression, Mises's overdue recognition was lost in the hoopla of the Keynesian Revolution. A refugee deprived of his academic or social base in Europe, Mises emigrated to the United States at the mercy of his new-found environment. But while, in the climate of the day, the leftist and socialist refugees from Europe were cultivated, feted, and given prestigious academic posts, a different fate was meted out to a man who embodied a methodological and political individualism that was anathema to American academia. Indeed, the fact that a man of Mises's eminence was not offered a single regular academic post and that he was never able to teach in a prestigious graduate department in this country is one of the most shameful blots on the none too illustrious history of American higher education. The fact that Mises himself was able to preserve his great energy, his remarkable productivity, and his unfailing gentleness and good humor in the face of this shabby treatment is simply one more tribute to the qualities of this remarkable man whom we now honor on his ninetieth birthday.

Agreed then that Ludwig von Mises's writings are the embodiment of a courageous and eminent man hewing to his discipline and to his vision, unheeding of shabby maltreatment. Apart from this, what substantive truths do they have to offer an American in 1971? Do they present truths not found elsewhere and therefore do they offer intrinsic interest beyond the historical record of a fascinating personal struggle? The answer—which obviously cannot be documented in the compass of this article—is simply and startlingly this: that Ludwig von Mises offers to us nothing less than the complete and developed correct paradigm of a science that has gone tragically astray over the last half-century. Mises's work presents us with the correct and radically divergent alternative to the flaws, errors, and fallacies which a growing number of students are sensing in present-day economic orthodoxy. Many students feel that there is something very wrong with contemporary economics, and often their criticisms are trenchant, but they are ignorant of any theoretical alternative. And, as Thomas Kuhn has shown, a paradigm, however faulty, will not be discarded until it can be replaced by a competing theory. Or, in the vernacular, "you can't beat something with nothing," and "nothing" is all that many present-day critics of economic science can offer. But the work of Ludwig von Mises furnishes that "something"; it furnishes an economics grounded not on the aping of physical science, but on the very nature of man and of individual choice. And it furnishes that economics in a systematic, integrated form that is admirably equipped to serve as a correct paradigmatic alternative to the veritable crisis situation—in theory and public policy—that modern economics has been bringing down upon us. It is not exaggeration to say that Ludwig von Mises is the Way Out of the methodological and political dilemmas that have been piling up in the modern world. But what is needed now is a host of "Austrians" who can spread the word of the existence of this neglected path.

Briefly, Mises's economic system—as set forth particularly in his *Human Action*—grounds economics squarely upon the axiom of action: on an analysis of the primordial truth that individual men exist and act, that is, make purposive choices among alternatives. Upon this simple and evident axiom of action, Ludwig von Mises deduces the entire systematic edifice of economic theory, an edifice that is as true as the basic axiom and the fundamental laws of logic. The entire theory is the working out of methodological individualism in economics, the nature and consequences of the choices and exchanges of individuals. Mises's uncompromising devotion to the free market, his opposition to every form of statism, stems from his analysis of the nature and consequences of individuals acting freely on the one hand, as against governmental coercive interference or planning on the other. For, basing himself on the action axiom, Mises is able to show the happy consequences of freedom and the free market in social efficiency, prosperity, and development, as against the disastrous consequences of government intervention in poverty, war, social chaos, and retrogression. This political consequence alone, of course, makes the methodology as well as the conclusions of Misesian economics anathema to modern social science.

As Mises puts it:

> Princes and democratic majorities are drunk with power They must reluctantly admit that they are subject to the laws of nature. But they reject the very notion of economic law. Are they not the supreme legislators? . . . In fact, economic history is a long record

of government policies that failed because they were designed with a bold disregard for the laws of economics.

It is impossible to understand the history of economic thought if one does not pay attention to the fact that economics as such is a challenge to the conceit of those in power. An economist can never be a favorite of autocrats and demagogues. With them he is always the mischief-maker. . . .

In the face of all this frenzied agitation, it is expedient to establish the fact that the starting point of all praxeological and economic reasoning, the category of human action, is proof against any criticisms and objections.... From the unshakable foundation of the category of human action praxeology and economists proceed step by step by means of discursive reasoning. Precisely defining assumptions and conditions, they construct a system of concepts and draw all the inferences implied by logically unassailable ratiocination.[5]

And again:

The laws of the universe about which physics, biology, and praxeology [essentially economics] provide knowledge are independent of the human will, they are primary ontological facts rigidly restricting man's power to act. . . .

Only the insane venture to disregard physical and biological laws. But it is quite common to disdain economic laws. Rulers do not like to admit that their power is restricted by any laws other than those of physics and biology. They never ascribe their failures and frustrations to the violation of economic law.[6]

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[5]Ludwig von Mises, *Human Action* (New Haven, Conn.: Yale University Press, 1949), p. 67.

[6]Ibid., pp. 755–56. As Mises indicates, the revolt against economics as the harbinger of a free market economy is as old as the classical economists whom Mises acknowledges as his forebears. It is no accident, for example, that George Fitzhugh, the foremost Southern apologist for slavery and one of America's first sociologists, brusquely attacked classical economics as "the science of free society," while upholding socialism as "the science of slavery." See George Fitzhugh, *Cannibals All!*, C. Vann Woodward, ed. (Cambridge, Mass.: Harvard University Press, 1960), p. xviii; and Joseph Dorfman, *The Economic Mind in American Civilization* (New York: Viking Press, 1964), vol. 2, p. 929. On the statist and anti-individualist bias embedded deep in the foundations of sociology, see Leon Bramson, *The Political Context of Sociology* (Princeton, N.J.: Princeton University Press, 1961), esp. pp. 11–17.

A notable feature of Mises's analysis of "interventionism"—of government intervention in the economy—is that it is fundamentally what could now be called "ecological"; for it shows that an act of intervention generates unintended consequences and difficulties, which then present the government with an alternative: either more intervention to "solve" these problems, or repeal of the whole interventionist structure. In short, Mises shows that the market economy is a finely constructed, interrelated web; and coercive intervention at various points of the structure will create unforeseen troubles elsewhere. The logic of intervention, then, is cumulative; and so a mixed economy is unstable—always tending either toward full-scale socialism or back to a free-market economy. The American farm-price support program, as well as the New York City rent-control program, are almost textbook cases of the consequences and pitfalls of intervention. Indeed, the American economy has virtually reached the point where the crippling taxation, the continuing inflation, the grave inefficiencies and breakdowns in such areas as urban life, transportation, education, telephone and postal service, the restrictions and shattering strikes of labor unions, the accelerating growth of welfare dependency, all have brought about the full-scale crisis of interventionism that Mises has long foreseen. The instability of the interventionist welfare-state system is now making fully clear the fundamental choice that confronts us between socialism on the one hand and capitalism on the other.

