

Murray N. Rothbard and Israel M. Kirzner: Recent “Deans” of the Modern Austrian School of Economics

Compiled and edited by John Cobin, Ph.D.

Note: This compendium was compiled under the auspices of Centro de Estudios Públicos in Santiago, Chile in order to provide Spanish speakers with access to some key portions of the work of Murray Rothbard and Israel Kirzner. In doing so, I have clearly emphasized their work in the theory of entrepreneurship, knowledge, and socialism, as well as a number of important applied topics and themes. I have sought to find the most relevant passages from a variety of books and articles, especially over the last 15 years, although I have, of course, left untouched many more articles and books from these two prolific scholars. Nevertheless, I hope that this compendium will be useful in informing Latin American and Spanish students about these important themes.

In addition, this compendium is being made available in English (on the internet) in hope that it might have some use as an overview of the work of these scholars, or as part of the readings in a social science, MBA, or law school elective course where Austrian economics is an important topic (as, for instance, in the critique of regulation). I think it will likewise be of use to those who have read (or used in a course) my textbook, A Primer on Modern Themes in Free Market Economics and Policy or the Spanish translation Ensayos Sobre Temas Modernos en la Economía y las Políticas de Mercado, and would like to deepen their understanding of Austrian economics and policy issues. My website Policy of Liberty contains many public choice, Austrian, and property rights theory resources (quotations, photos, papers/books, and links) that I hope will be of use to those studying free market and classically liberal themes.

After the Great Depression, the Austrian School fell into disrepute, even though its champions, such as Ludwig von Mises (1881-1973) and Friedrich von Hayek (1899-1992), were well known and widely respected during the first three decades of the twentieth century. The Austrians had made great strides in advancing the theories of marginal utility, subjective value, money, and economic calculation, from which they derived a strong critique of socialism. However, the trauma of the prolonged depression and the seeming failure of the market and capitalism, gave rise to a new brand of economics dominated by statistical aggregates and interventionist philosophy, led by economists such as John Maynard Keynes (1883-1946), Joan Robinson (1903-1983), Arthur Pigou (1877-1959), Oskar Lange (1904-1965), and Simon Kuznets (1901-1985). Many economists promised that similar economic disasters could be avoided by means of prudent intervention. Alternatively, both Mises and Hayek loudly decried this view and rejected it as being unsound theoretically and dangerous in terms of policy. Nevertheless, Mises and Hayek were widely ignored and jettisoned from the mainstream, although the mainstream did continue to embrace a semblance of Austrian themes pertaining to subjective value and marginal utility theory (which was developed not only by Austrian Carl Menger (1840-1921) but also William Stanley Jevons (1835-1882) and Léon Walras (1834-1910) his coeval European colleagues).

During the late 1960s, much due to the private seminar that Mises had been conducting for the previous decades, there was a resurgence in interest in Austrian economics. Taking the mantle from Mises, then young and energetic scholars like Murray Rothbard (1926-1995), Hans Sennholz (1922-), George Reisman (1935-), and Israel Kirzner (1930-), who also gleaned much from Hayek, began to vigorously apply and extend Misesian themes to economic theory and public policy. In addition, the Austrian influence was felt in other quarters, with economists such as James Buchanan (1919-) and Gordon Tullock (1922-) who formed the public choice school acknowledging their debt to Mises and Hayek, and Thomas Sowell (1930-) who applied and embellished the Austrian theory of knowledge and its critique of Marxism.

But the Austrian direct line primarily passed through Rothbard and Kirzner, both of which have been granted the sobriquet “Dean of the Austrian school” at one time or another. Through Kirzner’s work with students at New York University, and through Rothbard’s work as a professor, leader of the Libertarian and anti-war movements, and prolific and clever writing while head of the Ludwig von Mises Institute, a whole new generation of Austrian scholarship was spawned during the 1970s and 1980s. Many new faces appeared on the scene to herald the work of Mises and Hayek, i.e., to extol the virtues of free markets and deplore the eminent failure of socialism. The greatest inroads came in the theories of entrepreneurship, “free” banking or, alternatively, 100% gold reserves banking, and the idea of market process: i.e., discovery, rivalry, and disequilibrium states rather than the predominant static equilibrium paradigm.



Israel M. Kirzner (1930-)

Kirzner, who received his PhD in economics in 1957 from Brooklyn College (New York), during which time he was also studying under Mises, has major interests in the economics of entrepreneurship, the refinement of Austrian economics, ethics and economics, and the history of economic thought. He has been professor at New York University for many years, the university where Mises was affiliated, and has hosted doctoral and post doctoral research for a whole new generation of Austrian scholars. Some of his major works include: “Entrepreneurial Discovery and The Competitive Market Process: An Austrian Approach,” *Journal of Economic Literature* (March 1997), *The Meaning of Market Process* (Routledge 1992), *Discovery, Capitalism and Distributive Justice* (Basil Blackwell 1989), and *Competition and Entrepreneurship* (Chicago 1973).



Murray N. Rothbard (1926-1995)

Rothbard, who received his PhD in economics from Columbia University in 1956, was profoundly impacted by the publication of Mises’s *Human Action* in 1949. He was henceforth guided by Mises directly, attending Mises’s seminar from its first meeting, and became one of the greatest champions of the Austrian school. He was professor in New York, Las Vegas and Auburn, Alabama, as well as a frequent conference speaker. He wrote 25 books and thousands of articles (many of them for the general public) over his colorful career battling statism, relativism, scientism, and socialism. Some of his major books include *Man, Economy, and State* (1962), his *magnum opus* on economic theory, *America’s Great Depression* (1963), showing how tariff legislation and central bank bungling caused the Great Depression, *Conceived in Liberty* (1975-1979, four volumes), an account of early American history’s Libertarian character (1620-1780), *Power and Market* (1970), a treatise against state intervention, *The Case Against the Fed* (1994), which is perhaps his finest work on central banking, and *Economic Thought Before Adam Smith* (1995), which unmasks many myths, lies, and fallacies in economic history, the most notable of which was to denounce Adam Smith as a plagiarist. Rothbard shines as both an economic theorist and as a revisionist economic historian.

Despite the advances by Kirzner and Rothbard, however, the revived Austrian school remained on the fringes of the economic mainstream. The Austrian School was often associated more with Libertarianism than with hard economic theory, perhaps due in large part to Rothbard’s anarchism and outspoken political views. The Austrians continued to struggle for academic positions and respect in a world largely dominated by Keynesian or Chicago-monetarist interventionist policies, and the tremendous economic expansion that occurred after World War II that seemed to confirm their interventionist views. Optimism ran high that government planning, even if not in its pure Marxian form, would be able to correct “market failures” and thus engender improved social welfare and efficiency. The “free market” Chicago school (especially if one considers it apart from Milton Friedman, who was the most libertarian of the lot) retreated to a stilted form of extreme quantification in economic theory. They became mixed-bag; harbingers of prudent regulation of monopoly (via antitrust enforcement) and the money supply, although rejecting proactive policies such as rent control, subsidies, and welfare and promoting as much privatization as possible. Thus, the Chicago school developed a moderately interventionist stance, leaving only the Austrians, and to a lesser extent the new “public choice school” spin-off from Chicago, to herald the virtue of free markets.

Hayek managed to win a share of the Nobel Prize in 1974 (Mises having died the year before), for his “pioneering work in the theory of money and economic fluctuations and for [his] penetrating analysis of the interdependence of economic, social and institutional phenomena”, rather than explicitly for his most profound work in social knowledge or his critique of central planning. Other than that, however, Austrians received few accolades from the mainstream, much of which was content to relegate the Austrians to their place in economic history without expecting much in the way of further contributions to the body of economic theory. Compounding the problem, Rothbard’s hatred of the state tended to make many mainstream economists equate Austrian economics with political theory and philosophy rather than economics. Plus, the Austrian school’s rejection of mathematical methods in economics made them seem backwards to the now high-tech mainstream. Nonetheless, the fall of the Berlin wall in 1989 and the collapse of communism was clearly serendipity for the Austrian school. Many new students of Austrian economics and professors who came out of the Kirzner and Rothbard resurgence during the two previous decades benefited from the growing universal admission that the Austrians were right. As Robert Heilbroner said, “It turns out, of course, that Mises was right” (“After Communism”, *The New Yorker*, 1990, Sept. 10: 91-100). Francis Fukuyama proclaimed that we had arrived at the Hegelian “end of history” (*The End of History and the Last Man*, Avon Books, 1993), where large ideological battles no longer have a place. Since then, new scholars have been extend-

ing the work of the Austrian school to inject caution into the mainstream use of static equilibrium models, especially for policy, and criticizing government regulation in general.

Many of the modern ideas in Austrian economics can be gleaned from its two modern “deans”. A sampling of published articles and books about fundamental Austrian insights into action, subjectivism, knowledge, entrepreneurship, and Rothbard’s work in economic history, as well as excerpts outlining the Austrian critiques of socialism, interventionism, gradualism, and monetary controls is provided in the compendium below. I hope that it will provide the reader with an ample opportunity to review what the Austrian school has to contribute to economic science. Aside from a few passages from their very early work, I have deliberately chosen to skip many earlier works by Rothbard and Kirzner, such as the very important works like Rothbard’s *Man, Economy, and State* and Kirzner’s *Competition and Entrepreneurship*, largely because many of the central tenets of such work has been revised and improved in recent years, making it more opportune to focus on this latter work, and because Spanish translations of much of many of these earlier works are already available. Of course, with such prolific authors for m subjects, any selection condensed into the following small space can hardly do justice to their lifetime of work.

I have had the privilege of attending a seminar given by Kirzner, and another by Rothbard, and found them both to be exceptional teachers and truly great minds. Each of them has merited the title of “Dean of the Austrian School” in my view. It is my hope that this small compendium of their work will be of use in introducing students and faculty to the great motifs and insights of the Austrian School.

Although there is some overlap in the ensuing compendium, I have endeavored to categorize each of the passages under the most appropriate general headings. After making a few brief [bracketed] remarks and noting the citation information, I provide the quotations without adding quotation marks or emphasis.

Principles of Austrian Economics

[Rothbard’s devotion to Mises and the Austrian school can be seen from the earliest days of his academic career, such as when he outlines and defends the Misesian notion of praxeology in Murray N. Rothbard (1951), “Mises’ ‘Human Action’: Comment”, *American Economic Review*, vol. 41, no. 1 (March), pp. 181-185].

[p. 181] Praxeology consists of two main elements: (1) the fundamental axioms, and (2) the propositions successively deduced from these axioms. Neither the axioms nor the deduced propositions can be “tested” or verified by appeal to historical fact. However, although the axioms are *a priori* to history, they are *a posteriori* to the universal observations of the logical structure of the human mind and human action. The axioms are therefore open to the test of observation in the sense that, once postulated, they are universally recognized as true. Such recognition may be accused of being “introspective,” “but it is nonetheless scientific, since it is an introspection that can command the agreement of all. The deductive propositions are tested according to the universally accepted laws of logic. (Laws, incidentally, which are also *a priori* to historical fact.) The fact that a proposition comes at the end of a “long chain of deduction” makes it no less valid than a proposition at the end of a short chain.

[pp. 182-183] As an economist, Mises is value-free. But, if the demonstrated results of intervention and socialism are such as to lead to consequences which everyone will consider undesirable, then Mises as a citizen certainly has a right to agree that they are undesirable.

[pp. 183-184] When an individual chooses purchases on the market, either as consumer or as entrepreneur, he has certain definite guides for selection. The consumer knows the prices of the various goods, and he can test the quality by selection. If he buys what is labeled “breakfast cereal” and it turns out to be a package of hay, he knows it soon enough, and that firm soon finds itself out of business. The consumer is in a position to arrange a set of preferences according to his tastes, to evaluate the products open to him. But, in the political sphere, the reverse is true. The consequences of different sets of political measures can only be understood by the ability to grasp complex chains of abstract praxeological reasoning. The vast majority of the voting public do not have this ability. There is no empirical test that will demonstrate one type of governmental measure valid as opposed to another type. Consequently, the voter turns to whichever political leaders state their case with the greatest propaganda ability, *i.e.*, to demagogues. Thus, suppose that the government inflates the money and credit supply and prices rise. One party can point out the cause and call for a cessation of the governmental inflation. The other party can assert that the inflation is caused by wicked speculators and profiteers and that inflation of the currency has no effect on prices. The voting public has no rational way to choose except by exerting powers of reasoning which they do not possess.

Governors appointed by popular vote are Führers, while corporation directors are mandatories of the stockholders. This is no contradiction either. The corporation director is completely at the mercy of the stockholders. The head of the state, however, exercises, to a greater or lesser degree, coercive powers over the people. To the extent he exercises coercive power he is

a dictator rather than a mandatory. The “electoral mandate” is rather choice between two sets of aspirants to such a dictatorship.

[p. 184] When Mises presents us with the choice between the free market and socialism, he is saying that in-between systems of a hampered market are not coherent, consistent systems. He demonstrates that any measure of government intervention in the market creates problems and consequences which present the people with a further choice: repel this measure, or effect another measure of government intervention. Thus, if we may use the term in this sphere, we may say that an interventionist society is always unstable and in “disequilibrium,” while the only societies in “equilibrium” are the free market or socialism, since interventionist measures logically lead to one or the other. Since a socialist system cannot exist, the only intelligent choice is the purely free market.

For Mises, all government intervention in the market is irrational and therefore contrary to economic law.

[Rothbard’s discussion of fundamental Austrian themes continued in Murray N. Rothbard (1951), “Praxeology: Reply to Mr. Schuller”, *American Economic Review*, vol. 41, no. 5 (December), pp. 943-946].

[pp. 943-945] The fundamental praxeological axiom is that individual human beings *act*. Praxeology reveals the implications of the concept of “action.” Action results from the fact that the individual “actor” believes that there are other states of being preferable to the one in which he is at present, *and* from his belief that he may take certain steps which will bring him to a more satisfactory state. Given these preferences and “technological” ideas, the individual acts upon them in order to arrive at a more satisfactory state. The preferred state which the actor expects to attain is his “end”; the steps by which the actor attempts to attain his goal are the “means.” It is the praxeological concept of action that distinguishes the observed movements of men from those of inorganic matter.

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

Explanation of the rôles of praxeological laws and historical judgment of “understanding” may be provided by the following example: *If* the supply of a medium of exchange increases; *and if* the demand for that medium remains the same; *then*, the purchasing power of that medium will decline. This is a praxeological law. How many an historian apply this law? He must first determine whether or not a decline in purchasing power (increase the prices) has taken place. This involves difficulties of an historical-statistical nature; it is not a problem for praxeology or for that elaborated division of it known as “economic theory” or “catallactics.” Once he has determined that a fall in purchasing power of the medium has taken place, he searches for explanation by applying the praxeological-catallactic law. He investigates the historical situation to discover whether there has been an increase in the supply of the medium. If he finds a considerable increase in the supply, he is then in a position to insert three truths:

- A. It is an historical fact that the purchasing power of medium X has declined to such and such an extent.
- B. It is an historical fact that the supply of medium X has increased to such and such an extent.
- C. The praxeological law just mentioned. It is therefore concluded: that a significant cause of the decline, A, was the increase in supply, B.