Perhaps the most important single contribution of von Mises to the economics of intervention is also the one most grievously neglected in the present day: his analysis of money and business cycles. We are living in an age when even those economists supposedly most devoted to the free market are willing and eager to see the state monopolize and direct the issuance of money. Yet Mises has shown that:

1. there is never any social or economic benefit to be conferred by an increase in the supply of money;
2. the government's intervention into the monetary system is invariably inflationary;
3. therefore, government should be separated from the monetary system, just as the free market requires that government not intervene in any other sphere of the economy.

Here Mises emphasizes that there is only one way to ensure this freedom and separation: to have a money that is also a useful commodity, one whose production is like other commodities subject to the supply and demand forces of the market. In short, that commodity money—which in practice means the full gold standard—shall replace the fiat issue of paper money by the government and its controlled banking system.[7]

Mises's brilliant theory of the business cycle is the only such theory to be integrated with the economists' general analysis of the pricing system and of capital and interest. Mises shows that the business cycle phenomenon, the recurring alternations of boom and bust with which we have become all too familiar, cannot occur in a free and unhampered market. Neither is the business cycle a mysterious series of random events to be checked and counteracted by an ever-vigilant central government. On the contrary, the business cycle is generated by government: specifically, by bank credit expansion promoted and fueled by governmental expansion of bank reserves. The present-day "monetarists" have emphasized that this credit expansion process inflates the money supply and therefore the price level; but they have totally neglected the crucial Misesian insight that an even more damaging consequence is distortion of the whole system of prices and production. Specifically, expansion of bank money causes an artificial lowering of the rate of interest, and an artificial and uneconomic overinvestment in capital goods: machinery, plant, industrial raw materials, construction projects. As long as the inflationary expansion of money and bank credit continues, the unsoundness of this process is masked, and the economy can ride on the well-known euphoria of the boom; but when the bank credit expansion finally stops, and stop it must if we are to avoid a runaway inflation, then the day of reckoning will have arrived. For without the anodyne of continuing inflation of money, the distortions and misallocations of production, the overinvestment in uneconomic capital projects and the excessively high prices and wages in those capital goods industries become evident and obvious. It is then that the inevitable recession sets in, the recession being the reaction by which the market

[7]Thus, see Ludwig von Mises, *The Theory of Money and Credit* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1971).

economy readjusts itself, liquidates unsound investments, and realigns prices and outputs of the economy so as to eliminate the unsound consequences of the boom. The recovery arrives when the readjustment has been completed.

It is clear that the policy prescriptions stemming from the Misesian theory of the business cycle are the diametric opposite of the "post-Keynesian" policies of modern orthodox economics. If there is an inflation, the Misesian prescription is, simply, for the government to stop inflating the money supply. When the inevitable recession occurs, in contrast to the modern view that the government should rush in to expand the money supply (the monetarists) or to engage in deficit spending (the Keynesians), the Austrians assert that the government should keep its hands off the economic system—should, in this case, allow the painful but necessary adjustment process of the recession to work itself out as quickly as possible. At best, generating another inflation to end the recession will simply set the stage for another, and deeper, recession, later on; at worst, the inflation will simply delay the adjustment process and thereby prolong the recession indefinitely, as happened tragically in the 1930s. Thus, while current orthodoxy maintains that the business cycle is caused by mysterious processes within the market economy and must be counteracted by an active government policy, the Mises theory shows that business cycles are generated by the inflationary policies of government and that, once underway, the best thing that government can do is to leave the economy alone. In short, the Austrian doctrine is the only consistent espousal of *laissez-faire*; for, in contrast to other "free market" schools in economics, Mises and the Austrians would apply *laissez-faire* to the "macro" as well as the "micro" areas of the economy.

If interventionism is invariably calamitous and self-defeating, what of the third alternative: socialism? Here Ludwig von Mises is acknowledged to have made his best-known contribution to economic science: his demonstration, over fifty years ago, that socialist central planning was irrational, since socialism could not engage in that "economic calculation" of prices indispensable to any modern, industrialized economy. Only a true market, based on private ownership of the means of production and on the exchange of such property titles, can establish such genuine market prices, prices which serve to allocate productive resources—land, labor, and capital—to those areas which will most efficiently satisfy the demands of consumers. But Mises showed that even if the government were willing to forget consumer desires, it could not allocate efficiently for its own ends without a market economy to set prices and costs. Mises was hailed even by socialists for being the first to raise the whole problem of rational calculation of prices in a socialist economy; but socialists and other economists erroneously assumed that Oskar Lange and others had satisfactorily solved this calculation problem in their writings of the 1930s. Actually, Mises had anticipated the Lange "solutions" and had refuted them in his original article.[8]

It is highly ironic that, no sooner had the economics profession settled contentedly into the notion that Mises's charge had been refuted, when the Communist countries of Eastern Europe began to find, pragmatically and much against their will, that socialist planning was indeed unsatisfactory, especially as their economies were becoming industrialized. Beginning with Yugoslavia's breakaway from state planning in 1952, the countries of Eastern Europe have been heading with astonishing rapidity away from socialist planning and toward free markets, a price-system, profit-and-loss tests for enterprises, and so on. Yugoslavia has been particularly determined in its cumulative shift toward a free market and away even from state control of investments—the last government stronghold in a socialistic economy. It is unfortunate but not surprising that, neither in the East nor in the West, has Ludwig von Mises's name been brought up as the prophet of the collapse of central planning.[9]

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[8]Mises's classic article was translated as "Economic Calculation in the Socialist Commonwealth," in *Collectivist Economic Planning*, F.A. Hayek, ed. (London: George Routledge and Sons, 1935), pp. 87–130. Mises's and other articles by Lange and Hayek are reprinted in *Comparative Economic Systems*, Morris Bornstein, ed., rev. ed. (Homewood, Ill.: Richard D. Irwin, 1969). An excellent discussion and critique of the whole controversy may be found in Trygve J.B. Hoff, *Economic Calculation in the Socialist Society* (London: William Hodge, 1949).

[9]On Yugoslavia, see Rudolf Bicanic, "Economics of Socialism in a Developed Country," in *Comparative Economic Systems*, M. Bornstein, ed., pp. 222–35; on the other countries of Eastern Europe, see Michael Gamarnikow, *Economic Reforms in Eastern Europe* (Detroit, Mich.: Wayne State University Press, 1968).

If it is becoming increasingly evident that the socialist economies are collapsing in the East, and, on the other hand, that interventionism is falling apart in the West, then the outlook is becoming increasingly favorable for both East and West to turn before very long to the free market and the free society. For this courageous and devoted champion of liberty, there could be no more welcome prospect in his ninetieth year. But what should never be forgotten is that these events are a confirmation and a vindication of the stature of Ludwig von Mises, and of the importance of his contribution and his role. For Mises, almost singlehandedly, has offered us the correct paradigm for economic theory, for social science, and for the economy itself, and it is high time that this paradigm be embraced, in all of its parts.

There is no more fitting conclusion to a tribute to Ludwig von Mises than the moving last sentences of his greatest achievement, *Human Action*:

> The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race.[10]

Thanks in no small measure to the life and work of Ludwig von Mises, we can realistically hope and expect that mankind will choose the path of life, liberty, and progress and will at last turn decisively away from death and despotism.