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

Such is an example of what is involved in the work of historical explanation. The work of the “economic theorist,” or praxeologist, is to elaborate the laws (such as C) from the various axioms and according to the rules of logic. Clearly, neither Mises nor myself has ever cited “facts as if they provided support for his conclusions and for the axioms, postulates, and logical procedures.” I cited facts such as “dollar gaps” not as proof or test, but as *illustrations* of the workings of praxeological laws in (modern) historical situations. It is a praxeological law that if the government (or any other agency) law applied to media of exchange, which, in turn, leads to the explanation of the “dollar gap.” The historian sees a shortage of dollars in relation to pounds develop in England, and, using praxeological laws, explains it as the consequence of governmental overvaluation of the pound in relation to the dollar. In no way does he test or “prove” the theory.

[p. 945] What of the relation between praxeology and economic theory *per se*? Economic theory as has been developed is a component part of praxeology. It is deduced from the apodictic axiom of action, and most of economic theory, including the laws and implications of Uncertainty, Time Preference, the Law of Returns, the Law of Utility, etc. can be deduced directly with no further assumptions. With the help of a very small number of subsidiary axioms which are rather more “empirical” in nature—such as “the disutility of labor”—the rest of economic theory can be deduced.

[An important element in Austrian economics is the commitment to doing value-free science. In this article, Kirzner provides a good overview of this motif. Israel M. Kirzner (1998), “Value-Freedom”, in Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*, pp. 313-319].

[In its entirety] The doctrine of *Wertfreiheit* (of which the term ‘value-freedom’ is the literal translation) prescribes for the social scientist a methodological stance aimed at carefully separating and insulating scientific work from the personal (‘unscientific’) preferences of the researcher. (A standard work on the meaning and history of the doctrine is Hutchison, 1964.) The doctrine rests on several premises, each of which has been subjected to debate. First, the doctrine affirms a sharp qualitative distinction between scientific statements presenting empirical or theoretical assertions, on the one hand, and ‘unscientific’ expressions of personal preference, on the other. The latter, ‘judgments of value’, are in fact *Wertfreiheit* discussions often held to be inherently incapable of being established on objective, scientific grounds that might convince an impartial observer insisting on proof. Second, the doctrine of *Wertfreiheit* assumes the possibility of in fact being able to engage in scientific work in a manner ensuring that personal value judgements are in no way expressed in the substantive content of the science. It is possible, that is, to enunciate scientific propositions the validity of which can be equally apparent to detached scientific observers holding opposing judgements of value. Third, the *Wertfreiheit* doctrine maintains that, both in order to maintain the integrity of the scientific enterprise and in order to ensure widespread confidence in the validity of the conclusions reached by scientists, it is necessary to insist on *Wertfreiheit*, and to ensure that the public be convinced that science is not simply an elaborate façade expressing the personal interests and preferences of scientists. *Wertfreiheit* is a tenet to be adhered to, in other words, not only in order to guard the integrity of science, but also in order to ensure that its integrity be recognized and appreciated.

The doctrine has had, of course, particular reference to economics, where the pronouncements of economists have often (justifiably) been dismissed as simply expressing the political or ideological positions of the economists or of those whom the economists are supporting. *Wertfreiheit* has often been urged as the only way to correct this unfortunate situation. In particular, Austrian economists have traditionally been outspoken on the need for *Wertfreiheit* in economics. Despite certain murmurings of apparent dissent on this matter within the ranks of contemporary Austrian economists, as we shall see, *Wertfreiheit* is still stoutly upheld as an ideal within the mainstream of contemporary Austrian economics (for examples, see Rizzo, 1992; White, 1992).

In what follows we shall (1) draw brief attention to well-known major pronouncements by important figures in the Austrian tradition which have argued for *Wertfreiheit* in economics; (2) refer briefly to some recent statements on the part of some Austrian economists which appear, at first glance, to challenge some of the assumptions upon which the *Wertfreiheit* doctrine must rest; and (3) explore the thesis that, for economists steeped in the Austrian tradition in economics, the doctrine is likely to seem especially plausible and, indeed, well-nigh essential to the methodological underpinnings of that tradition.

Value-freedom in the Austrian tradition

The Austrian tradition was, of course, born into a struggle with the German historical school of economics. The outstanding figures in that school tended to fuse their economics with their personal ethical views on social justice and morality, sometimes addressing their lecture classes almost as if they were political rallies. It was against this style of economics that Max Weber was, at the start of the present century, to rebel vigorously in his call for an austere *Wertfreiheit* in scientific economic research and discussion. It is no surprise, therefore, to discover that the first statement on the *Wertfreiheit* issue made within the Austrian tradition was indeed directed – years before Max Weber – against the German historical school. In his 1883 *Untersuchungen* (in which he threw down the methodological gauntlet in his criticisms of the historical method), Carl Menger wrote an appendix in which he briefly but emphatically criticized the tendency of the German economists to confuse ethical positions with the conclusions of economics.

The next prominent statement arising out of the Austrian tradition that should be cited is that of Robbins. Lionel Robbins wrote his classic *An Essay on the Nature and Significance of Economic Science* under strong Austrian influence (see, for example, Robbins, 1935, pp. xv–xvi). It can be persuasively argued that it is due to Robbins that the early Austrian commitment to *Wertfreiheit* came to be routinely accepted within mainstream neoclassical post-Second World War economics. An important element in Robbins’s position in his *Essay* was his enthusiastic adoption of Max Weber’s position on *Wertfreiheit*: ‘Economics is neutral as between ends. Economics cannot pronounce on the validity of ultimate judgments of value ... Between the generalizations of positive and normative studies there is a logical gulf fixed which no ingenuity can disguise and no juxtaposition in space or time bridge over... [Economic Science] is fundamentally distinct from Ethics’ (ibid., pp. 147–52). What is distinctive in Robbins’s statement of the *Wertfreiheit* doctrine is the fact that the doctrine emerges organically from Robbins’s conception of the very nature of economic science (we shall take up this feature of his work in a later section

of this essay). Robbins's 'positivism' was sharply attacked by his critics, who denounced his refusal to accord the name 'science' of normative disciplines, but Robbins stood his ground in the second edition of his book, emphasizing his continued acceptance of Max Weber's position (ibid., pp. xif).

Since Robbins, the most emphatic voice within Austrian economics on the issue of *Wertfreiheit* has certainly been that of Ludwig von Mises. It seems fair to say that that it is due to Mises's insistence on this matter that Austrian economics is today widely recognized as endorsing the Weberian doctrine. The theme seems to have been foremost in Mises's mind over the last several decades of his scientific career. In 1933, Mises's dwelt at length on the obligation of the economic scientist to maintain objectivity and neutrality in regards to judgements of value: 'What is impermissible...is the obliteration of the boundary between scientific explanation and political value judgement' (Mises, 1933, p. 37). Mises had no doubt that this boundary can be clearly drawn: 'The objectivity of bacteriology...is not in the least vitiated by the fact that the researchers in this field regard their task as a struggle against the viruses responsible for conditions harmful to the human organism' (p. 36). In his 1949 magnum opus, *Human Action*, Mises again carefully addressed this issue, concluding that the economics 'is perfectly neutral with regards to all judgements of value, as it refers always to means and never to the choice of ultimate ends'. The fact that this discussion comes in the very last chapter of the book is surely significant. It serves to highlight some of Mises's concluding sentence in the book, in which he calmly declares that disregard of the warnings of the neutral science of economics must 'stamp out society and the human race' (Mises, 1947, p. 881). Mises returned to the *Wertfreiheit* in one of his last books, *Theory and History* (1957). Here the discussion does not conclude the book, but is in fact the substance of the first chapter and generally pervades the whole of Part One of the book. It serves as a prelude to a trenchant dismissal of Marxist (and other) charges that the teachings of economics are the product of bias.

Of course the *Wertfreiheit* doctrine is not peculiar to the Austrian tradition. In a comprehensive critique of the doctrine, Subroto Roy links the doctrine to Hume's insistence upon a categorical distinction between 'ought' statements and 'is' statements (with the concomitant denial of the possibility of deducing the former from the latter). Roy cites closed to 20 of the most renowned figures in nineteenth and twentieth-century economics as having subscribed to some form of this doctrine (Roy, 1989, p. 17 and p.194, note 1). Yet, despite the apparent near-universal acceptance of the doctrine among both mainstream and Austrian economists, a case does appear to be able to be made that Austrian economics tends to support the *Wertfreiheit* doctrine in a peculiarly characteristic way. We shall take up this argument in a later section of this essay. Here we pause to take brief note of certain intimations of apparent dissent concerning the *Wertfreiheit* doctrine, which might at first suggest a possible incompleteness in the unanimity of contemporary support for the doctrine.

Dissent within the Austrian camp?

Although several statements by Austrian economists during recent decades seem to point in a direction opposite to that taken by the proponents of *Wertfreiheit*, careful examination of them reveals that the disagreements involved (with the traditional Austrian position on the matter) are relatively minor. In several papers, Murray Rothbard has challenged, not so much the *Wertfreiheit* doctrine itself, as a claim that economics policy pronouncements can be made without violating the doctrine. Whereas Mises and other Austrians have appealed to *Wertfreiheit* as the basis for the possibility of economic policy pronouncements being made independently of any ethical presuppositions, Rothbard flatly denies any such possibility. While Misesian 'economic theory is extremely useful in providing data and knowledge for framing economic policy, it cannot be sufficient by itself ... to advocate any public policy whatsoever' (Rothbard, 1976, p. 109). Economic policy, Rothbard argues, necessarily involves some ethical foundation. Although this conclusion of Rothbard's *appears* diametrically opposed to Mises's claims that the objectivity of value-free economic science ensures the unbiased character of implied policy pronouncements, one may question the extent of the substantive disagreement between Mises and Rothbard. Rothbard, too, insists that sciences, including economics, are in themselves value-free; he merely claims that policy prescriptions by economics cannot fail to transcend such value-freedom. Although there is room for differences in nuance between the Misesian and Rothbardian approaches to economic policy advice, it seems that they share a basic commitment to the Weberian ideals.

Jack High (1985) sharply criticizes the thesis that economics is 'independent of ethics'. High argues that in fact the very definitions of basic entities crucial to economic inquiry must necessarily implicitly rely upon ethical norms for their very meaning. We cannot sensibly distinguish between market and government without resort to ethical standards (needed in order to assign meaning to the concepts of 'voluntary', 'coercive' and 'ownership'). It might seem, on a first reading, that High is attacking that separation between economics and ethics which served Menger and Weber as the foundation of the *Wertfreiheit* doctrine. Indeed, High cites critically those very observations of Menger of the subject which we saw earlier to be the foundation of *Wertfreiheit* in the Austrian tradition. Yet it becomes clear, upon further study, that High does *not* wish to challenge the doctrine itself. In fact he concludes his paper by assuring the reader that his central thesis leaves 'the much-cherished "value-freedom" of economic science' untouched. In other words, what High has argued is not at all that economic science is committed to a *particular* set of values, but that *some* set of values must be supplied before the propositions of economic science can be applied to concrete situations. For example, High writes, we can characterize the market economy as 'acquisition and use of resources that respect natural rights' without endorsing the ethical correctness of natural rights. So that High accepts, after all, the central foundation of the *Wertfreiheit* doctrine, that any ethical content implied in substantive economic propositions *can* be disentangled and separated from the non-ethical components in such propositions.

It is true that Rothbard's (and perhaps High's) position expresses disagreement with the thesis (central to at least many statements of the *Wertfreiheit* doctrine) which declares the correctness of value-judgements to be incapable of scientific demonstration. (In this they are concurring with a number of recent philosophical contributions). But their position is nonetheless entirely consistent with traditional Austrian emphasis on the desirability of pursuing economic analysis in a way which it protects it from dependency upon any particular ethical norms whatsoever. We conclude, therefore, that, while the degree of enthusiastic support for the centrality of the *Wertfreiheit* doctrine may vary among at least some Austrian economists, it yet remains valid to assert that acceptance of the doctrine remains characteristic of the Austrian tradition. Let us further explore this connection.

Wertfreiheit and the Austrian approach

Although, as noted, the *Wertfreiheit* doctrine has been accorded general acceptance by many schools of modern economic thought, it may be argued that its affinity to Austrian economics is an especially natural and organic one. It may be argued, that is, that the very way in which Austrian economics has conceived of its subject-matter entails a methodological stance which can hardly fail to be highly sympathetic to the *Wertfreiheit* doctrine.

No doubt the initial thrust of the Austrian tradition, its affirmation of the independence of the theory from historical context, helped crystallize the ideas which were to mature into the *Wertfreiheit* doctrine. To declare the validity of propositions showing chains of causation which apply across widely differing institutional and historical backgrounds must certainly help promote understanding of the objectivity of such causation chains and their independence of the analyst's ethical evaluation of any of the specific situations in which they may manifest themselves. But Austrian economics, of course, was not the only school of modern economics to reject the position of the German historical school.

More to the point, perhaps, has been the Austrian focus on *individual choice* as the analytical unit in economics. The implications for *wertfreiheit* are perhaps more clearly seen in Robbins. Because economics is the logic of choice, the working out of the systematic consequences of the circumstance that man's actions are dictated by the configuration of his scarce *given* means in multiple, ranked, *given* ends, it follows that the propositions of economics depend not one whit on the ethics underlying the choice of ends or the morality of the distributive system responsible for the given means. For Robbins, writing under Austrian influence, the independence of economic science from ethics was explicitly seen as flowing out of his definition of the science. To be sure, Robbins's ideas on economics as logic of choice have become the foundation for mainstream (non-Austrian) treatments of microeconomics, yet we should not lose sight of the characteristically Austrian influences which appear to have helped shaped Robbins's *Wertfreiheit* commitment.

Mises's own commitment to *Wertfreiheit* appears to have emerged in a manner parallel to (although not quite identical with) that which we have seen in Robbins. As is well known, Mises saw economics as praxeology, the pure science of human action. Because Mises saw praxeology as consisting of propositions developed a priori from economic reasoning, and applying in the real world wherever the relevant circumstances pertain, it followed that the positive truths of economics will manifest themselves whether we like them or not, whether we approve of the ethics of any particular set of circumstances (in which these truths manifest themselves) or not. Through appropriate demonstration, it is then possible to hope, these truths can appear as reasonable and persuasive to open-minded students of economics, regardless of any ethical prejudgments which they may hold.

The notion of human action, central to the very idea of Misesian praxeology, appeared to have confirmed, for Mises, the underpinnings of the *Wertfreiheit* doctrine; 'The significance of value judgements consists precisely in the fact they are the springs of human action. Guided by his valuations, man is intent upon substituting conditions that please him better for conditions which he deems less satisfactory. He employs means in order to attain ends sought' (Mises, 1957, p. 20). Mises sees this as the basis for asserting a sharp distinction between ultimate judgements of value and the propositions of economics; 'As soon as we start to refute by arguments an ultimate judgement of value, we look upon it as a means to attain definite ends. But then we merely shift the discussion to another plane. We no longer view the principle concerned as an ultimate value but as a means to attain an ultimate value' (Mises, 1957, pp. 22-3).