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[10]Mises, *Human Action*, p. 881.

12

Value Implications of Economic Theory

Economics, as a science, attempts and claims to be purely value-free; that is, separate from the personal, valuational, or political proclivities of the economist. And yet economics and economists are continually making political pronouncements; economics *per se* is shot through with value-loaded assumptions, usually implicit, which then emerge as political conclusions and recommendations. It is my contention that this procedure is illegitimate and unscientific, and that it is incumbent on economic theory to purge itself of all vestiges of the unsupported value judgment. As a science, economics can and should stand apart from such value judgments. But since all political policy recommendations necessarily involve value judgments, does this mean that the economist must never make any policy recommendations or indeed, never use any terminology that is value-loaded? Not necessarily.

There are only two possible kinds of philosophical status for value judgments. *Either* they are all necessarily purely subjective and personal whims on the part of the valuer, in which case for the economist to remain a scientist he must indeed refrain from all policy recommendations whatever. *Or* these judgments may well be part of a general ethical system which is rationally and objectively demonstrable; in that case, it is perfectly legitimate for the economist when he applies his scientific theory to public policy to use this ethical system to arrive at economic policy recommendations. Let us take an example from medicine. A "purely" scientific, value-free medical procedure enables a physician to say that Treatment X will cure disease Y.

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As an applied scientist, the physician can then take this knowledge and *combine* it with the ethical judgment that "cure of the disease is good" and indeed is the goal of his treatment, and then conclude with the "policy" conclusion that he should apply Treatment X. In this case both the patient and the physician are proceeding, implicitly or explicitly, on the basis of a deeply shared ethical system; their value judgments are neither personal nor arbitrary, but stem from a shared ethical system which pronounces health and life as great goods for man and death and disease as corresponding evils.[1]

The point is that in medicine all parties proceed from the basis of a deeply shared ethical system. In the case of economics, this is scarcely true; here there are many competing and clashing values and value-systems held in society. Hence, the applied economist is in a more difficult situation. If an economist does not have an ethical system, but only subjective and arbitrary values, then it is incumbent upon him as a scientist ruthlessly to keep them out of his work. In short, the economist who lacks an ethical system must refrain from any and all value-loaded or political conclusions. (This statement, of course, is itself a value judgment stemming from an ethical system which holds that science must confine itself strictly to the search for, and the exposition of, truth.) But suppose on the other hand that an economist *also* holds an ethical system. What then?

It must be emphasized that if ethics is a rational and demonstrable discipline, it is self-subsistent, that is, its principles are arrived at apart from economics or any other particular science except itself. As in the case of medicine, the applied economist would then have to take this ethical system and add it to his economic knowledge to arrive at policy conclusions and recommendations. But in that case it is incumbent upon the applied economist to state his ethical system fully and with supporting argument; whatever he does, he must not slip value judgments, *ad hoc*, unanalyzed, and unsupported, into the body of his economic theory or into his policy conclusions. And

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[1]In some cases, of course, Treatment X may lead to other effects that both patient and physician may consider "harmful"; again both share a judgment stemming from a shared ethic about the evils of injury to the human organism. Both parties will then have to judge the treatment by weighing these contrasting effects.

yet this is precisely what the bulk of economists have been doing. They, and economic theory along with them, habitually make a host of value judgments which are smuggled into their analyzes, and which then permit them to make policy recommendations, implicit or explicit, without presenting or defending a coherent ethical system. Because they cannot, like physicians, work from a universally shared ethical system, it is incumbent upon economists to present a coherent and supported ethical system or forever hold their valuational and political peace.

There is no room here to cover more than a few of the outstanding examples of the smuggling of unsupported value judgments into economic analysis. In the first place, there is the familiar case of the "Pareto Optimum." If A and B trade two goods or services, they each do so because they will be, or rather expect to be, better off as a result of the trade. Surely it is legitimate then to say that A and B are both better off, and "therefore" that "society is better off," since no one demonstrably loses by the exchange. It is implicit, and even explicit from the use of the value-loaded term "optimal," that this exchange is therefore a "good thing." I am sympathetic to the view that this exchange is a good thing, but I do not believe that this can be concluded merely from the fact of exchange, as the Pareto Optimum does. In the first place, there might well be one or more people in existence who dislike and envy A or B, and who therefore experience pain and psychic loss because the object of their envy has now improved his lot. We cannot therefore conclude from the mere fact of an exchange that "everyone" is better off, and we can therefore not simply leap to the valuational idea of social utility. In order to pronounce this voluntary exchange as "good," we need another term to our syllogism: we must make the ethical pronouncement that envy is evil, and should not be allowed to cloud our approval of the exchange. But in that case we are back to the need for a coherent ethical system. I believe, as an "ethicist," that envy is evil, but I see no willingness among economists to admit the need for, much less set forth, any sort of coherent ethical position.

This brings me to the position of the bulk of free market economists, such as the Chicago School, who favor the free market but claim to do so not on ethical grounds, but purely on the grounds of "efficiency." I maintain that it is impermissible to advocate the free market without bolstering one's economic analysis with an ethical framework. Indeed, in some cases it is even *impossible* to set forth a coherent free-market approach without taking a frankly ethical position, and a position which goes beyond the almost universally-held utilitarian viewpoint of economists. Let us ponder our above-mentioned voluntary exchange between A and B. The free market economist advocates a world where such exchanges are legitimate and not interfered with. But any exchange implies an exchange of titles to private property. If I buy a newspaper for fifteen cents, what has happened is that I have ceded my ownership of the fifteen cents to the newsdealer, who in turn has granted his ownership of the newspaper to me. But this means that to *advocate* our right to make this exchange, means *also* to advocate the propriety, and hence the justice, of the existing property titles in the first place. To pronounce it "good" for myself and the newsdealer to have the right to make the exchange, means also to pronounce it "good" and just for each of us to own the fifteen cents and the newspaper to begin with. Yet economists are not willing to make this extension, for to do so would mean adopting a systematic concept of justice in property titles, which would involve the adoption of a system of political ethics. Economists have generally regarded such ethical systems as beyond their province; but if so, it is illegitimate for them to advocate a free market at all.

Let us illustrate: suppose that in our presumed exchange between A and B, A has sold to B a watch which he has stolen from a third party, C. Here it becomes clear that it is illegitimate to cheer this voluntary exchange from the sidelines. For since A had stolen the watch, it was not his legitimate property, and therefore he had no right to keep it or sell it; the watch was not in his legitimate title to do with as he wished. But if this is true in the case of the watch, then it would also be true in other less directly flagrant cases of unjust property titles.

Furthermore, not only is it illegitimate for the economist to *advocate* a free market without also adumbrating a theory of justice in property titles; he cannot even *define* a free market without doing so. For even to define and expound upon the free-market model, the economist is describing a system in which property titles are being exchanged, and therefore he must also define and expound upon how these titles are arrived at in the first place; he must have a theory of original property and of how property comes into being.