It seems to follow that Mises's commitment to the doctrine of *Wertfreiheit* does not depend on the assertion that the correctness of value judgments can never be demonstrated or disproved by scientific methods. His commitment to the doctrine rests merely on the contention that, in the context of any economic problem, the correctness of the relevant judgments of value is not itself the issue. In this respect Mises and Robbins appear to concur in every significant respect.

Austrian economics has often been understood to support the free market political program. What we have seen is that, despite the fact that many Austrian economists (Mises in particular!) were indeed emphatic in their belief that economic science lends support to proponents of the free enterprise system, they have consistently maintained that the theoretical basis of such support is by itself politically neutral. Precisely because the support by economists for free market institutional arrangements has been often been sharply attacked as the product of bias, Austrian economists have felt it necessary to emphasize the need for their science to be absolutely untainted by such bias. They have, we have seen, found the basis for such a possible 'purity', unstained by judgments of value in most fundamental of their conceptions of what makes a science of economics possible. It is because of their conviction of the soundness of this possibility, and their lively awareness of the need to

escape unfair charges of pro-market bias, that Austrians have again and again felt impelled to uphold the doctrine of value-freedom. (Peter J. Boettke “The Elgar Companion to Austrian Economics”, pp. 313-319)

Problems in Modern Efficiency Economics

[Austrian economists have long been leery of modern tendencies to assume away humanity in order to make mathematical models functional. On article dealing with this problem is Israel M. Kirzner (1978), “Economics and Error”, in Louis M. Spadaro, *New Directions In Austrian Economics*, Kansas City: Sheed Andrews & McMeel, pp. 57-76].

[pp. 57-58] Economists have traditionally concerned with issues related to efficiency. Inefficiency occurs when one places oneself in a position which one views as less desirable than an equally available alternative state of affairs. Inefficiency can therefore not be thought of except as the result of an error, a mistake, an incorrect wrong and wrong move. Much of the work of the modern economist has, in fact, the declared aim of avoiding errors, of achieving efficiency. At the same time, however, as he directs his energies towards the obviation of error, the contemporary economist is frequently to be found pursuing his analysis on the assumption that men do not, and will not, ever fall into error. “Waste,” declares Stigler in a recent note, “is error within framework of modern economic analysis, and it will not become a useful concept until we have a theory of error.” Modern economic analysis, we are to understand, lacking a theory of error, can and does proceed only by assuming it away: error and waste have no place in the world of economic theory. It is this position that we wish to examine critically. Is it really the case, we must ask, that economic theory requires us to abstract completely from the phenomenon of error?

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[pp. 73-74] Our concern in this paper to defend the possibility of genuine error in economics is based on more than our wish to show how positive economic theory cannot proceed without such possibility. Our concern rests, in addition, upon important normative grounds. Allocative inefficiency in a society of errorless individual maximizers must, it appears on reflection, be accounted for only by the existence of prohibitive transaction costs. Improvement in social well-being must, in such a world, appear to be possible only as a result of unexplained technological breakthroughs.

Surely such a picture of the world, a picture in which no genuine opportunities for improvement are permitted to exist, is wholly unsatisfying. Surely we are convinced that enormous scope exists at all times for genuine economic improvement and that the world is chock-full of inefficiencies. It is most embarrassing to have to grapple with the grossly inefficient world we know, with economic tools which assume away the essence of the problem of which we wish to deal.

On the other hand, as soon as we admit genuine error into our purview, our embarrassment fades away. Our world *is* a grossly inefficient world. What is inefficient about the world is surely that, at each instant, enormous scope for improvement exists, is one way or another ready at hand, and is yet simply not noticed. At each instant, because the market is in a state of disequilibrium, genuine allocative inefficiencies remain yet to be removed simply because entrepreneurs have not yet noticed the profit opportunities represented by these inefficiencies. At each instant available technological improvements (in some sense already at hand) remain to be exploited; they remain untapped because entrepreneurs have not yet noticed that the profit opportunities embedded in these possibilities. It is genuine error to which we can ascribe many of the world’s ills, and we need an economics that can recognize this.

Fortunately, Austrian economics, with its emphasis on disequilibrium and on the entrepreneurial role, is richly suited to fill our need in this respect. Only economics which recognized how the profit motive (by which we mean the lure of pure entrepreneurial profits) can harness entrepreneurial activity toward the systematic elimination of error can be of service in pointing the way to those institutional structures necessary for the steady improvement of the lot of mankind.

[Kirzner too made some significant contributions to the defense of Austrian economics principles against the rising mainstream tide that treated human behavior in the context of static equilibrium models. Israel M. Kirzner (1962), “Rational Action and Economic Theory”, *Journal of Political Economy*, vol. 70, no. 4 (August), pp. 380-385].

[pp. 384] As soon, therefore, as one begins to analyze the consequences of the *absence* of the conditions for equilibrium, it becomes apparent that plan revisions must be the focus of attention. It is primarily upon the systematic revisions of disappointed plans that the market process depends. It is generally recognized that the market process (whether within a given industry or for an entire economy) is a *means of communicating* knowledge. The knowledge that a market communicates is made up of precisely elements of information necessary to bring about the systematic revisions of plans in the direction of equilibrium (whether partial or general). Each market decision is made in the light of market information. Where the decisions of *all* market participants dovetail completely, all of them can be implemented without disappointments and without subsequent alterations of plans; the market is in equilibrium. When not all decisions dovetail, some will not be able to be implemented, bringing about disappointments in plans. These disappointments—the forms in which the market reveals the absence of full co-ordination among plans—lead to plan revisions. The economic theory is to tell us anything at all, it must explain the direction of these revisions in plans—and for this rationality must be retained.

[pp. 385] If molecules acted purposefully, no physicist would dare ignore the information which he could derive *from this fact alone*. Because molecules do not, as far as the physicist is aware, act purposefully, the physicist is at liberty to confine

his inquiries to the explanation of empirical phenomena. any source of explanation which is not strictly necessary for this purpose becomes, therefore, logically superfluous. But in the field of human action we have not fulfilled our scientific obligations merely by explaining empirical regularities so long as we have not incorporated into our explanations the consequences of rational action. *These consequences are there; they cannot be escaped by ignoring them.*

[As we can see in this early paper, Kirzner has always been keen to point out the defects of static equilibrium modeling—such as are popular in the Chicago school—and extol the importance of disequilibrium and ignorance in markets. Israel M. Kirzner, (1963), “Rational Action and Economic Theory: Rejoinder”, *Journal of Political Economy*, vol. 71, no. 1 (February), pp. 84-85].

[In its entirety] In my comment on Gary S. Becker’s paper I pointed out that the theory of market prices depended in an essential way on the systematic revision by market participants of plans that, in the conditions of the non-equilibrium market, had been found to be unsatisfactory or unrealizable. Such systematic revisions of plans, I argued, could not be expected to be carried out by market participants whose decisions were chronically made solely on impulse or out of habit. It is followed, therefore, that Becker’s interesting demonstrations concerning the responses to given changes, on the part of markets made up of such irrational decision-makers, must necessarily stop short of explaining the course of market prices.

In his “Reply,” Becker defends the generality of his conclusions by advancing an example of market for a single product in which an initial above-equilibrium price does become systematically lowered, even for the case in which the price-setters are irrational. This example, Becker suggests, is sufficient to show the possibility of determinate movements in market prices that do not depend on rational decision-making. My remarks here are confined to the direct consideration of this claim, other points raised by Becker being treated incidentally. Careful examination of Becker’s example, will, in fact, show (a) that the cited systematic price reduction does crucially depend (Becker’s impression to the contrary notwithstanding) on price-setters’ *not* acting out of impulse or habit; and (b) that example appears to extend Becker’s use of the constraints imposed by the limits of opportunity sets, in a direction that raises serious questions not aroused by the original treatment.

The simplest setting in which the analytics of the single-commodity market process can be studied is the following. Market participants are seen as coming to market each “day” with prepared buying and selling plans. Each such plan consists of a decision to buy or sell given quantities of the product for given prices. During the courses of one “day” no plan can be changed. At the close of each day plans can be revised for the following day desired. (It is assumed that the basic data—tastes of buyers and costs of producers—continue unchanged from day to day, regardless of yesterday’s experiences in the market.) In this setting an initial nonequilibrium market signifies that the initial plans of buyers to not dovetail with those of sellers. Market theory requires that this initial experience bring about systematic revisions in plans. Traditional theory explains these revisions as the reactions of rational participants to the discovery that their opportunities are not those which they had believed to be valuable when yesterday’s plans were being laid. This is described as the adjustment of plans under the constraints imposed by the market—the point being that yesterday’s market experience revealed constraints *that had not been known* when yesterday’s plans were made. When, on the other hand, one follows Becker into a world of impulsive or habit-following price-setters, a world in which knowledge and ignorance do not affect decisions, one searches in vain for any reason why today’s decisions need to be systematically different from those of yesterday. Clearly the opportunity is set open to each market participant today is *precisely the same* as that which was open to him yesterday. The fact that some of yesterday’s plans were disappointed can, within the market framework adopted here, in no way alter the objective opportunity set open to a participant today. Thus the constraints operating today on the impulsive or habit-following decision-makers are precisely the same as those which were operative yesterday.

How, then, does Becker, in his new example, achieve a systematic price reduction? The answer can only be that Becker’s sellers (or at least those unable to sell at the going price) follow what must seem, for impulsive or habit-following individuals, a curious, a typically systematic pattern of decision-making. Yesterday these producers unsuccessfully offered to sell at the above-equilibrium going price. Today, “realizing” that yesterday’s decisions were outside their opportunity sets, they offer to sell for less!

One is, in fact, left completely puzzled as to the precise nature of the “constraints” imposed on irrational producers by the range of opportunity sets. Becker in his original paper used the “survival” argument to justify the consideration only of those decisions involving positive profits. Accepting this, one was led to understand the resulting constraints upon producer decisions as being objectively imposed by the necessity to survive—in other words as constraints that were as essentially “arithmetical” and inescapable as the income constraints operative upon consumers, in no way depending on any partial moratorium on impulsive or habit-following decisions, or on any particular state of the decision-maker’s knowledge. One can only ask, then, what enabled Becker’s producers yesterday to adopt price-output decisions *outside* their opportunities sets and what it was in yesterday’s market experience that suddenly rendered operative the constraints imposed by the limits of the relevant opportunity sets. It is, in fact, impossible to avoid the conclusion that in his “Reply” Becker has unwittingly permitted a small dose of wholesome rationality to enter into his example. Yesterday’s impulsive producers offered to sell at above-equilibrium prices, in ignorance of or in defiance of the limits implicit in their true opportunity sets. Today, enlightened or chastened by yesterday’s grim market experience, brought face to face with the extinction threatened by continued defiance of the “constraints,” they reluctantly rained in their impulses, confined themselves carefully within the bounds of their opportunity sets, and revise prices downward—exactly as traditional theory describes.

[Kirzner's understanding of action, entrepreneurship, and liberty changed somewhat over his career, as he explains in this short article. While still aggrandizing the themes of market process, disequilibrium, discovery, and dynamism which produces ceaseless movement toward equilibrium, he lately taken a stronger, more blatant view of the general importance of individual liberty. Thus, Kirzner joins more resolutely with the strong classically liberal elements in Mises and Rothbard. Israel M. Kirzner, (1992), "Human Action, Freedom, and Economic Science", chapter 18 in *A Man of Principle: Essays in Honor of Hans F. Sennholz*, pp. 241-249].

[pp. 242-246] The difference between my 1960 understanding of Misesian human action and my 1991 appreciation of it can be expressed as follows: In 1960 I had understood Misesian economics as preceding by logically tracing through the consequences of individual human decisions—each of which was governed by reason—in pursuit of respective individual purposes. It is this purposefulness of action which characterized “conduct that is accompanied by the consciousness of volition, of something more than a bundle of reflexes responding to specific simile. The nature of these various simile and the directions towards which they variously tend to guide action are completely independent of the desires and will of the actor... But because man possesses the power to reject one course of action for another..., the physical, physiological, and psychological sciences do not exhaust the facts of action that are capable of scientific explanation... Sciences of human action will be distinct from other sciences in that the former begin where the latter end, *viz* in the implications of the rationality that governs purposeful behavior.”

The possibility of a science of economics, explaining the emergence of a market regularities out of the freely made decisions of autonomous individuals, rested not on any fictitious reduction of man to the classical caricature of selfish *homo economicus* single-mindedly pursuing material wealth. Nor did it rest on the neoclassical view of man as lightning calculator of mathematical problems of utility maximization in the context of given ends and means. Instead of the Misesian system (as interpreted in my 1960 chapter) rested simply on the “praxeological” insight that the action taken by a purposeful human being will be one reflecting his rationality, his reasoned assessment of the possibilities for and consequences of alternative attempts at improving his situation. (Optimal, economizing, allocation of scarce means among competing given ends might well be one possible consequence of this rational assessment. But what renders a science of economics possible is this latter rationality, rather than the particular allocative pattern which has monopolized the attention of neoclassical economics.)

There is nothing in this 1960 discussion which draws attention to the role of entrepreneurial discovery in generating the systematic results which economic science is able to explain. And, from my perspective of 1991, it is this that seems the major inadequacy of the earlier treatment.

I should perhaps emphasize that the characteristic Austrian emphasis on market *processes* (as distinct from the exclusive neoclassical preoccupation with market states of equilibrium) was well known to me in 1960. Although (as will be made clear in section III) I was not yet sufficiently aware of the cardinal role of entrepreneurial discovery in Mises's system. I certainly did appreciate the sense in which Mises saw the market as a *process* (possibly pointing in the direction of equilibrium). There is no discussion of market process in my 1960 chapter not because I was unaware of it's central role in Mises's understanding of the operation of the market, but because (as I then thought) the process character of the market had no bearing on the definition of the “economic” side of social phenomena (which my 1960 book was devoted to explore). What made the economic science possible, I understood Mises to argue, was the rationality, the purposefulness of human action. Market processes emerge in systematic fashion because of this rationality, of this purposefulness. The critics who had attacked the validity of economics because it depended upon the view of man as unrealistically selfish, or as mechanically maximizing, were wrong; economics does not depend (and, Mises's eyes, never did really depend) on these caricatures. The theorems of economics depend only on the power of reason to guide purposeful behavior, that is all. It was thus not necessary to emphasize the process nature of markets in order to identify the unique “point of view” which economics expresses. So I believed in 1960.

What I wish now to emphasize is that, from my 1991 perspective, this earlier way of understanding Mises is inadequate. When Mises identified the concept of human action as the essential building block for the praxeological economic science, it is now clear to me that this implies far more than simply the importance of purposefulness for the analysis of *decision made in given situations*. The concept of human action, it is now clear to me, is important in the Misesian system because of its fruitfulness in explaining how *economics agents discover changes that have occurred in their very market situations*, and generate, as a consequence, those systematic market process which are so central to Misesian economics.

Critics of economics have, for close to two hundred years, criticized it for depending upon some variant of the idea of universal human selfishness. In 1960 I understood the Misesian response to this criticism to consist simply in identifying the essential key to human behavior *in given situations* as purposefulness rather than selfishness. I now understand the proper Misesian response to this criticism to consist in showing how the purposefulness of human action (without any necessary selfish motivations) is the essential key to the discovery by agents that they are in fact *not* in the “given situations” which they had hitherto assumed to be relevant.

For my 1960 understanding, the entrepreneurial element in Misesian human action is not important for the distillation of an analytically unique economic point of view. For my present understanding matters appear rather differently. What sets Mises's conception of human action (as the foundation of economics) apart from the mainstream neoclassical conception of the rational, economizing decision (in that same role) is, as I now see, that, unlike the latter, the concept of human action illuminates directly those dynamic processes through which the market absorbs and responds to exogenous changes. When we challenge the erroneous belief that the efficiency of market outcomes depends upon selfishness, we are able to do so by

showing how the flexibility and responsiveness of market adjustments is rooted, not necessarily in man's passion for material wealth, (and certainly not in any programmed pattern of allocative maximization) but in man's entrepreneurial propensity to discover changes which can redound to his benefit (i.e., to the more successful attainment of his goals, *whatever* they may be). If we are able to recognize that possibility for understanding social phenomena which is not covered by the most complete imaginable application of the physical, physiological, and psychological sciences, we are inevitably drawn to recognize also that this possibility transcends the narrow scope of static decision making. That uniquely economic element which enables us, in Misesian fashion, to understand the economic rationale of the human decision, inevitably illuminates for us at the same time the manner in which that rationale extends to the dynamics of discovery in the context of change, and hence to the dynamic processes which are thus generated.

Whereas my 1960 exposition implied, in effect, that the entrepreneurial element in Misesian human action is not essential for the identification of what constitutes, for Mises, the economic point of view, I now believe this to be incorrect. A Misesian appreciation for the existence of a uniquely economic point of view rests, it now seems to me, squarely on that understanding of the discovery-potential in human action which constitutes its entrepreneurial aspect. Let me, in section III, now turn to place my new appreciation of "what Mises really meant," in the context of some of the more fundamental changes in the core of Austrian economics which have occurred during the past three quarters of a century.

[pp. 247-248] Late twentieth-century Austrian economics has consistently paid at least lip service to the idea that economics is a science of human action. But we have perhaps not paid sufficient attention to what Mises meant by this insight. We can now see, I believe, that human action drives the market in a sense that is quite distinct from any of the implications of the maximizing rationality which governs Robbinsian equilibrium economics. Human action drives the market, more fundamentally, in that it expresses the changes in agents' awareness of their environment and of their visions of the future—changes which are inspired by their "entrepreneurial" alertness to the dynamic in which we live. This alertness is motivated by the purposefulness which defines and identifies conscious human action. If we are to understand the world in which we live—the world of disequilibrium as distinct from the analytical-model world of equilibrium—we must recognize how the decisions taken during any given span of time reflect this aspect of human action. It is the systematic market process of mutual discovery so generated, which constitutes the core of Misesian economics. Our understanding of what causes *these* facts of the market process is not exhausted by the fullest application of the physical, physiological and psychological sciences; for the fullest possible understanding we can draw, in addition, upon the explanatory power of the science of economics, the science of human action. The systematic changes in bids, offers, and completed transactions, which constitute the competitive market process, can be grasped by understanding how initial errors generate profitable opportunities which come to be perceived and exploited by alert, purposeful market participants. One cannot identify the economic side of life without drawing attention to this feature of human action and its implications for social processes.

It is worthy of our notice that our deepened understanding of the manner in which human action inspires the market process and identifies the economic aspect of social phenomena affords us a correspondingly deeper appreciation for the role of individual freedom in Misesian economics. Individual freedom, quite apart from its ethical or philosophical appeal, is important, of course, for all schools of microeconomics, as a prerequisite for the beneficial operation of the market system. But for a science of human action this observation means more than the simple insight that free individuals can be relied on to squeeze maximum benefits from any given situation. For the science of human action, freedom is the circumstances which permits and inspires market participants *to become aware* of beneficial (or other) *changes* in their circumstances. An environment in which human freedom is limited, in which profitably exploited opportunities invoke confiscatory social reactions, is an environment in which beneficial changes may never be noticed in the first place. An understanding of Misesian economics thus permits us to see directly how it points unerringly to the social usefulness of political institutions which guarantee individual liberties and the security of individual rights to life and property.

Critique of Hermeneutical Economics

[Rothbard was also valiant to expose modern tendencies, which he deemed as absurd and even as "bullshit", within Austrian economics circles. The hermeneutics movement was one error which received some of Rothbard's harshest critiques. Murray N. Rothbard (1989), "The Hermeneutical Invasion of Philosophy and Economics", *The Review of Austrian Economics*, vol. 3, no. 1, pp. 45-59.]

[pp.] The essential message of deconstructionism and hermeneutics can be variously summed up as nihilism, relativism, and solipsism. That is, either there is no objective truth or, if there is, we can never discover it. With each person being bound to his own subjective views, feelings, history, and so on, there is no method of discovering objective truth. In literature, the most elemental procedure of literary criticism (that is, trying to figure out what a given author meant to say) becomes impossible. Communication between writer and reader similarly becomes hopeless; furthermore, not only can no reader ever figure out what an author meant to say, but even the author does not know or understand what he himself meant to say, so fragmented, confused, and driven is each particular individual. So, since it is possible to figure out what Shakespeare, Conrad, Plato, Aristotle, or Machiavelli meant, what becomes the point of either reading or writing literary or philosophical criticism?

It is an interesting question, one that the deconstructionists and other hermeneuticians have of course not been able to answer. By their own avowed declaration, it is impossible for deconstructionists to understand library texts or, for example, for Gadamer to understand Aristotle, upon whom he has nevertheless written at an enormous length. As the English philosopher Jonathan Barnes has pointed out his brilliant and witty critique of hermeneutics, Gadamer, not having anything to say about Aristotle and his works, is reduced to reporting his own subjective musings—a sort of lengthy account of “what Aristotle means to me.” Setting aside the hermeneutical problem of whether not Gadamer can *know* even what Aristotle means to him, we push back the problem another notch. Namely, why in the world should anyone but Gadamer except possibly his mother or his wife, be the least interested in what Aristotle means to him? And even in the improbable event that we *were* interested in this earth-shattering question, we would in any case be prevented on hermeneutical principles from understanding Gadamer’s answer.

[pp. 45-46] Deconstruction and hermeneutics are clearly self-refuting on many levels. If we cannot understand the meaning of any texts, then why are we bothering with trying to understand or to take seriously the works or doctrines of authors who aggressively proclaim their own incomprehensibility?

[pp. 50-51] Here we must note the two variants of the common hermeneutical theme. One the one hand are the candid relativists and nihilists, who assert, with an inconsistently absolutist fervor, that there is no truth. These hold with a notorious dictum of the epistemological anarchist Paul Feyerabend that “anything goes.” Anything, be it astronomy or astrology, is of equal validity or, rather, equal invalidity. The one possible virtue of the “anything goes” doctrine is that at least everyone can abandon the scientific or philosophic enterprise and go fishing or get drunk. This virtue, however, is rejected by the mainstream hermeneuticians, because it would put an end to their beloved and interminable “conversation.” In short, the mainstream hermeneuticians do not like the “anything goes” dictum because, instead of being epistemological anarchists, they are epistemological pests. They insist that even though it is impossible to arrive at an objective truth or indeed even to understand other theorists or scientists, that we all still have a moral obligation to engage in an endless dialogue or, as they call it, “conversation” to try to arrive at some sort of fleeting quasi truth. To the hermeneutician, truth is the shifting sands of subjective relativism, based on an ephemeral “consensus” of the subjective minds engaging in the endless conversation. But the worst thing is that the hermeneuticians assert that there is no objective way, whether by empirical observation or logical reasoning, to provide any criteria for such a consensus. Since there are no rational criteria for agreement, any consensus is necessarily arbitrary, based on God know what—personal whim, charisma of one or more of the conversationalists, or perhaps sheer power and intimidation. Since there is no criterion, the consensus is subject to instant and rapid change, depending on the arbitrary mind-set of the participants or, of course, a change in the people constituting the eternal conversation.

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

[pp. 51-52] In short, we end with the Feyerabendian “anything goes” or, to use the admiring phrase of Arthur Danto in his summary of Nietzsche, that “everything is possible.” Or, in a word, total “openness.”

But if all things are open, and there are no criteria to guide conversationalists to any conclusions, how will such conclusions be made? It seems to me, following Veatch, that these decisions will be made by those with the superior Will-to-Power. And so it is not a coincidence that leading hermeneuticians have found themselves and “open” in response to the stern demands of state power. After all, if Stalin, Hitler, or Pol Pot enters the “conversational2 circle, they cannot be rejected out of hand, for they may too offer a superior way to consensus. If nothing is wrong and all things are open, what else can we expect? And who knows, even these rulers may decide, in a sardonic burst of Marcusean “repressive tolerance,” to keep some sort of Orwellian “conversation” going in the midst of a universal gulag.

[p. 53] So why then have not the distinguished critics of hermeneutics played the game on their opponents’ own turf and waded through the mountains and oceans of hogwash, patiently to cite and refute the hermeneutics point by point and journal article by journal article? To ask that question is virtually to answer it. In fact, we have asked some of the critics this question, and they immediately responded in a heartfelt manner that they do not propose to dedicate the rest of their lives to wading through this miasma of balderdash. Moreover, to do so, to play by the hermeneuticians’ own rules, would be to grant them too much honor. It would wrongfully imply that they are indeed worthy participants in our conversation. What they deserve instead is scorn and dismissal. Unfortunately, they do not often receive such treatment in a world in which all too many intellectuals seem to have lost their built-in ability to detect pretentious claptrap.

[pp. 56-57] Which brings us back to hermeneutics. For this sort of atmosphere, even the underworld of hermeneutics will vie for its day in the sun. Probably the most prominent hermeneutical economist in the United States is Donald McCloskey, who calls his viewpoint “rhetoric” and whose attack on truth occurs in the name of rhetoric and of the eternal hermeneutical

conversation. McCloskey, unfortunately, follows the modern path of rhetoric run hog-wild and divorced from a firm anchor in truth, overlooking the Aristotelian tradition of “noble rhetoric” as the most efficient way of persuading people of correct and true propositions. For Aristotelians, it is only “base” rhetoric that is divorced from true principles. McCloskey is now organizing a center for rhetorical studies at the University of Iowa, which will organize volumes on rhetoric in a number of diverse disciplines.

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

It is more difficult to excuse the path travelled by the major group of hermeneuticians in economics, a cluster of renegade Austrians and ex-Misesians gathered in the Center for Market Processes at George Mason University. The spiritual head of this groupuscule, Don Lavoie, has reached the pinnacle of having his photograph printed in his magazine *Market Process* talking to the great Gadamer. Lavoie has organized a Society for Interpretive Economics (*interpretation* is a code word for hermeneutics) to spread the new gospel, and has had the effrontery to deliver a paper entitled “Mises and Gadamer on Theory an History,” which as a colleague of mine has suggested, is the moral equivalent of my writing a paper entitled “Lavoie and Hitler on the nature of Freedom.”

It must be noted that nihilism had seeped into current Austrian thought before Lavoie and his colleagues at the Center for Market Processes embraced it with such enthusiasm. It began when Ludwig M. Lachmann, who had been a disciple of Hayek in England in the 1930s and who had written a competent Austrian work entitled *Capital and Its Structure* in the 1950s, was suddenly converted by the methodology of the English economist George Shackle during the 1960s. Since the mid-1970s, Lachmann, teaching part of every year at New York University, has engaged in a crusade to bring the blessings of randomness and abandonment of theory to Austrian economics. When Lavoie and his colleagues discovered Heidegger and Gadamer, Lachmann embraced the new creed at the 1986 first annual (and, if luck is with us, the last annual) conference of the Society of Interpretive Economics at George Mason University. The genuine Misesian creed, however, still flourishes at the Ludwig von Mises Institute at Auburn University and Washington, D.C., and in its publications: *Free Market*, the *Austrian Economics Newsletter*, and the *Review of Austrian Economics*, which in its first issue included a critique of a quasi-hermeneutical book by two ex-Misesians who claim to have discovered the key to economics in the works of Henri Bergson.

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

[pp. 57-58] In the peroration to his paean to hermeneutical economics, ex-Misesian Richard Ebeling proclaims: “Man loves to talk about himself.” But in rebuttal I point to the sage words of the American cultural and political satirist Tom Lehrer. In the 1960s, Lehrer noted that “a lot of people are whining about their ‘ability to communicate.’ ” “It seems to me,” Lehrer added, “that if you are unable to communicate, the *least* you can do is to shut up.” That, alas, is something that Ebeling and his hermeneutical colleagues have not learned to do.

Economic and Social Knowledge

[Kirzner has prepared a good synopsis of the calculation debate, emphasizing why Hayek (and Mises) were right and those who thought the state could plan efficiently and effectively in the public interest were simply mistaken. Israel M. Kirzner (1984), “Prices, the Communication of Knowledge, and the Discovery Process”, in *The Political Economy of Freedom: Essays in Honor of F.A. Hayek*, K.R. Leube and A.H. Zlabinger, eds., Philosophia Verlag, and reprinted as chapter 8 of his book, *The Meaning of Market Process*, New York: Routledge, 1992, pp. 139-151].

[In its entirety] Among the fundamental contributions that Professor Hayek has made to economic science, certainly one of the most significant and far-reaching must be judged to be his path-breaking articulation of the nature of the ‘economic problem which society faces’ (Hayek 1949b: 77). It was in this context that Hayek decisively drew the attention of the economics profession to the unique problems that arise from the *dispersal of knowledge*.

The economic problem of society is... not merely a problem of how to allocate ‘given’ resources – if ‘given’ is taken to mean given to a single mind which deliberately solves the problem set by these ‘data’. It is rather a problem, of how to se-

cure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality. (Hayek 1949b: 77-8)

Hayek's insight represented a breakthrough, of course, in the modern history of welfare economics, as well as providing a brilliant new way of stating the crucial arguments making up the 'Austrian' side of the socialist economic calculation debate (see particularly Lavoie 1985a). In addition, however, Hayek's emphasis on the role of knowledge constituted an important step forward in our understanding of the way in which markets work, and of how the price system in fact tends to solve the economic problem which society faces. Indeed it seems to be this aspect of Hayek's contribution that has attracted the most attention in the economics profession. While accounts of modern developments in welfare economics rarely refer to Hayek's dismissal of the allocative-efficiency criterion (in favour of the co-ordination' perspective), and while accounts of the socialist economic calculation debate have, notoriously, thoroughly and unforgivably muddled it up (Lavoie 1985a), Hayek's insights into the role of prices in solving the knowledge dispersal problem have been widely cited, and often by the most orthodox of neoclassical economists. I shall argue in this chapter that, in spite of its citation of Hayek's work in this regard, the economic literature has regrettably failed to do justice to the full significance of that work. As a result professional concern with problems of knowledge dispersal has tended to remain, unfortunately, at a rather superficial level. In demonstrating the validity of this assertion it will be necessary to distinguish sharply between two quite different 'communications' challenges arising out of knowledge dispersal, and (consequently) two quite different functions that markets may possibly fulfil in the context of the 'economic problem with society faces'. It may perhaps be helpful to start with an analogy drawn from a rather different context, that of automobile traffic through a busy urban street intersection.