This problem of justice in property titles also exposes a fatal flaw in the concept of the "Unanimity Principle" as a supposedly value-free guide for the applied economist. Thus, Professor James Buchanan and others have declared that it is legitimate and presumably value-free for the economist to advocate a public policy, provided that everyone can agree on such a policy. Once again, and even more than in the case of the Pareto Optimum, this position is scarcely self-evident when subjected to analysis. For the implicit assumption of the Unanimity Principle is that all existing property titles are just. The Unanimity Principle would mean, for example, that it would be illegitimate to confiscate A's watch *even though* he had stolen it from C. But if we regard A's property title as illegitimate, then we must say that A's watch *should be* confiscated and returned to C. Once again, our ethical systems intrude ineluctably into the discussion.

The well-known Compensation Principle, adopted by most economists as a supposedly value-free route for making political recommendations, is in even worse straits than the pure Unanimity Principle. (*A fortiori*, the "weak" version of the Compensation Principle—that compensation does not *actually* have to be made but only be conceptually possible—seems to me to have no rational foundation whatever.) For the Compensation Principle assumes also that it is conceptually possible to measure losses and thereby to compensate the losers. But "utility" is a purely subjective and unmeasurable concept, and being purely psychic, it cannot be measured, either conceptually or in practice. If I buy the newspaper, all that can be known is that my utility from the newspaper is greater than from the fifteen cents, and *vice versa* for the newsdealer. There is no way of measuring these utility gains, for utility is not a quantity, but a rank order of subjective valuation.

Let us take, for example, the hypothetical proposition that the imposition of a tariff on zinc is "good" or socially useful because the gainers can (and even do) take their gains from the tariff, recompense the losers, and still have monetary gains left over. But suppose that I, as a convinced adherent of free trade and opponent of tariffs, declare that my psychic loss from the imposition of a zinc tariff is so great that no feasible monetary compensation could compensate me for that disutility. No one can say to me nay, and therefore the Compensation Principle falls to the ground. Conversely, the same could be true for the idea that *repeal* of the tariff on zinc could be advocated in some sort of value-free manner on compensation grounds. Once again, I might be such a dedicated protectionist that I could not feasibly be compensated for my psychic loss stemming from repeal of the tariff. The Compensation Principle falls in either case.

The relation between the Compensation Principle (as well as the related Unanimity Principle) and theories of justice can be starkly demonstrated from the example of slavery. During the debates in the British Parliament in the early nineteenth century on abolition of slavery, the early adherents of the Compensation Principle were maintaining that the masters must be compensated for the loss of their investment in slaves. At that point, Benjamin Person, a member of the Manchester School, declared that "he had thought it was the slaves who should have been compensated."[2] Here is the stark example of the need, in advocating public policy, of an ethical system, of a concept of justice. Those of us who hold that slavery is unjust would always oppose the idea of compensating the masters, and indeed would think rather in terms of reparations: of the masters compensating the slaves for their years of oppression. But what is there here for the *wertfrei* economist to say?

A similar argument applies to the Coase-Demsetz analysis of property rights and external cost. Coase-Demsetz declare that "it doesn't matter" from the point of view of allocation of resources whether, for example, a railroad is given the property right to pour smoke onto the land of neighboring farmers, or the farmers are given the property right to require compensation for invasion of their land by the railroad. The implication is that the effect is "only" a matter of distribution of wealth. In the first place, of course, the decision "matters" a great deal to the railroad and the farmers. I contend that it is totally invalid to dismiss such "distribution effects" as somehow unworthy of consideration by the economist, even though it is clear that ethical considerations are directly relevant to any treatment of such distribution. But apart from this, the Coase-Demsetz analysis is not even correct for short-run allocational problems (setting aside its validity or invalidity for long-run allocation) if we realize that social costs are psychic to the individual and therefore cannot be measured

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[2]William D. Grampp, *The Manchester School of Economics* (Stanford, Calif.: Stanford University Press, 1960), p. 59.

in monetary terms. One or more of the farmers, for example, may love his land so deeply that no feasible monetary compensation for the smoke loss could be made by the railroad. As soon as we admit these psychic costs into the picture, the Coase-Demsetz analysis becomes invalid even for the short-run allocation of resources. This is apart from another consideration: that in law, an invasion of property can be stopped completely by court injunction and not merely be compensated after the fact.

This brings us to the entire analysis of neighborhood effects in the economic literature. It is simply assumed without adequate support, for example, that external economies *should* be internalized. But why? What is the ethical groundwork for this position? Let us take an example of an external economy which no economist has suggested we internalize—not out of logical consistency but simply from empirical convenience. Women, let us say, purchase and use cosmetics; this use has a great deal of external spillover effects in conferring psychic benefits among a large part of the population; and yet these males are "free riders"; they are not paying for the cosmetics. The neighborhood effect theorist, to be consistent, must claim that "too little" cosmetics are being used; that men are free riders on the female use of cosmetics and therefore should be taxed to subsidize females in their use. There are, of course, many problems with this doctrine, apart from those that we have already stated. The "internalizing" theorist must assume illegitimately that he can measure, even conceptually, how much men are being benefited, and gauge the precise amount of tax and subsidy. But apart from the conceptual impossibility of doing this, there are other grave problems involved in all attempts to apply such a principle for governmental action. One is that some men may dislike cosmetics intensely, and that *they* are therefore being penalized still further by the subsidy program. And furthermore, the very use of government implies a whole host of questionable political value judgments: for example, that government action *per se* involves neither psychic costs nor ethical injustice.

But there is a flaw even more directly germane to the concept of internalizing external economies. For by what ethical standard is the production and use of cosmetics "too low"? Too low for whom, and by what ethical standards? The very concept of "too low" is a value judgment which is by no means self-evident and arrives here unsupported by any sort of ethical system.

Professor Demsetz goes on to advocate an allocation of property rights in accordance with whichever allocation involves lower total social transaction costs, such as costs of enforcing the given property right.[3] But once again, there are two grave flaws in this position. One, since social costs embody psychic costs or disutilities for each individual, it is impossible to measure and hence to add them up interpersonally. But apart from this, such a gauge for the allocation of property rights brusquely sets aside any consideration of the justice of property titles. But this *itself* is an ethical position unsupported by the economist. In the case of slavery, for example, it might well be found that the monetary cost of enforcing slave titles is lower than the monetary cost of each freed slave defending himself from re-enslavement. For those of us who claim that slavery is unjust, such considerations would be piddling as compared to the dictates of justice. But for an economist to try to decide such questions as the allocation of property rights by discarding considerations of justice must be totally unscientific and illegitimate.

There is only space here to touch very briefly on a few other examples of the illegitimate use of implicit value assumptions in economics. One example is the long-standing aim of the Chicago School—at least until Milton Friedman's recent essay on the "Optimum Quantity of Money"—to achieve a constant price level, either in the short or the long run. But little has been written to justify this goal. The value of the goal is scarcely self-evident, particularly when we consider the fact that a growing, unhampered economy will lead to secularly falling prices and costs, with the resulting higher living standards spread throughout the ranks of the consumers. And if falling prices would be a consequence of an increased demand for money, then again it is surely not self-evident that it is the business of government deliberately to thwart the desire of the public for a higher level of real cash balances—any more than it is the business of government to thwart the desires of consumers for any other goods or services.

[3]Thus, see Harold Demsetz, "When Does the Rule of Liability Matter?" *Journal of Legal Studies* 1, no. 1 (1971): 25–28; and Demsetz, "Some Aspects of Property Rights," *Journal of Law and Economics* (October 1966): 66.

Another example is the problem of rational pricing for governmental services. Thus, in recent years, much valuable work has been done advocating market-clearing prices for such services as streets, roads, and subways; for example, that pricing be graduated in accordance with peak hours and the degree of congestion on the roads. All this makes a great deal of sense, but one vital assumption is missing: that there is nothing wrong with the fact that an increased amount of revenue will thereby accrue to the coffers of government. The implicit value assumption is that there is nothing wrong economically or ethically with an increased amount of social resources being siphoned off to government. For those of us who do not take such a sanguine ethical view of government, this consideration must be an important factor in our policy conclusions.

In the area of government, indeed, there has been much discussion of the difficulties of national product accounting, but little has been said of the implicit—and scarcely self-evident—value assumption at the heart of the treatment of government. The blithe assumption that government expenditure on its own salaries can in any way measure government's contribution to the national product encapsulates what some of us would consider a highly naive view of the functions and operations of government—indeed a view that places one's ethical *imprimatur* on every one of the government's activities. In these days of military overkill, and of pyramid-building on a grand scale, there are not very many people who would still automatically accept Lord Keynes's famous dictum that building pyramids is just as productive an expenditure as anything else. In fact, anyone who believes that government expenditure contains at least 51 percent waste—surely not a very unreasonable assumption by anyone's reckoning—would construct national product accounts by *subtracting* government expenditures as a burden upon production and upon society, rather than adding it as a productive contribution.

Finally, there is the generally held view that an economist can provide technical advice to his client while remaining purely value-free. I submit, on the contrary, that servicing a client's ends thereby commits the economist to the ethical value of the end itself. Often it is held that by simply furnishing advice on the pursuit of goals or values held by the majority of the public, the economist remains uncommitted to values. But surely value-freedom means free of values, period; and the fact that the majority of the public might have such values does not make commitment to them any less value-laden. To take a deliberately dramatic example, let us suppose that an economist is hired by the Nazis to advise the government on the most efficient way of setting up concentration camps. I submit that by doing so, the economist has, willy-nilly, adopted a pursuit of "better," that is, more efficient, concentration camps as a goal. And he would be doing so even if this goal were heartily endorsed by the great majority of the German public. To underscore this point, it should be clear that an economist whose value system led him to oppose concentration camps might well then give such advice to his clients as to make the concentration camps as *inefficient* as possible, that is, to sabotage their operations. In short, whatever advice he gives to his clients, the economist's value-commitment, for or against the clients' project, is inescapable. But if this is true for concentration camps, it is true also for the myriad of other and usually less significant projects that his clients have in mind.

I would like to cite a passage on this question from the last essay of the great Italian economist Luigi Einaudi. Einaudi wrote that the economic advisors to government "indispensable, extremely learned, extremely informed, the experts, the only people who know the jargon, have become . . . one of the seven plagues of Egypt, a disgrace to humanity." A "plague," Einaudi wrote, because of the typical economist's view that "I have performed my duty fully when I have decided whether the proposed means or other alternatives are consistent with the end prosecuted by the politician." Einaudi then commented: "No. The economist has failed in that case to perform the essential part of his task . . . The economist . . . has not the right to be neutral or to hide under an unreal distinction between means and ends. He must declare himself for that end to which he is closest; and must prove what he assumes."[4]

It is important to stress what this paper is *not* saying: I am *not* taking the position, now fashionable in many quarters, that there is no such thing as a value-free economics, that all economic analysis is inextricably shot through with value assumptions. On the contrary, I believe that the main body of economic analysis is scientific and value-free; what I *am* saying is that any time that economists impinge

[4]Luigi Einaudi, "Politicians and Economists," *Il Politico* (Pavia) (June 1962): 258, 262–63.

on political or policy conclusions, value-judgments have entered into their discussion. My conclusion, then, is that economists must *either* make their value judgments explicit and defend them with a coherent ethical system, *or* strictly refrain from entering, directly, or indirectly into the public policy realm.

13

The Myth of Efficiency

I am delighted that Dr. Rizzo, in chapter 4 [of *Time, Uncertainty, and Disequilibrium*], is calling the highly touted concept of "efficiency" into grave question. I would like to carry his critique still further.

One of Rizzo's major points is that the concept of efficiency has no meaning apart from the pursuit of specified ends. But he concedes too much when he states, at least at the beginning of his paper, that "of course it [the common law] is efficient" relative to certain specified goals. For there are several layers of grave fallacy involved in the very concept of efficiency as applied to social institutions or policies: (1) the problem is not only in specifying ends but also in deciding *whose* ends are to be pursued; (2) individual ends are bound to conflict, and therefore any additive concept of social efficiency is meaningless; and (3) even each individual's actions cannot be assumed to be "efficient"; indeed, they undoubtedly will not be. Hence, efficiency is an erroneous concept even when applied to each individual's actions directed toward his ends; it is *a fortiori* a meaningless concept when it includes more than one individual, let alone an entire society.

Let us take a given individual. Since his own ends are clearly given and he acts to pursue them, surely at least *his* actions can be considered efficient. But no, they may not, for in order for him to act efficiently, he would have to possess perfect knowledge—perfect knowledge of the best technology, of future actions and reactions by

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Originally appeared as the comment to chapter 4 "Uncertainty, Subjectivity, and the Economic Analysis of Law," in *Time, Uncertainty, and Disequilibrium*, Mario Rizzo, ed. (Lexington, Mass: D.C. Heath, 1979), pp. 90–95.

other people, and of future natural events. But since no one can ever have perfect knowledge of the future, no one's action can be called "efficient." We live in a world of uncertainty. Efficiency is therefore a chimera.

Put another way, action is a learning process. As the individual acts to achieve his ends, he learns and becomes more proficient about how to pursue them. But in that case, of course, his actions cannot have been efficient from the start—or even from the end—of his actions, since perfect knowledge is never achieved, and there is always more to learn.

Moreover, the individual's ends are not *really* given, for there is no reason to assume that they are set in concrete for all time. As the individual learns more about the world, about nature and about other people, his values and goals are bound to change. The individual's ends will change as he learns from other people; they may also change out of sheer caprice. But if ends change in the course of an action, the concept of efficiency—which can only be defined as the best combination of means in pursuit of given ends—again becomes meaningless.

If the concept of efficiency is worthless even for each individual, it is *a fortiori* in far worse straits when the economist employs it in an additive way for all of society. Rizzo is being extremely gentle with the concept when he says that it amounts "to little more than maximizing gross national product" which "immediately breaks down once externalities are introduced into the system." The problem, however, is far deeper. For efficiency only makes sense in regard to people's ends, and individuals' ends differ, clash, and conflict. The central question of politics then becomes: *whose* ends shall rule?