Automobiles and the Problem of Dispersed Knowledge

Consider cars approaching the intersection of two urban streets, the one north-south and the other east-west. The driver of a car approaching from (say) the north must decide whether or not to stop before proceeding south across the east-west street. The driver's decision will depend on his knowledge or expectations concerning the decisions that the drivers of other cars (that may possibly be driving toward the intersection from the other directions) will make when *they* reach the cross-roads. In order for traffic to move smoothly and safely through the intersection it is clearly necessary that these various decisions be somehow co-ordinated. Absence of co-ordination may, rather obviously, result in regrettable, costly (because perhaps quite unnecessary) delays at the intersection before proceeding through it, or in even more regrettable and costly automobile collisions. It is easy to see that such regrettable events are to be attributed at least in part to the dispersal of knowledge: the driver of one car knows, at the moment when he makes his decision, what he has decided to do, but the drivers of other cars do not know what the first driver has decided (or perhaps even that there *is* this first driver). *Their* decisions are then likely to fail to be co-ordinated as well as is possible with that of the first driver, and so on. Were an omniscient single mind to make the decisions for *all* the drivers, that mind might arrange the drivers' actions in smooth and safe fashion. In the absence of such a central omniscient mind, a well-designed (and fully enforced) system of traffic signals can achieve co-ordination by providing each driver of a vehicle with confident assurance as to what the other driver will decide to do. The green light beckoning a southward-bound driver is in fact assuring him that cars proceeding in the east-west street will not cross the intersection in the immediate minute or minutes ahead. A red light directs him to stop, while at the same time it provides conviction (in a well-designed system) that the waiting is not wasted (since it implies that cars are being permitted to proceed east and west). By the time the light changes appropriately, smoothly co-ordinated traffic conditions can be achieved. Let us analyse what we mean when we say that a signal system 'achieves co-ordination'. It will be convenient to focus on the manner in which the system eliminates *unnecessary delays*. (Rather similar considerations apply to the system's elimination of avoidable collisions.)

A successful traffic signalling system will not only succeed in avoiding collisions, it will avoid requiring cars to wait needlessly (such as at times when traffic along the other direction is extremely light). Superior co-ordination would permit the timing of light changes to reflect the relative intensities of traffic along the two intersecting streets. 'To achieve co-ordination' is thus a phrase which, in the context of the automobile example, can have two quite distinct meanings.

First, a traffic signal system may be said to be achieved co-ordination when its timing, from the very installation of the system, is such as in fact to control the flow of traffic in some optimal manner. No undesired collisions, no unjustified waiting, result from unanimous obedience of the traffic signals. This successful achievement of co-ordination has clearly involved the efficient communication of correct information. The information fed to the drivers of cars has been such as (a) correctly to inform each of them of the consequences of the decisions of other drivers, leading them, in turn (b) to make those decisions to that permit this above property (a) to hold, with the resulting set of drivers' decision being such as (c) to result in no unnecessary waiting. This is certainly a valid sense of the phrase 'to achieve co-ordination'. But a second possible meaning may be intended by use of this phrase.

For this second meaning consider a traffic signal system that, when installed, is timed suboptimally. Southbound drivers find themselves waiting at red light, let us say at 3:00 in the afternoon, for several minutes during which no traffic flows at all in the east-west directions. Clearly this waiting is unnecessary; it means that north-south drivers are compelled to act in a

fashion that is not co-ordinated with the decisions of east-west drivers (since the latter have decided not to pass through the intersection at this time, yet the former have been preventing from taking advantage of those east-west decisions). But imagine now that the signal system is programmed in a matter that, at the beginning of each day, alters the system's timing to reflect yesterday's actual time-profile of traffic experience (registered not only on dearth of traffic in the east-west direction at 3:00 in the afternoon, but also the heavy volume of traffic in the north-south direction). Then the very experience that results today from the as-yet-imperfectly co-ordinated system plays its part in bringing about a revision in the system's timing, in a way that substitutes a better co-ordinated system in place of the less co-ordinated one. This kind of signal system (including its property <of improving itself by 'learning' from the unfortunate results of its earlier imperfections) may also be described as one that 'achieves co-ordination'. However, here the phrase refers to the property of the system that permits it to identify and begin to correct its earlier weaknesses. The system begins its coordinating task at the very time when its signals promote *uncoordinated* activity that provides the information necessary for improved timing. The system's ability to achieve co-ordination, in this sense, certainly does not mean that, at the outset, it achieved the sets of results (a), (b) and (c) described in the preceding paragraph. Drivers proceeding south who have been directed to wait needlessly at the red light, in effect, have been informed *incorrectly* concerning the rate of traffic flow in the east-west direction. Yet, as we have seen, the system, from the very outset, has possessed the property of 'achieving coordination' in the sense of incorporating a feedback mechanism that deploys the results of its own inadequacies towards their systematic elimination. Here too the co-ordinating property of the system arises from the way that it provides information – but in a sense quite different from that relevant to the system that is *already* perfectly timed. In this second, initially faulty, system, the co-ordinating properties arise from ability to *communicate information concerning its own faulty information communication properties*.

Let us return to the role of the price system in coping with the problems arising from dispersed knowledge – the 'economic problem which society faces'. We shall find (a) that prices tend to 'achieve co-ordination' in *both* the senses we have noticed in the traffic signal example, while (b) the literature has in fact recognized (and cited Hayek in regard to) only one of these two senses.

Equilibrium Prices And Market Co-Ordination

Economists often speak, nowadays, of the competitive equilibrium price system as an effective way in which the individual decisions of many market participants can be co-ordinated. Prices are, indeed, often compared with signals. Without knowing the details concerning the preferences of other market participants or concerning the conditions surrounding production process, decision makers, through the guidance of these price signals, are led – economists explain – to that pattern of attempted activities that permits all of them to be carried out without disappointment and without regret.

In the Marshallian market for a single commodity, for example, the equilibrium market price for that commodity inspires the pattern of market clearing bids and offers. The price is such as to motivate potential buyers to ask for exactly that aggregate quantity of the commodity that potential suppliers have been motivated – by that same price – to produce. No buyer has been misled by the lowness of the price to buy *more* than is in fact offered for sale. (And no buyer is discouraged from bidding for what is in fact available to him at a price he is prepared to pay.) No supplier has been misled by the height of this price to seek to produce more than is in fact being sought to be bought. (Nor is any supplier discouraged from offering that for which a price acceptable to him can be obtained.) No buyer need in fact know anything all about the conditions of supply, the availabilities or the costs of inputs, and the like. Nor need the seller know anything about the preferences of consumers, the availability to them of substitute commodities, and the like. All that market participants need to know, for the Marshallian market to co-ordinate buying and selling conditions perfectly, is the prevailing equilibrium price of the commodity. By offering to buy all they wish to buy at this price, buyers find that their offers smoothly dovetail with the offer of sellers to sell (with the latter merely offered to sell all they wish to sell at this same prevailing equilibrium price). The equilibrium price co-ordinates. All of this of course well understood, and is part of the basic equipment common to all economists.

Hayek's emphasis is on knowledge is frequently cited in the context of this understanding of what equilibrium prices can achieve. Equilibrium prices are explained to be communicated to potential buyers and sellers, in highly economic fashion, the information necessary for co-ordinated decisions to emerge. It is because the detailed information concerning the preferences of individual potential buyers, and concerning the peculiar productive capabilities of individual sources of potential supply, is so scattered and dispersed that the co-ordinated ability of the equilibrium price system is so valuable and impressive.

This kind of co-ordinative ability recognized as being possessed by equilibrium prices is clearly analogous to the ability of an optimally timed traffic signal system smoothly and safely to co-ordinate traffic. Equilibrium prices, like optimally timed signal changes, correctly communicate the information that (by virtue of the very notion of 'context' in this context) motivates and enables individual decision makers to generate a smoothly dovetailing set of decisions; a set that will entail neither disappointment nor regret. We must now show that, in addition to this possible sense in which prices may be said to achieve co-ordination (i.e. when the prices are already equilibrium prices – analogous to the already optimally timed signal system), there is also a much more important other possible sense in which prices may be said to achieve co-ordination. This sense refers to the possible ability of *disequilibrium* prices to generate systematic changes in market decisions about price offers and bids, in a way that, by responding to the regrettable results of initially *uncoordinated* sets of decisions, tends to replace them by less coordinated sets. (Here, of course, the analogy is to the non-optimally timed traffic signal system that contains a

feedback mechanism through which the regrettable results of initial poor timing generate a tendency towards improved timing.)

Disequilibrium Prices and Market Co-ordination

Consider the market for a single commodity (say, a given quality of tea) that has *not* attained equilibrium. Imagine, for example, that in different parts of this market there have occurred during the past ‘day’ sales of tea at widely differing prices. Imagine, moreover, that by the end of the day the total quantity of tea that has changed hands is far less than that which the realities of supply and demand conditions in fact warrant, so that the potential suppliers remain holding inventories of tea which could, in truth, have been reduced by sale to eager buyers at prices that these suppliers would have found attractive. These market conditions express the co-ordination failures that have occurred; prices have failed to clear the market. The signals offered by bids and offers have failed to generate completely dovetailing sets of decisions; market participants, because of inadequate information concerning each other’s attitudes, preferences and capabilities, have failed to take advantage of existing opportunities for mutually gainful exchange.

These unfortunate market conditions can be expected to result, sooner or later, in both disappointment and regret. Disappointment and regret may occur because sooner or later the buyers will, perhaps, realize that, had they offered higher prices, they could have attained more tea (and that they would be happy to do so, even at the higher price, rather than go without tea because they foolishly believed it would be forthcoming at lower prices). Or sellers may realize that they might, had they only offered to sell at lower prices, have sold more tea (and that they would have preferred to do so rather than refusing to sell because of a mistaken belief that higher prices were available). In these cases disappointments arise as buyers (sellers) discover that their hopes to buy (sell) at low (high) prices were unrealistic. Regrets arise at not have realized that they would have been better advised to have offered to buy (sell) at lower (higher) prices. In addition, of course, since tea was sold at many different prices during the same day, many of those who sold (bought) at the low (high) prices will regret not doing so at the higher (lower) prices at which in fact tea exchanged elsewhere in the very same market.

These disappointments and regrets may generate sharp changes in the decisions made by potential buyers and sellers (even in the absence of change in the sets of ‘real’ determinants of their preferences and productive capabilities). Buyers who paid the high prices and sellers who accepted the low prices may revise their market attitudes, so that a tendency towards a uniform price may occur. Buyers (or sellers) who have overestimated the willingness of potential suppliers (or buyers) to sell (or buy) will realize their earlier errors and adjust their offers to the realities. In fact it is precisely because these adjustments are likely to cause initial sets of prices to give way to a different set (a set perhaps less divergent, and perhaps less likely to generate disappointments and regrets) that the initial market must be described as having been in disequilibrium. Without any outside forces whatever (such as changes in preferences or in supply conditions) the initial sets of buying and selling offers are likely to give way to different sets. Where the changes generated in this way are systematically in the direction of better co-ordinated sets of decisions (than in the initial period), we may surely describe the market (even in its early, grossly dis-coordinated state) as possessing, to some degree, an ability to achieve co-ordination. The very disappointments and regrets that result from initial co-ordination failures systematically bring about improved sets of market decisions. Here the appropriate analogy, surely, is to the initially faulty traffic signal system.

It should be noticed that here too the ‘co-ordinative properties’ of the (disequilibrium) market derive from the ability of prices to communicate information, *but in a sense a quite different from that in which equilibrium prices may be said to co-ordinate through the accurate communication of information*. Equilibrium prices co-ordinate because they are *already* so adjusted (‘pre-reconciled’) that decisions that take these prices into account turn out to be mutually reinforcing. Disequilibrium prices can, if at all, be described as ‘co-ordinating’ only in the sense that they reveal, to alert market participants, how *altered* decisions on their part (from those who contributed to the emergence of these disequilibrium prices) may be wiser for the future. Thus disequilibrium prices that are ‘too low’ (and which therefore generated excess demand) suggest to some disappointed buyers that they should offer to pay higher prices. Or again, to the extent that disequilibrium has manifested itself in the emergence of many prices in the same market for tea, this very spread between high and low prices suggests to some alert entrepreneurs that arbitrage may be won through offering to buy at somewhat higher (than the lowest) prices and simultaneously offering to sell elsewhere at somewhat lower (than the highest) prices. The information that inspires these ‘co-ordinating’ changes is indeed information that is supplied by the initial structure of prices, but so supplied only through alert *realization of the failures* of those initial prices to achieve the kind of co-ordination that we found in the case of equilibrium prices.

Dispersed Knowledge, the Price System and Economic Literature

We have thus seen that the Hayekian insights into the nature of the economic problem facing society permits us to recognize the co-ordinative role of prices in a sense far more important than that played by equilibrium prices. The circumstance that information is dispersed offers society a ‘communication’ challenge not only because even the most fully co-ordinated set of decentralized decisions must *presuppose* and *contain* an effective signalling system. The circumstance that information is dispersed offers society a far more important ‘communications’ challenge – that of generating flows of information or of

signals that might somehow stimulate the *revision* of initially *uncoordinated* decisions in the direction of greater mutual co-ordinatedness.

So long as the economists saw the economic problem to be one of achieving an efficient allocation of social resources (in the same way as the individual economizer faces the problem of private resource allocation), there could, of course, hardly be appreciation for the ‘co-ordinative’ contributions to social well-being that a price system can offer in helping overcome the problem of dispersed knowledge. As is by now fairly widely understood, as a consequence of what we have learned from Hayek, to talk of the problem of efficiently allocating society’s resources is completely *to assume away and thus to overlook* the dispersed knowledge problem.

What is disappointing, in the way in which the profession has absorbed the Hayekian lesson, is that the literature appears to have failed to grasp the way in which the price system meets the ‘communications’ challenge, offered by the circumstance of dispersed knowledge, that we have described as being by far the more important one. Instead it appears to have focused entirely on the more superficial sense in which a price system may be said to communicate information, namely on the signalling role fulfilled by equilibrium prices.

Now, for textbook purposes this limited exploitation of the Hayekian insights is arguably understandable and defensible. Thus a number of contemporary textbooks cite Hayek’s well-known example of the tin market.

Assume that somewhere in the world a new opportunity for the use of...tin, has arisen, or that one of the sources of supply of tin has been eliminated. It does not matter for our purpose – and it is significant that it does not matter – which of these two causes has made tin more scarce. All that the users of tin need to know is that...they must economize tin. There is no need for the great majority of them to even know...in favor of what others needs they ought to husband the supply...The mere fact that there is one price for any commodity...brings about the solution which...might have been arrived at by one single mind possessing the information which is in fact dispersed among all the people involved in the process. (Hayek 1949b: 85f.)