The blindness of economic thought to the realities of the world is systematic and is a product of the utilitarian philosophy that has dominated economics for a century and a half. For utilitarianism holds that everyone's ends are *really* the same, and that therefore all social conflict is merely technical and pragmatic, and can be resolved once the appropriate means for the common ends are discovered and adopted. It is the myth of the common universal end that allows economists to believe that they can "scientifically" and in a supposedly value-free manner prescribe what political policies should be adopted. By taking this alleged common universal end as an unquestioned given, the economist allows himself the delusion that he is not at all a moralist but only a strictly value-free and professional technician.

The alleged common end is a higher standard of living, or, as Rizzo puts it, a maximized gross national product. But suppose that, for one or more people, part of their desired "product" is something that other people will consider a decided detriment. Let us consider two examples, both of which would be difficult to subsume under the gentle rubric of "externalities." Suppose that some people pursue as a highly desired end the compulsory equality, or uniformity, of all persons, including each having the same living conditions and wearing the same shapeless blue garment. But then a highly desired goal for these egalitarians would be considered a grave detriment by those individuals who do not wish to be made equal to or uniform with everyone else. A second example of conflicting ends, of clashing meanings allotted to the concept of "product," would be one or more people who greatly desire either the enslavement or the slaughter of a disliked ethnic or other clearly defined social group. Clearly, the pursuit of product for the would-be oppressors or slaughterers would be considered a negative product, or detriment, by the potential oppressed. Perhaps we could jam this case into an externality problem by saying that the disliked social or ethnic group constitutes a "visual pollutant," a negative externality, for the other groups, and that these external "costs" can be (should be?) internalized by forcing the disliked group to pay the other groups enough to induce the latter to spare their lives. One wonders, however, how much the economist wishes to minimize social costs, and whether or not this proffered solution would really be "value-free."

In these cases of conflicting ends, furthermore, one group's "efficiency" becomes another group's detriment. The advocates of a program—whether of compulsory uniformity or of slaughtering a defined social group—would want their proposals carried out as efficiently as possible; whereas, on the other hand, the oppressed group would hope for as *in*efficient a pursuit of the hated goal as possible. Efficiency, as Rizzo points out, can only be meaningful relative to a given goal. But if ends clash, the opposing group will favor maximum inefficiency in pursuit of the disliked goal. Efficiency, therefore, can never serve as a utilitarian touchstone for law or for public policy.

Our cases of clashing ends bring us to the question of minimizing social costs. The first question to raise is: why *should* social costs be minimized? Or, why *should* externalities be internalized? The answers are scarcely self-evident, and yet the questions have never been satisfactorily addressed, let alone answered. And there is an important corollary question: even given the goal of minimizing costs, for the sake of argument, should this goal be held as an absolute or should it be subordinated, and to what degree, to other goals? And what reasons can be given for any answer?

In the first place, to say that social costs *should* be minimized, or that external costs *should* be internalized, is not a technical or a value-free position. The very intrusion of the word *should*, the very leap to a policy position, necessarily converts this into an ethical stand, which requires, at the very least, an ethical justification.

And second, even if, for the sake of argument, we consent to a goal of minimized social costs, the economist still must wrestle with the problem: how absolute should this commitment be? To say that minimized social costs must be absolute, or at least the highest-valued goal, is to fall into the same position that the cost-benefit economists scorn when it is taken by ethicists: namely, to consider equity or rights heedless of cost-benefit analysis. And what is their justification for such absolutism?

Third, even if we ignore these two problems, there is the grave fallacy in the very concept of "social cost," or of cost as applied to more than one person. For one thing, if ends clash, and one man's product is another man's detriment, costs cannot be added up across these individuals. But second, and more deeply, costs, as Austrians have pointed out for a century, are subjective to the individual, and therefore can neither be measured quantitatively nor, *a fortiori*, can they be added or compared among individuals. But if costs, like utilities, are subjective, nonadditive, and noncomparable, then of course any concept of social costs, including transaction costs, becomes meaningless. And third, even within each individual, costs are not objective or observable by any external observer. For an individual's cost is subjective and ephemeral; it appears only *ex ante*, at the moment before the individual makes a decision. The cost of any individual's choice is his subjective estimate of the value ranking of the highest value foregone from making his choice. For each individual tries, in every choice, to pursue his highest-ranking end; he forgoes or sacrifices the other, lower-ranking, ends that he could have satisfied with the resources available. His cost is his second-highest ranking end, that is, the value of the highest ranking end that he has foregone to achieve a still more highly valued goal. The cost that he incurs in this decision, then, is only *ex ante*; as soon as his decision is made and the choice is exercised and his resource committed, the cost disappears. It becomes an historical cost, forever bygone. And since it is impossible for any external observer to explore, at a later date, or even at the same time, the internal mental processes of the actor, it is impossible for this observer to determine, even in principle, what the cost of any decision may have been.

Much of chapter 4 [in *Time, Uncertainty, and Disequilibrium*] is devoted to an excellent analysis demonstrating that objective social costs make no sense outside of general equilibrium, and that we can never be in such equilibrium, nor could we know if we were. Rizzo points out that since disequilibrium necessarily implies divergent and inconsistent expectations, we cannot simply say that these prices approximate equilibrium, since there is an important difference *in kind* between them and consistent equilibrium prices. Rizzo also points out that there is no benchmark to enable us to decide whether existing prices are close to equilibrium or not. I would simply underline his points here and make only two comments. To his point that tort law would not be needed in general equilibrium, I would add that torts themselves could not be committed in such a situation. For one feature of general equilibrium is certainty and perfect knowledge of the future; and presumably with such perfect knowledge no accidents could possibly occur. Even an intentional tort could not occur, for a perfectly foreseen tort could surely be avoided by the victim.

This comment relates to another point I would make about general equilibrium; not only has it never existed, and is not an operational concept, but also it could not conceivably exist. For we cannot really conceive of a world where every person has perfect foresight, and where no data ever change; moreover, general equilibrium is internally self-contradictory, for the reason one holds cash balances is the uncertainty of the future, and therefore the demand for money would fall to zero in a general equilibrium world of perfect certainty. Hence, a money economy, at least, could not be in general equilibrium.

I would also endorse Rizzo's critique of attempts to use objective probability theory as a way of reducing the real world of uncertainty to certainty equivalents. In the real world of human action, virtually all historical events are unique and heterogeneous, though often similar, to all other historical events. Since each event is unique and nonreproducible, it is impermissible to apply objective probability theory; expectations and forecasting become a matter of subjective estimates of future events, estimates that cannot be reduced to an objective or "scientific" formula. Calling two events by the same name does not make them homogeneous. Thus, two presidential elections are both called "presidential elections," but they are nevertheless highly varied, heterogeneous, and nonreproducible events, each occurring in different historical contexts. It is no accident that social scientists arguing for the use of the objective probability calculus almost invariably cite the case of the lottery; for a lottery is one of the few human situations where the outcomes are indeed homogeneous and reproducible, and, furthermore, where the events are random with no one possessing any influence upon its successors.