It is certainly true that this particular example of Hayek’s is concerned only with the communication-of-information function fulfilled by equilibrium prices. (This is quite clear, for example, from the concluding sentences referring to the single price and to the incidence between the results of there being a single price for tin throughout the market, and the solution that might be arrived at by a single omniscient mind.) This example does not focus on the communication problem that confronts a price in which, as yet, the bewildering arrays of market prices reflect only *uncoordinated* decisions on the parts of potential buyers and sellers. Yet there is no need to criticize the textbooks for not going beyond the simplest communication function of prices. There can be no doubt that an understanding of this simpler Hayekian lesson at the beginning of one’s study of economics can be profoundly beneficial.

What is more puzzling is that the deeper implications of the Hayekian lesson have somewhat to be noticed, not only in the textbooks, but also in the more advanced literature that has referred to Hayek’s contribution. Thus, a considerable mathematical literature has emerged exploring the extent to which market prices convey information in the face of stochastic supply and/or demand conditions (see, for example, Grossman 1976; Grossman and Stiglitz 1976, 1980; Frydman 1982). The questions asked in this literature concern whether or not uniformed market participants can derive correct information from the market prices themselves. Nowhere is there enquiry as to whether entrepreneurial alertness and motivation may perhaps be ‘switched on’ by the configuration of market prices, to conjecture (and try out!) hunches that may in fact be closer to the truth (than the information that the prices themselves reflect). Similarly, in what surely must be regarded as the most extensive and wide-ranging development of the implications of the Hayekian insights, Thomas Sowell’s monumental *Knowledge and Decisions*, one looks in vain for any discussion of the way in which prices and price differences may stimulate a deployment of existing information that might be superior to that which these prices themselves express.

To emphasize, as Sowell does it throughout his work that prices *summarize* economic knowledge (see especially Sowell 1980: 38) is of unquestioned value. But this insight into the relationship between prices and knowledge ignores the far more important truth that it is the very *inadequacies* that cloud the manner in which these price-summaries express existing knowledge that create the market incentives for their modification. The profit opportunities embedded in existing prices are thus extraordinarily effective communicators of knowledge (in a sense quite different from that in which prices summarize knowledge). Thus governmentally imposed obstacles to price flexibility not only (as Sowell so well, and in such rich detail, explains) prevent prices from telling the truth – they smother the emergence of those disequilibrium-price-generated incentives upon which the system depends for its very ability to discover and announce the truth.

Hayek and the Market discovery process

Hayek himself (especially in the earlier work in which he developed his seminal insights concerning the social significance of the circumstance of dispersed knowledge) was not as explicit as one might have wished on the role of prices in the discovery process of the market. A reader mistakenly believing that the only sense in which prices may be said to carry information is that in which equilibrium prices correctly reflect (‘summarize’) the truth supply and demand conditions might be excused for coming away from a reading of Hayek’s papers on knowledge of 1937 and of 1945 without sensing any chal-

lenge to that belief. Although a number of passages in these earlier papers of Hayek criticized the standard view among welfare economists and others (i.e. the view that saw the economic problem as that of securing an efficient allocation by society of its given scarce resources) as reflecting undue emphasis on the equilibrium state (see for example Hayek 1949a: 93, fn. 2; 188), these papers did not explicitly show how disequilibrium prices play their role in solving Hayek's problems of dispersed knowledge. Yet, as we have seen, there can be no doubt, once one has understood the co-ordination problems implied by this dispersed knowledge, about the role of disequilibrium prices in this regard. That Hayek did in fact intend his formulation of the knowledge problem to include also the role of prices in providing the incentives for their own modification appears clear from his discussions of competition as a process, and particularly from his later work on competition as a discovery procedure (Hayek 1949e, 1978b).

In Hayek's 1946 lecture, 'The meaning of competition' he brilliantly distinguished the *state* of perfect competition from the dynamic competitive *process*. One of the conditions required for the former is perfect knowledge; the central achievement of the latter that 'it is only through the process of competition that the facts will be discovered'. When Hayek in this paper talks of 'spreading information' (1949e: 96, 106), he is not referring to the instantaneous transmission, through equilibrium price signals, of already known information. He is referring, instead, to the 'process of the formation of opinion' (p.106). This process of opinion formation is one built out of a series of entrepreneurial steps, made possible by competitive freedom of entrepreneurial entry, exemplified by the entry of one 'who possesses the exclusive knowledge. . . to reduce the cost of production of a commodity by 50 percent' and thus 'reduces its price by . . . 25 percent' (p.101).

These insights were deepened and made even more explicit in Hayek's later 'Competition as a discovery procedure'. In this paper what is emphasized is not that prices act as signals transmitting existing information – but rather that it is the competitive process which *digs out* what is in fact discovered. The competitive process relies upon market data at any particular time only in the sense that 'provisional results from the market process at each stage . . . tell individuals what to look for' (1978b: 181). The 'high-degree of coincidence of expectations' that the market achieves 'is brought about by the systematic disappointments of some kind of expectations' (p. 185). The 'generally beneficial effects of competition must include disappointing or defeating some particular expectations or intentions' (p. 180). In fact, 'competition is valuable *only* because, and so far as, its results are unpredictable and on the whole different from those which anyone has, or could have, deliberately aimed at'.

What emerges from these Hayekian insights into the *discovery* properties inherent in the competitive process is the recognition, surely, that the incentives offered by market prices *during* this competitive process are the key elements in motivating competitive-entrepreneurial entry and discovery. In this sense prices play a role in 'spreading information' quite different from their role as signals communicating *already discovered* information under equilibrium conditions.

Communication and Discovery

Equilibrium prices permit market participants to 'read' the relevant information needed for their activities to be mutually adjusted in coordinated fashion. Disequilibrium prices are far less helpful in this regard; in fact a good deal of the 'information' that trusting market participants 'learn' from disequilibrium prices is quite incorrect and may be responsible for waste and frustration. As communicators, as signals, disequilibrium prices are relatively poor performers (when compared, of course, with the questionably-relevant standard set in this regard by equilibrium prices). Indeed, markets and the market system have often been criticized for the co-ordination failures that disequilibrium prices both express and help generate. What Hayek's 'Austrian' insights permit us to see is that the social function served by market prices is captured far more significantly by the concept of *discovery* than by that of communication.

In regard to discovery, market prices (especially disequilibrium prices) should be seen not so much as known signals to be deliberately consulted *in order to find out* the right thing to do, but rather as spontaneously generated flashing red lights *alerting* hitherto unwitting market participants to the possibility of pure entrepreneurial profit or the danger of loss. These discoveries, surely, constitute the crucial steps through which markets tend to achieve co-ordination, gradually replacing earlier states of widespread mutual ignorance by successively better co-ordinated states of society.

No doubt the economics profession has much to learn about the subtle manner in which this market discovery procedure works. Surely the future historian of economic thought will trace back future development in this branch of social understanding to those seminal and path-breaking papers in which Hayek taught us the crucial importance of dispersed knowledge in creating *the* economic problem which society faces.

[Kirzner has also contributed to the advancement of the theory of the "knowledge problem", as originally posed by Hayek, by identifying two distinct types of knowledge problems, and by showing how entrepreneurs spontaneously evolve in markets to solve one of these types. Israel M. Kirzner (1990), "Knowledge Problems and their Solutions: Some Relevant Distinctions", *Cultural Dynamics*, and reprinted as chapter 10 of his book, *The Meaning of Market Process*, New York: Routledge, 1992, pp. 164-179].

[In its entirety] Introduction

A central role in Hayek's thought has been played by his insights into the problems posed by the phenomenon of dispersed knowledge. These insights first emerged as a result of Hayek's participation in the inter-war debate on the possibility of so-

cialist economic calculation and crystallized in his classic 1945 paper 'The use of knowledge in society' (1949b). Although these insights were originally born out of Hayek's economics, for the past three decades they have nourished those profound contributions to other branches of social philosophy which have come to dominate Hayek's recent work.

The classic 1945 passage in which Hayek definitively articulated his original, economic insight, reads as follows:

The peculiar character of the problem of a rational economic order is determined . . . by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is thus not merely a problem of how to allocate 'given' resources – if 'given' is taken to mean given to a single mind which deliberately solves the problems set by these 'data'. It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality. (Hayek 1949b: 77-8)

Some thirty years later, in introducing his three-volume *Law, Legislation and Liberty*, Hayek recognized the seminal part played by these insights for his more general discussions of later years.

The insight into the significance of our institutional ignorance in the economic sphere . . . was in fact the starting point for those ideas which in [*Law, Legislation and Liberty*] are systematically applied to a much wider field. (Hayek 1973: 13)

Indeed, already in 1960, in *The Constitution of Liberty*, Hayek was applying his 1945 economic insights into a far wider field. Hayek there points out that the 'sum of the knowledge of all the individuals exists nowhere as an integrated whole. The great problem is how we can all profit from this knowledge, which exists only dispersed as the separate, partial, and sometimes conflicting beliefs of all men.' He proceeds immediately to observe: 'In other words, it is largely because civilization enables us constantly to profit from knowledge which individually we do not possess and because each individual's use of his particular knowledge may serve to assist others unknown to him in achieving their ends that men as members of civilized society can pursue their individual ends so much more successfully than they could alone.' All this leads Hayek to refer to the 'identification of the growth of civilization with the growth of knowledge' (1960: 25), pointing out that the 'more civilized we become, the more relatively ignorant must each individual be of the facts on which the working of his civilization depends. The very division of knowledge increases the necessary ignorance of the individual of most of his knowledge' (p. 26). Our discussion in this chapter explores the meaning of the problem of dispersed knowledge by probing the legitimacy of Hayek's extension of his original, narrowly economic insight to apply to civilization in general, and to its various institutions in particular.

The Extension of Hayek's Knowledge Problem

In his recent work Hayek has indeed concentrated on the significance of the 'knowledge problem' (as, following Lavoie (1985: Ch. 3), we shall now call it) as extending far beyond the capacity of market process to co-ordinate the mutual expectations which market participants hold concerning one another. Hayek has emphasized the significance of the knowledge problem for the evolution of social and cultural norms and institutions. The intricate webs of mutually sustaining expectations required for the emergence of our most valuable social institutions, Hayek argues, could never conceivably have been deliberately simulated by any centralized organization. What was nurtured the spontaneous emergence of such benign cultural norms and institutions, Hayek maintains, is the circumstance that social processes of spontaneous co-ordination have been able to evolve. It is only in this way that a social fabric consisting of innumerable threads of mutual expectations – a fabric the totality of which displays a complexity transcending the capacity of any single mind – could possibly come to be woven.

Now, it is no doubt incorrect and unfair to attribute to Hayek the categorical assertion that whatever institutions evolve spontaneously are more likely to be socially benign than any deliberately constructed institutions could possibly be. Yet various writers have noted their discomfort at feeling how close Hayek appears sometimes to be to such a view. Although Hayek points out that he 'has carefully avoided saying that evolution is identical with progress', he makes it clear that 'it was the evolution of a tradition which made the civilization possible', and asserts flatly 'that spontaneous evolution is a necessary if not a sufficient condition of progress' (Hayek 1979: 168). Buchanan, in particular, has placed his finger on the theme that has become increasingly important in Hayek's recent writings:

This theme involves the extension of the principle of spontaneous order, in its *normative* implications, to the emergence of institutional structure itself . . . There is no room left for the political economist, or for anyone else who seeks to reform social structure to *change* laws and rules, with an aim of securing increased efficiency in the large. Any attempt to design, construct, and to change institutions must, within this logical setting strictly interpreted, introduce inefficiency. Any 'constructively rational' interferences with the 'natural' processes of history are therefore to be studiously avoided. The message seems clear: relax before the slow sweep of history. (Buchanan 1986: 75-6)

Buchanan struggles to exonerate Hayek from the charge of actually supporting the full extreme position outlined in the preceding paragraph, and to resolve apparent contradictions between Hayek's more consistently anti-constructivist statements and his own attempts (such as his proposal for the denationalization of money, and his proposals for political constitutional reconstruction) at institutional reform. Yet the strong impression one gains from Hayek remains that he has profound faith in the possibility, in general, of benign institutional evolution.

In the present chapter I shall join Hayek's critics in questioning the asserted parallelism (between the achievements of free markets within a given institutional setting and the spontaneous evolution of institutions themselves) which has formed the foundation for Hayek's work in recent decades. I shall proceed by first carefully dissecting the original Hayekian knowledge problem into two distinct component problems, both of which have their counterparts in the context of the emergence of social norms and institutions. It will then become apparent that only one of these two component problems permits solution, in the context of institutional development, in a manner parallel to that in which its counterpart problem is solved in markets. The remaining component of the knowledge problem turns out, in the institutional development context, not to be solvable by the spontaneous process through which its counterpart problem in markets is to be solved. The purpose of our critique, it should be emphasized, is not so much to challenge the analogies which Hayek draws between market and society, as to explore some subtleties in the knowledge problem which Hayek has taught us to appreciate. That Hayek has himself not always seemed sensitive to these subtleties makes this task, of course, only all the more important.

The Knowledge Problem in Market Context

Consider a single commodity market in competitive equilibrium. A market clearing price prevails. No market participant need know more than the market price be able to carry out his plans without disappointment or regret. Each seller finds himself able to sell what he wishes to sell at the market price. Each buyer finds himself able to buy what he wishes to buy at the market price. The amount of knowledge possessed by each market participant need not be more than a minuscule; no one need know the shape or position of either the demand or the supply curve. Yet the market price stimulates a series of independent decisions which permits all possible mutually gainful trades between any pair of market participants to occur. Suppose now that some catastrophe strikes the industry producing our commodity, drastically shifting its supply curve to the left. Market price will rise and buyers of the commodity will find themselves constrained to economize more than previously on the use of this product – and will be guided by the higher market price to do so, without ever learning about the catastrophe, knowing only that the market price is now higher than it had been before. Many textbook presentations of Hayek's vision of how markets solve the knowledge problem see this achievement of the equilibrium market as the paradigmatic illustration of the knowledge problem and its market solution.

What the market solution has achieved, these expositions show, is that the market is able to mobilize dispersed knowledge as if all the information were concentrated in a single mind. Although knowledge is in fact dispersed, to a degree making it inconceivable that all that all of it might indeed be made available to single mind, the market successfully and spontaneously yields a social result which exploits every relevant bit of knowledge.

Careful consideration of this achievement of market in equilibrium reveals, we wish to point out, two quite different achievements. Each of these achievements, we argue, corresponds to a distinct component of Hayek's knowledge. Let us see how this is the case.

The market clearing price can prevail only because no market participant makes any offer to sell or buy which is not accepted. Each market participant correctly anticipates the responses which others will make to any offer or bid he proposes. No attempted decision has been based on undue optimism; no attempted decision has thus been disappointed. Of course we can easily imagine situations in which this happy state of affairs does not occur. Market participants mistakenly believe that others will buy even at very high prices or that others will be prepared to sell at even at very low prices. Such over-optimistic mistakes are very natural: they arise because market participants may not know what other market participants know about themselves, namely that they are not prepared to buy at high prices (or sell at the low prices). As a result of this dispersed knowledge (people knowing only their own attitudes, not those of others), markets easily fail to clear (since over-optimistic sellers may have held out for prices that were too high *etc.*). We shall recognize this possible failure, due to over-optimism (resulting from the dispersion of this knowledge), as the first of the two knowledge problems we wish to identify. We shall refer to it as Knowledge Problem A.