Not only is "efficiency" a myth, then, but so too is any concept of social or additive cost, or even an objectively determinable cost for each individual. But if cost is individual, ephemeral, and purely subjective, then it follows that no policy conclusions, including conclusions about law, can be derived from or even make use of such a concept. There can be no valid or meaningful cost-benefit analysis of political or legal decisions or institutions.

Let us now turn more specifically to Rizzo's discussion of the law, and its relation to efficiency and social costs. His critique of the efficiency-economists could be put more sharply. Let us take, for example, Rizzo's discussion of the Good Samaritan problem. As he poses the problem, he supposes that B could save A "at minimal cost to himself," and he concludes that, from the point of view of the efficiency theorists, B should be liable for injuries to A if B doesn't save A. But there are more problems with the efficiency approach. For one thing, there is the characteristic confusion of monetary and psychic costs. For, since B's costs in this case are purely psychic, how can anyone but B, say a court, know what B's costs would entail? Suppose indeed that B is a good swimmer and could rescue A easily, but that it turns out that A is an old enemy of his, so that the psychic costs of his rescuing A are very high. The point is that any assessment of B's costs can only be made in terms of B's own values, and that no outside observer can know what these are.[1] Furthermore, when the efficiency theorists put the case that, in Rizzo's words, "clearly . . . A would have been willing to pay B more than enough to compensate his costs in order to be rescued," this conclusion is not really clear at all. For how do we know, or how do the courts know, if A would have had the money to pay B, and how would B know it—especially if we realize that no one except B can know what his psychic costs may be?

Furthermore, the question of causation could be put far more sharply. Rizzo's quotation from Mises on nonaction also being a form of "action" is praxeologically correct, but is irrelevant to the law. For the law is trying to discover who, if anyone, in a given situation has aggressed against the person or property of another—in short, who has been a tortfeasor against the property of another and is therefore liable for penalty. A nonaction may be an "action" in a praxeological sense, but it sets no positive chain of consequences into motion, and therefore cannot be an act of aggression. Hence, the wisdom of the common law's stress on the crucial distinction between misfeasance and nonfeasance, between a wrongful aggression against someone's rights, and leaving that person alone.[2] *Vincent* v. *Lake Erie Transport* was a superb decision, for there the court was careful to investigate the causal agent at work—in this case, the boat, which clearly slammed against the dock. In some ways, tort law can be summed up as: "No liability without fault, no fault without liability." The vital importance of Richard Epstein's strict liability doctrine is that it

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[1]Marc A. Franklin, *Injuries and Remedies* (Mineola, N.Y.: Foundation Press, 1971), p. 401.

[2]There is no distinction more deeply rooted in the common law and more fundamental than that between misfeasance and nonfeasance, between active misconduct working positive injury to others and passive inaction, a failure to take positive steps to benefit others, or to protect them from harm not created by any wrongful act of the defendant.

Francis H. Bohlen, "The Moral Duty to Aid Others as a Basis of Tort Liability," *University of Pennsylvania Law Review* 56, no. 4 (April 1908): 219–21; cited in Williamson M. Evers, "The Law of Omissions and Neglect of Children," *Journal of Libertarian Studies* (Winter, 1978).

returns the common law to its original strict emphasis on causation, fault, and liability, shorn of modern accretions of negligence and pseudo-"efficiency" considerations.

I conclude that we cannot decide on public policy, tort law, rights, or liabilities on the basis of efficiencies or minimizing of costs. But if not costs or efficiency, then what? The answer is that only *ethical principles* can serve as criteria for our decisions. Efficiency can never serve as the basis for ethics; on the contrary, ethics must be the guide and touchstone for any consideration of efficiency. Ethics is the primary. In the field of law and public policy, as Rizzo wittily indicates, the primary ethical consideration is the concept that "dare not speak its name"—the concept of justice.

One group of people will inevitably balk at our conclusion; I speak, of course, of the economists. For in this area economists have been long engaged in what George Stigler, in another context, has called "intellectual imperialism." Economists will have to get used to the idea that not all of life can be encompassed by our own discipline. A painful lesson no doubt, but compensated by the knowledge that it may be good for our souls to realize our own limits—and, just perhaps, to learn about ethics and about justice.

14

Breaking Out of the Walrasian Box: Schumpeter and Hansen

Since World War II, mainstream neoclassical economics has followed the general equilibrium paradigm of Swiss economist Léon Walras (1834–1910).[1] Economic analysis now consists of the exegesis and elaboration of the Walrasian concept of general equilibrium, in which the economy pursues an endless and unchanging round of activity—what the Walrasian Joseph Schumpeter aptly referred to as "the circular flow." Since the equilibrium economy is by definition a changeless and unending round of robotic behavior, everyone on the market has perfect knowledge of the present and the future, and the pervasive uncertainty of the real world drops totally out of the picture. Since there is no more uncertainty, profits and losses disappear, and every business firm finds that its selling price exactly equals its cost of production.

It is surely no accident that the rise to dominance of Walrasian economics has coincided with the virtual mathematization of the social sciences. Mathematics enjoys the prestige of being truly "scientific," but it is difficult to mathematize the messy and fuzzy

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Originally appeared in the *Review of Austrian Economics* 1, no. 2 (1987): 97–108. Rothbard learned the basic insights of this article many years ago from lectures of Professor Arthur F. Burns at Columbia University.

[1]Before World War II, the dominant paradigm, at least in Anglo-American economics, was the neo-Ricardian partial equilibrium theory of Alfred Marshall. In that era, Walras and his followers, the earliest being the Italian Vilfredo Pareto, were referred to as "the Lausanne School." With the Walrasian conquest of the mainstream, what was once a mere school has now been transformed into "microeconomics."

uncertainties and inevitable errors of real world entrepreneurship and human actions. Once one expunges such actions and uncertainties, however, it is easy to employ algebra and the tangencies of geometry in analyzing this unrealistic but readily mathematical equilibrium state.

Most mainstream economic theorists are content to spend their time elaborating on the general equilibrium state, and simply to assume that this state is an accurate presentation of real world activity. But some economists have not been content with contemplating general equilibrium; they have been eager to apply this theory to the real world of dynamic change. For change clearly exists, and for some Walrasians it has not sufficed to simply translate general equilibrium analysis to the real world and to let the chips fall where they may.