A little thought will convince us, however, that Knowledge Problem A is not the only knowledge problem successfully solved in the case of the market clearing price. Over-optimism is not the only reason why the market clearing price may not be achieved throughout the market. Imagine a situation – the stylized conditions of which are postulated only to illustrate a point relevant to far more realistic and typical problems – in which a wall, or an ocean, separates one half of the market from another (but with this separation entailing no costs of transportation for the journey from one market sector to the other). It could easily happen, in such a situation, that this separation generates two separate markets, in each of which a (different) market clearing price prevails. It should be clear here, too (just as in the *single* market clearing price case discussed earlier), Knowledge Problem A has been successfully solved. No market participant (in the two separate 'markets') has made a buy-

ing/selling proposal, fully expecting it to be accepted, which turns out to be rejected. No one has been over-optimistic concerning the responses of others to offers made available to them.

But it should also be clear that, in this case of the two ‘markets’, even though in each of them the local price clears the market, errors have none the less been made. The existence of two separate prices (in these two markets) for the identical commodity indicates that those paying the higher price erroneously overlooked the possibility of buying more cheaply in the other market; those selling for the lower price erroneously overlooked the possibility of selling at a higher price in the other market. Some participants in the high-price market refrain from buying (because of the high price) and remain without the commodity, even while that commodity is available in other market. This is matched by the circumstance that some participants in the low-price market refrain from selling (at the low price) while potential buyers willing to pay higher prices could have been found in the high-price market. Market participants have failed to grasp opportunities that *might* have been grasped – if only they had more accurate knowledge concerning what others *might* have been prepared to do. Clearly these errors (while not constituting a problem identical with Knowledge Problem A, which arose because market participants were over-optimistic) constitute a knowledge problem: market participants are (over-pessimistically) unaware of what others *might* be willing to pay (or be willing to sell for). We shall call this second problem, the problem of undue pessimism arising from dispersed knowledge, Knowledge Problem B.

The Two Knowledge Problems

A little thought will convince us that Knowledge Problems A and B really are distinct problems. Both arise from the circumstance of dispersed information, but consist in distinctly different kinds of error. My incomplete information concerning what others would like to do may lead me over-optimistically to expect to sell at very high prices. Here my incomplete information has led me to expect behavior on the part of others which will in fact not occur. The errors thus constituting Knowledge Problem A tend to be *self-revealing* – since they stimulate proposals which are bound to be disappointed. Knowledge Problem A, in the market contest, generates a process of equilibration which appears well-nigh inevitable. As Hayek himself put it, in apparently referring to this kind of equilibration process, the relevant knowledge which a market participant ‘must possess in order that equilibrium may prevail is the knowledge which he is bound to acquire in view of the position in which he originally is, and the plans which he then makes’.

My incomplete information concerning what others would like to do may, on the other hand, unduly pessimistically lead me to believe at impossible to sell at quite low prices (at which others would in fact be delighted to buy), compelling me to give up the idea of selling altogether. Here incomplete information has led market participants (between whom the possibility for mutually gainful exchange exists) to overlook this possibility, to their mutual (but never sensed) misfortune. Knowledge Problem B is here responsible for failure to make a move required for Pareto optimality. This Knowledge Problem B does not result in disappointed plans; it results in failure to achieve potential gains (because they remain unperceived). Because the misfortune caused by Knowledge Problem B has been unperceived, there is (unlike in the case of Knowledge Problem A) no inevitability that the problem will ever be revealed and corrected. What market participants fail to know about each other today, they may easily continue to fail to know tomorrow.

In market clearing equilibrium, of course, *both* Knowledge Problems have come to be solved (in regard to the market under consideration). It is not only the case, in market clearing equilibrium, that each attempt to buy or to sell is successfully able to be carried out. It is also the case that no possibly mutually gainful trade between a potential buyer and seller (both of whom are participants in this market) fails to be consummated. We can easily understand how it has come about, in this equilibrium, that no one has been led over-optimistically to ask any too-high price (or to offer any too-low price). We understand, that is, that any such over-optimistic errors have *corrected themselves*: disappointments have taught market participants not to expect unrealizable responses. We understand, that is, how Knowledge Problem A has been solved.

But we are not so immediately able to understand how, in market clearing equilibrium, Knowledge Problem B, as well, has come to be solved. It is not at all so obvious how the many overlooked possibilities for mutually gainful trade – possibilities which, given initial dispersed knowledge, could hardly have failed to have been overlooked – have somehow come to be revealed. What has caused market participants to know (about each other’s potential attitudes) what they did not know yesterday?

Of course, economic theory explains how Knowledge Problem B has come to be solved in market equilibrium. It turns out that this solution is in fact quite different from that which has solved Knowledge Problem A. Whereas Knowledge Problem A was self-correcting, Knowledge Problem B created *an incentive for its solution by discovery in the activity of profit-alert entrepreneurs*. Where undue pessimism caused possible Pareto-optimal moves to fail to be made, the opportunity was thereby created for the possible grasping of pure entrepreneurial profit. Potential seller X, being pessimistically ignorant of potential buyer Y’s willingness to pay as much as \$10 for an item, failed to offer it for sale, even though he would himself have been very pleased to sell it for as low as \$3. This overlooked opportunity for a mutually gainful trade between X and Y constitutes an inviting opportunity for the winning of pure entrepreneurial profit. Anyone, say entrepreneur Z, alert to this opportunity can, without any capital resources whatsoever, offer to buy from X at, say, a price of \$4 (so that X, on our assumptions, will be delighted to accept), paying this price out of the gross revenue available to him through his offering to sell to Y at a price of \$9 (which again, on our assumption, Y will gladly accept). Wherever mutual ignorance, due to dispersed

knowledge, causes Pareto-indicated moves not to be made, we have before us a situation inviting the alert entrepreneur to make pure profit.

Economic theory teaches us that, in this way, there is a powerful market tendency for all pure profit opportunities to be noticed and grasped. Knowledge Problem B comes to be solved through entrepreneurial discovery of hitherto overlooked opportunities.

Thus our understanding that in market clearing equilibrium *both* Knowledge Problems have been solved – ensuring that both overoptimistic and unduly pessimistic mutual errors (that might arise out of dispersed information) are *not* being made – rests on two distinct completed processes of market learning. The process whereby Knowledge Problem A is solved is a process which, without relying on entrepreneurial, profit-motivated alertness, arises from well-nigh inevitable learning of the unrealism of over-optimistic expectations. The process whereby Knowledge Problem B is solved, is a process which must rely entirely on the discovery by entrepreneurs of available opportunities of which nobody was hitherto aware.

The Two Knowledge Problems in a Wider Setting

As Hayek came to emphasize, the Knowledge Problem is not only a problem in the context of the market. It is a problem crucially relevant to the emergence of social institutions as well. Such institutions as the law, language, the use of money, the respect for private property, require a concurrence of mutual knowledge and expectations completely analogous to the mutual knowledge required for market equilibrium. What we wish now to point out is that the problem which the phenomenon of dispersed knowledge creates for the emergence of benign social institutions is made up (exactly as the corresponding Knowledge Problem in the market context was) of two distinct problems. Let us consider the use in society of a common unit for the measure of distance. Obviously, the common use of a single scale of measurement is an important element in social intercourse. It would be most cumbersome and most obstructive to the emergence of standardized dimensions relevant to innumerable possible situations were several different measurement systems to be in use in the same society. For the emergence of a common system of measurement we require that members of the society correctly expect others to be employing that measurement system. A system using feet and inches can prevail only when, and because, each correctly expects others to use that system. More precisely it can prevail only when and because each correctly expects others to expect that system to be universally used. And so on.

Clearly such mutually sustaining expectations may be absent – resulting in and expressing the absence of a common system of measurement. What Hayek has emphasized is that the spontaneous emergence of such institutions has occurred throughout history. Members of society have learned, without central direction, to participate in social systems of language, measurement, monetary exchange – all of which have required mutually sustaining patterns of expectations. As Hayek has taught us, much of our civilization consists of such spontaneously developed systems of mutually reinforcing anticipations.

What must, for our present purpose, be stressed is that these institutions do not necessarily require that all conceivable opportunities for Pareto-superior social institutions be grasped and exploited. The common use of the system of feet and inches for measuring length does not in the slightest degree require that it be the end result achieved by grasping all conceivable opportunities for more efficient measurement. It could be that a superior system of measurement might have emerged. The fact that it did not does not deny usefulness to the system of feet and inches. That system is based on the concurrence of expectations on the part of millions of members of society. No one of them is disappointed in his expectations that others will employ this system. The usefulness of the system depends entirely and solely upon the successful solution of Knowledge Problem A (ensuring that expectations not be disappointed). It does not intrinsically depend on the solution of Knowledge Problem B. Even if some superior measurement system *could* be somehow devised and put into operation (by persuading the members of the society of its merits and its imminence), failure to do so in no way affects the viability of the measurement system that has in fact been adopted.

It is so with all of the institutions we usually cite. Use of a common language does not depend on the emergence of the simplest, clearest form of interpersonal communication. It depends only on members of society having learned to expect a single vocabulary and grammar.

Spontaneous order, in the sense of the spontaneous emergence of a set of rules, such as rules of language, behaviour or law, requires only that *some* given set of rules come to be universally expected. For the existence of none of these institutions is it inherently necessary that we go beyond the solution of Knowledge Problem A, the avoidance of disappointment regarding the behaviour of others.

The Spontaneous Emergence of Institutions

We understand, therefore, Hayek's convictions concerning the possibility of spontaneously emerging benign social institutions. Such institutions can emerge, it is clear, by the same solution of Knowledge Problem A which contributes to the spontaneous emergence of market equilibrating tendencies. People do tend to learn correctly to expect what other people will do, and the emergence of such mutually sustaining expectations may constitute the establishment of stable social institutions.

But it is equally clear that the solution of Knowledge Problem B, involving the discovery of hitherto unexamined attractive opportunities for mutual gain through interaction, is *not* needed for the emergence of any single institution. What we wish to point out in the following pages is that, except in the context of the market, we have in fact no generally operative tendency at all for Knowledge Problem B ever systemically to be solved.

If this contention of ours be accepted, we will surely have established grounds for challenging any assertion that spontaneous processes are able, in general, to generate not only stable institutions expressing mutually sustaining expectations, but also tendencies parallel to those operating in markets to solve Knowledge Problem B, towards the replacement of socially inferior institutions by superior ones. There *may* be long-run survival-of-the-fittest type tendencies (or, for that matter, other kinds of tendencies) for societies to generate more rather than less ‘useful’ social norms and institutions. It is our contention here that any such tendencies are entirely distinct from the tendency, within markets, for socially useful opportunities to be discovered and exploited through the solution of Knowledge Problem B.

Institutions, whether more useful to society, less useful to society, or even downright harmful to society, require only the solution to Knowledge Problem A. This solution, in the context of wider social interaction, can indeed be counted upon to be forthcoming in the same way as it is forthcoming in the market context. For this reason institutions may and do indeed emerge spontaneously, constituting classic examples of spontaneous co-ordination.

But the replacement of an inferior institution (say, a measurement system based on feet and inches) by a superior institution (say the metric system) requires more than the solution of Knowledge Problem A: it requires also the solution of Knowledge Problem B. Our contention is that no solution of Knowledge Problem B, parallel to its solution in markets, can be counted upon, outside the market context itself. Thus a belief in the spontaneous development of better and better social institutions cannot rely on the analogy with, or uncritical extrapolation of, our insights into the processes whereby Knowledge Problem B is solved in the attainment of Pareto-optimal outcomes in market equilibrium. Our contention requires some further elaboration.

The Solution of Knowledge Problem B: The Externality Problem

As will be recalled, the market process includes a tendency for the solution of Knowledge Problem B resulting from the incentives provided by pure profit opportunities. Alert entrepreneurs are attracted to notice suboptimalities (constituting expressions of Knowledge Problem B) because they respond to the scent of pure profit which accompanies such suboptimalities. By grasping the profit accompanying such suboptimalities, the entrepreneur benefits the market as a whole (since he moves prices and costs closer to equality, eliminating hitherto unnoticed, unexploited opportunities for mutually gainful exchange between unalert market participants). But there was no externality. The stimulus needed to attract the entrepreneur to benefit society was provided by the prospect of pure profit for himself. Every possibility for social gain through the overcoming of Problem B implies the attraction of private gain for the alert entrepreneur who can notice the opportunity. We wish to point out that no such fortunate coincidence of private and social profit occurs in the context of the emergence of social norms and institutions.

Let us imagine a society employing a measurement system based on feet and inches. Let us postulate that use of the metric system would substantially lower transaction and other costs throughout the system. There appears no obvious way in which any private entrepreneur could be attracted to notice the superiority of the metric system – let alone any chance of it being within his power to effect its adoption. The externality of the relevant benefit to society arising from a change to the metric system appears to block the translation of this unexploited opportunity, jointly available to members of society, into concrete, privately attractive opportunity capable of alerting entrepreneurial discovery.

The metric system remains unadopted as a result of a special case of Knowledge Problem B. Individuals are not aware that use of the metric system would be an improvement. Moreover, even if some (or all) were to become so aware, they (correctly) believe others (even where they are so aware) not to be using the metric system (because they believe that nobody is using the system). The possibility of all members of society simultaneously becoming aware of the social preferability of a metric system (or, at any rate, of all members of society somehow coming correctly to expect others to expect universal use of the metric system . . .) is a possibility running head-on into conflict with the concrete-like obstacle of Knowledge Problem B. How is it possible to generate among a population who have happily been employing the common measurement system of feet and inches the realization of the imminent actual workability and superiority of the metric system, or, at least, the expectation that others will from now on use only the metric system?

Solution to Knowledge Problem B always calls for entrepreneurial imagination. The externality feature endemic to Knowledge Problem B outside the market context discourages us from having faith in any spontaneous discovery procedure that is patterned after the process of entrepreneurial discovery which drives the market process.

Hayek, Menger and the Emergence of Money

Hayek frequently cites Carl Menger’s insight into the spontaneous emergence of socially useful institutions (Hayek 1967a: 94; 1969b: 100-1; 1955: 83; 1973: 22; 1978c: 265n). It will be instructive to observe how the most famous Mengerian example of the spontaneous emergence of such a socially benign institution, namely the spontaneous emergence of a commonly

accepted medium of exchange (making possible the transition from a barter economy to the far more efficient monetary economy), in fact occurs in Menger's exposition (Menger 1981: 257-62; 1985: 151-5). We shall discover that the spontaneous social process through which the evolution of a widely used money occurs is *not* one in which Knowledge Problem B is solved *analogously to its solution in market processes of equilibration*. To understand how Knowledge Problem B is overcome in the Mengerian process through which money emerges, it may be helpful to consider a similar spontaneous social process which does not involve any knowledge problem at all.