As someone who has proclaimed that Léon Walras was the greatest economist who ever lived, Joseph A. Schumpeter (1883–1950) faced this very problem. As a Walrasian, Schumpeter believed that general equilibrium is an overriding reality; and yet, since change, entrepreneurship, profits, and losses clearly exist in the real world, Schumpeter set himself the problem of integrating a theoretical explanation of such change into the Walrasian system. It was a formidable problem indeed, since Schumpeter, unlike the Austrians, could not dismiss general equilibrium as a long-run tendency that is never reached in the real world. For Schumpeter, general equilibrium had to be the overriding reality: the realistic starting point as well as the end point of his attempt to explain economic change.[2]

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[2]In maintaining that Schumpeter was more influenced by the Austrians than by Walras, Mohammed Khan overlooks the fact that Schumpeter's first book, and the only one still untranslated into English, *Das Wesen und der Hauptinhalt der Theoretischen Nationalökonomie* (The essence and principal contents of economic theory; Leipzig, 1908), written while he was still a student of Böhm-Bawerk, was an aggressively Walrasian work. Not only is *Das Wesen* a nonmathematical apologia for the mathematical method, but it is also a study in Walrasian general equilibrium that depicts economic events as the result of mechanistic quantitative interactions of physical entities, rather than as consequences of purposeful human action—the Austrian approach. Thus, Fritz Machlup writes that:

> Schumpeter's emphasis on the character of economics as a quantitative science, as an equilibrium system whose elements are

To set forth a theory of economic change from a Walrasian perspective, Schumpeter had to begin with the economy in a real state of general equilibrium. He then had to explain change, but that change always had to *return* to a state of equilibrium, for without such a return, Walrasian equilibrium would only be real at *one single point* of past time and would not be a recurring reality. But Walrasian equilibrium is a world of unending statics; specifically, it depicts the consequences of a fixed and unchanging set of individual tastes, techniques, and resources in the economy. Schumpeter began, then, with the economy in a Walrasian box; the only way for any change to occur is through a change in one or more of these static givens.

Furthermore, Schumpeter created even more problems for himself. In the Walrasian model, profits and losses were zero, but a rate of interest continued to be earned by capitalists, in accordance with the alleged marginal productivity of capital. An interest charge became incorporated into costs. But Schumpeter was too much of a student of Böhm-Bawerk to accept a crude productivity explanation of interest. The Austrian approach was to explain interest by a social rate of time preference, of the market's preference for present goods over future goods. But Schumpeter rejected the concept of time-preference as well, and so he concluded that in a state of general equilibrium, the rate of interest as well as profits and losses are all zero.

> "quantities of goods," led him to regard it as unnecessary, and, hence, as methodologically mistaken for economics to deal with "economic conduct" and with "the motives of human conduct." (Fritz Machlup, "Schumpeter's Economic Methodology," *Review of Economics and Statistics* 33 [May 1951]: 146–47)

Cf. Mohammed Shabbir Khan, *Schumpeter's Theory of Capitalist Development* (Aligarh, India: Muslim University of India, 1957).

On *Das Wesen*, see Erich Schneider, *Joseph Schumpeter: Life and Work of a Great Social Scientist* (Lincoln: University of Nebraska Bureau of Business Research, 1975), pp. 5–8. On Schumpeter as Walrasian, also see Schneider, "Schumpeter's Early German Work, 1906–17," *Review of Economics and Statistics* (May 1951): 1–4; and Arthur W. Marget, "The Monetary Aspects of the Schumpeterian System," ibid., pp. 112ff. On Schumpeter as not being an "Austrian," also see "Haberler on Schumpeter," in Henry W. Spiegel, ed., *The Development of Economic Thought* (New York: John Wiley and Sons, 1952), pp. 742–43.

Schumpeter acknowledged that time-preference, and hence interest, exist on consumption loans, but he was interested in the production structure. Here he stressed, as against the crude productivity theory of interest, the Austrian concept of imputation, in which the values of products are imputed back to productive factors, leaving, in equilibrium, no net return. Also, in the Austrian manner, Schumpeter showed that capital goods can be broken down ultimately into the two original factors of production, land and labor.[3] But what Schumpeter overlooked, or rather rejected, is the crucial Böhm-Bawerkian concept of time and time-preference in the process of production. Capital goods are not *only* embodied land and labor; they are embodied land, labor, and *time*, while interest becomes a payment for "time." In a productive loan, the creditor of course exchanges a "present good" (money that can be used now) for a "future good" (money that will only be available in the future). And the primordial fact of time-preference dictates that every one will prefer to have wants satisfied

[3]Thus, Schumpeter wrote that

> in the normal circular flow the whole value product must be imputed to the original productive factors, that is to the services of labor and land; hence the whole receipts from production must be divided between workers and landowners and there can be no permanent net income other than wages and rent. Competition on the one hand and imputation on the other must annihilate any surplus of receipts over outlays, any excess of the value of the product over the value of the services of labor and land embodied in it. The value of the original means of production must attach itself with the faithfulness of a shadow to the value of the product, and could not allow the slightest permanent gap between the two to exist. . . . To be sure, produced means of production have the capacity of serving in the production of goods. . . . And these goods also have a higher value than those which could be produced with the produced means of production. But this higher value must also lead to a higher value of the services of labor and land employed. No element of surplus value can remain permanently attached to these intermediate means of production. (Joseph A. Schumpeter, *The Theory of Economic Development: An Inquiry Into Profits, Capital, Credit, Interest and the Business Cycle* [New York: Oxford University Press, 1961], pp. 160, 162)

now than at some point in the future, so that a present good will always be worth more than the *present prospect* of the equivalent future good. Hence, at any given time, future goods are discounted on the market by the social rate of time-preference.

It is clear how this process works in a loan, in an exchange between creditor and debtor. But Böhm-Bawerk's analysis of time-preference and interest went far deeper, and far beyond the loan market for he showed that time-preference and hence interest return exist apart from or even in the absence of any lending at all. For the capitalist who purchases or hires land and labor factors and employs them in production is buying these factors with money (present good) in the expectation that they will yield a future return of output, of either capital goods or consumer goods. In short, these original factors, land and labor, are future goods to the capitalist. Or, put another way, land and labor produce goods that will only be sold and hence yield a monetary return at some point *in the future*; yet they are paid wages or rents by the capitalist now, in the present.

Therefore, in the Böhm-Bawerkian or Austrian insight, factors of production, hence workers or landowners, do *not* earn, as in neoclassical analysis, their marginal value product in equilibrium. They earn their marginal value product discounted by the rate of time-preference or rate of interest. And the capitalist, for his service of supplying factors with present goods and waiting for future returns, is paid the discount.[4] Hence, time-preference and interest income exist in the state of equilibrium, and not simply as a charge on loans but as a return earned by every investing capitalist.

Schumpeter can deny time-preference because he can somehow deny the role of time in production altogether. For Schumpeter, production apparently takes no time in equilibrium, because production and consumption are "synchronized."[5] Time is erased from the

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[4]See the attack on this Austrian view from a Knightian neoclassical perspective in Earl Rolph, "The Discounted Marginal Productivity Doctrine," in *Readings in the Theory of Income Distribution,* W. Fellner and B. Haley, eds. (Philadelphia: Blakiston, 1946), pp. 278–93. For a rebuttal, see Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash Publishing, 1970), vol. 1, pp. 431–33; included in this volume as chapter 15.

[5]On this alleged synchronization, see Khan, *Schumpeter's Theory*, pp. 51, 53. The concept of synchronization of production is a most un-Austrian