Consider the way in which a well-trodden path through the snow may be spontaneously achieved, without any deliberate, centralized plan to create it. At first, some hardy soul who has an urgent need to get to a destination makes the difficult crossing through the high snow. It is a costly journey (in terms of getting wet) but is apparently worthwhile. The precise route taken across the snow may be quite random, or it may be dictated by the pioneer's destination as viewed from the pioneer's starting point. What is important is that the first hike across the snow lowers the costs to others of crossing the snow subsequently. The snow is somewhat less intimidating where the first crossing was made. Others (who might otherwise perhaps not have crossed the snow at all, or who might have chosen some different route across the snow) now feel it worthwhile to cross exactly where the pioneer made the first crossing. Notice (a) that the reduced cost to the subsequent snow crossers is an unintended consequence of the first crossing and (b) that subsequent crossings will obviously tend to follow the path taken by the pioneer. Those who do indeed cross the snow in the footsteps of the pioneer make their own unintended contributions to the spontaneous emergence of a clear path across the snow. Each crossing treads down the snow a little more, thus further reducing the costs to others of walking across the snow. In this way, the familiar, socially benign phenomenon of a new path is the unintended consequence of self-regarding behaviour.

Now the sequence of actions which led to the spontaneous creation of the path has nothing to do with the solution of any knowledge problem. It is simply the fortunate implication of the different degrees of urgency with which people need to cross the snow (and also, possibly, of the different times at which different people need to cross the snow.) No creative, imaginative, entrepreneurial leap was needed – none has occurred – for the path occurred without central planning for it to be created – not because entrepreneurs were independently inspired to produce it, but because each step in the snow unintentionally induced further steps to be taken.

We should remember, incidentally, that, just as processes may occur in which (as in the path-in-the-snow case) each step reduces costs in a way that promotes benign, spontaneously achieved results, we can easily envisage exactly opposite kinds of process. We can easily envisage, that is, processes each step of which unintentionally, *but perversely*, changes costs to others (of taking further steps). If urban concentration increases the chances of economic survival in the city compared with the surrounding villages (or at any rate if villagers believe this to be the case), then the city may spontaneously sink into congestion which becomes progressively more and more horrible and intolerable. Feuding tribes or nations may find it wise to arm themselves against possible attack; but each such step taken may enhance the danger to others, leading to a spiraling sequence of armament building, heightening the suspicions on all sides and increasing the likelihood of war. Such tragic processes are well known and well understood (if not easily controlled). Our point is that, whether benign or otherwise, these spontaneous processes proceed as they do because each step taken systematically renders it more rational for other similar steps to be taken by others. This results in the familiar snowballing effect. Menger's process of the spontaneous emergence of money proceeds in exactly this fashion.

What drives the dynamic Mengerian process through which money evolves is the gradually increasing liquidity of some particular commodity that has come to be used, not yet as money, but as a means for an indirect exchange between resourceful, bartering market participants. Starting from a barter economy, alert market participants find they can improve their chances for trading what they initially possess for what they would prefer to possess if they trade the former for something which they themselves do *not* wish to acquire for final consumption use, but which they believe *is* likely to be sought after by those who possess the items which these alert market participants *do* wish to acquire. As this occurs, the 'liquidity' of this item (which they acquire even though they have no wish to consume it themselves) increases. That is, the very circumstance that *these* alert market participants are buying this item increases now the chance that *other* market participants will find that initial acquisition of this item increases *their* chances of finally obtaining the items *they* wish finally to consume. The dynamics of this process of increasing liquidity becoming attached to certain items can lead to the emergence of a degree of liquidity so complete as, in effect, to render an item no longer an ordinary commodity but rather a generally accepted medium of exchange. Let us consider carefully the sense in which Menger's process (unlike our path-in-the-snow example) does involve the solution of a knowledge problem. We shall then more carefully appreciate Menger's process, while it very certainly does solve Knowledge Problem B, does so in a way quite different from the market process solution to Knowledge Problem B.

In an initial barter society, the inconveniences attributable to the absence of a generally accepted medium of exchange can be seen as caused by Knowledge Problem B. (Knowledge Problem A, in which participants in society entertain false expectations about what others will do, is not a problem here. Everyone correctly expects others to engage only in barter transactions. No one mistakenly expects to be able to receive 'money' in exchange for offered commodities.) What is preventing use of a monetary medium is the failure of market participants to know, not what in fact others *are* doing, but what others *might* be very willing to do (if they, in turn, knew that others would act similarly). Because the transition from a barter economy to a monetary economy involves grasping a new, universally gainful opportunity which has not yet been perceived, barter remains the prevailing mode. Even were I to understand the superior efficiency of moving to, say, a silver monetary standard, I

will not try to sell anything for silver because silver is not now money (i.e. I do not expect others so to accept silver). Where in fact others, like me, do understand the advantages of moving from barter to a silver monetary standard, I am correct in my judgement that silver is not money only because each one of us (who does not understand the virtues of silver money) fails to know what *might* be acceptable to others. Surely if I knew that others knew that I knew their appreciation of the virtues of silver money, et cetera *ad infinitum*, silver *would* now be accepted by all as money. Thus the knowledge problem obstructing the transition to widespread use of a silver money is Knowledge Problem B.

The transition from a barter society to a monetary economy, outlined in the Mengerian process, has thus certainly involved the spontaneous overcoming of Knowledge Problem B. after the transition, market participants have learned to behave in new ways which benefit them all. But these lessons have been learned in a manner that does not parallel the entrepreneurial processes which tend to overcome Knowledge Problem B in the market context. In them market context Knowledge Problem B manifests itself in market errors which reveal themselves as opportunities for entrepreneurial profit making. In the Mengerian context this was not the case. (The alertness which market participants display in the course of the Mengerian process regarding the steadily increasing liquidity of the commodity in question is never alertness to prospects of *further* increasing that liquidity; what is involved is strictly alertness to the personal efficiencies to be achieved by taking advantage of that commodity's *already increased* liquidity.) No entrepreneur could, by himself, discover opportunities for pure profit by attempting to move the barter society towards the use of money. None the less a spontaneous process which did move the society in that direction occurred in Menger's story. Our point is that it occurred in the same non-entrepreneurial fashion that marks the creation of paths in the snow.

Conclusion

What stimulates solutions to Knowledge Problem B in markets is the circumstance that in the market context this problem consists in unexploited opportunities for mutually gainful exchange. Such opportunities offer opportunities for private entrepreneurial gain to their discoverers. This sets in motion the familiar entrepreneurial process tending to bring separated markets into full contact with others, eliminating price discrepancies (and opportunities for further profit).

But in the broader societal context the manner in which Knowledge Problem B stands in the way of the emergence of feasible, cost-efficient, social institutions is not such as to offer opportunities for private gain to its discoverers. There is thus no systematic discovery procedure upon which we can rely for the spontaneous emergence of superior institutional norms.

This circumstance does not prevent genuinely spontaneous processes of institutional development from occurring. Paths in the snow happen. But it does mean that we cannot use, as copybook example for such spontaneous processes, *the manner in which markets systematically tend to solve Knowledge Problem B*. To be sure, the spontaneous emergence of *any* institution indeed relies on the very same processes through which Knowledge Problem A is solved in markets. Hayek is on firm ground in seeing his insights into the market qua discovery procedure as providing the foundation for his own later work on the spontaneous emergence of cultural norms and institutions and its link with the phenomenon of diversion of knowledge.

On the other hand, however, it has been our aim to point out in this chapter that these earlier economic insights into the spontaneously co-ordinative properties of markets do not, in themselves, provide any reassurance concerning the benign quality of the long-run tendencies of institutional development. Such benign tendencies may well be powerful and important in some or many instances; but the spontaneous co-ordination which occurs in markets provides us with no basis for any extension of the welfare theorems relating to markets to the broader field of the theory of institutional evolution. The explanation for such benign tendencies, if indeed they exist, must be sought elsewhere.

Money

[A key theme in Austrian economics is to discredit government manipulation of money, a commodity which should be left to buoy under market forces where it emerged spontaneously. One article dealing with this problem is Murray N. Rothbard (1978), "Austrian Definitions of the Supply of Money", in Louis M. Spadaro, *New Directions In Austrian Economics*, Kansas City: Sheed Andrews & McMeel, pp. 143-156].

[pp. 143-144] The concept of the supply of money plays a vitally important role, in differing ways, in both the Austrian and Chicago schools of economics. Yet, neither school has defined the concept in a full of satisfactory manner; as a result, we are never sure to which of the numerous alternative definitions of the money supply either school is referring.

The Chicago School definition is hopeless from the start. For, in a question-begging attempt to reach the conclusion that the money supply is the major determinant of national income, and to reach it by statistical rather than theoretical means, the Chicago School *defines* the money supply as an entity which correlates most closely with the national income. This is one of the most flagrant examples of the Chicagoite desire to avoid essentialist concepts, and to "test" theory by statistical correlation; with the result that the supply of money is not really defined at all. Furthermore, the approach overlooks the fact that statistical correlation cannot establish causal connections; this can only be done by a genuine theory that works with definable and defined concepts.

In Austrian economics, Ludwig von Mises set forth the essentials of the concept of the money supply in his *Theory of Money and Credit*, but no Austrian has developed the concept since then, and unsettled questions remain (e.g., are saving deposits properly to be included in the money supply?). And since the concept of the supply of money is vital both for the theory and for applied historical analysis of such consequences as inflation and business cycles, it becomes vitally important to try to settle these questions, and to demarcate the supply of money in the modern world. In *The Theory of Money and Credit*, Mises set down the correct guidelines: money is the general medium of exchange, the thing that all other goods and services are traded for, the final payment for such goods on the market.

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[pp. 151-152] Thus, we propose that money supply should be defined as all entities which are redeemable on demand in standard cash at a fixed rate, and that, in the United States at the present time, this criterion translates into:

M_a (a = Austrian) = total supply of cash-cash held in the banks and saving banks + total shares in savings and loan associations + time deposits and small CDs at current redemption rates + total policy reserves of life insurance companies—policy loans outstanding—demand deposits owned by savings banks, saving and loan associations, and life insurance companies + savings bonds, at current rates of redemption.

M_a hews to the Austrian theory of money, and, in so doing, broadens the definition of the money supply far beyond narrow M_1 , and yet avoids the path of those who would broaden the definition to the virtual inclusion of all liquid assets, and who thus would obliterate the uniqueness of the money phenomenon as the final means of payments for all other goods and services.

II. The Money Supply And Credit Expansion To Business

In contrast to the Chicago School, the Austrian economist cannot rest content with arriving at the proper concept of the supply of money. For the while the supply of money (M_a) is the vitally important supply side of the “money relation” (the supply of and demand for money) that determines the array of prices, and is therefore the relevant concept for analyzing price inflation, different parts of the money supply play very different roles in affecting the business cycle. For the Austrian theory of the trade cycle reveals that *only* the inflationary bank credit expansion enters the market through new business loans (or through purchase of business bonds generates the overinvestment in higher-order capital goods that leads to the boom-bust cycle. Inflationary bank credit that enters the market through financing government deficits does *not* generate the business cycle; for, instead of causing overinvestment in higher-order capital goods, it simply reallocates resources from the private to the public sector, and also tends to drive up prices.

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[pp. 153-155] In addition to M_a , then, Austrian economists should be interested in *how much* of a new supply of bank money enters the markets through new loans to business. We might call the portion of new M_a that is created in the course of business lending, M_b (standing for either business loans or business cycle). If, for example, a bank creates \$1 million of deposits in a given time period, and \$400,000 goes into consumer loans and government bonds, while \$600,000 goes into business loans and investments, then M_b will have increased by \$600,000 in that period.

In examining M_b on the American financial scene, we can ignore savings banks and saving and loan association, whose assets are almost exclusively invested in residential mortgages. Saving bonds, of course, simply help finance government activity. We are left, then, with commercial banks (as well as life insurance investments). Commercial bank assets are comprised of reserves, government bonds, consumer loans, and business loans and investments (corporate bonds). Their liabilities consist of demand deposits, time deposits (omitting large CDs), large CDs, and capital. In trying to discover moments of M_b with any precision, we founder on the difficulty that it is impossible in practice to decide to what extent increases of business loans and investments have been financed by an increase of deposits, thus increasing M_b , and how much they have been financed by the increases of capital and large CDs. Looking at the problem another way, it is impossible to determine how much of an increase in deposits (increase in M_a) went to finance business loans and investments, and how much went into reserves or consumer loans. In trying to determine increases in M_b for any given period, then, it is impossible to be scientifically precise, and the economic historian must act as an “artist” rather than as an apodictic scientist. In practice, since bank capital is relatively small, as are bank investments in corporate bonds, the figure for commercial bank loans to business can provide a rough estimate of movements in M_b .

With the development of the concepts of M_a (total supply of money) and M_b (total new money supply going into business credit), we have attempted to give more precision to the Austrian theory of money, and to the theoretical as well as historical Austrian analysis of monetary and business cycle phenomena.

[Another important work on money, along with a nonplusing of government monetary intervention, is Murray N. Rothbard (1990), *What Has Government Done to Our Money?*, Auburn, Alabama: The Ludwig von Mises Institute].

[pp. 53-54] What have we learned about money in a free society? We have learned that *all* money has originated, and must originate, in a useful commodity chosen by the free market as a medium of exchange. The unit of money is simply a

unit of weight of the monetary commodity—usually a metal, such as gold or silver. Under freedom, the commodities chosen as money, their shape or form, are left to the voluntary decisions of free individuals. Private coinage, therefore, is just as legitimate and worthwhile as any business activity. The “price” of money is its purchasing power in terms of all goods in the economy, and this is determined by its supply, and by every individual’s demand for money. Any attempt by government to fix the price will interfere with the satisfaction of people’s demands for money. If people find it more convenient to use more than one metal for money, the exchanging rate between them on the market will be determined by the relative demands and supplies, and will tend to equal the ratios of their perspective purchasing power. Once there is enough supply of a metal to permit the market to choose it as money, no increase in supply can improve its monetary function. An increase in money supply will then merely dilute the effectiveness of each ounce of money without helping the economy. An increased stock of gold or silver, however, fulfills more *non*-monetary wants (ornament, industrial purposes, etc.) served by the metal, and is therefore socially useful. Inflation (an increase in money substitutes not covered by an increase in the metal stock) is never socially useful, but merely benefits one set of people at the expense of another. Inflation, being a fraudulent invasion of property, could not take place on the free market.

In sum, freedom can run a monetary system as superbly as it runs the rest of the economy. Contrary to many writers, there is nothing special about money that requires extensive governmental dictation. Here, too, free men will best and most smoothly supply all their economic wants. For money as for all other activities of man, “liberty is the mother, not the daughter, of order.”

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[pp. 88-89] Many people believe that the free market, despite some admitting advantages, is a picture of disorder and chaos. Nothing is “planned,” everything is haphazard. Government dictation, on the other hand, seems simple and orderly; decrees are handed down and they are obeyed. In no area of the economy is this myth more prevalent than in the field of money. Seemingly, money, at least, must come under stringent government control. But money is the lifeblood of the economy; it is the medium for all transactions. If government dictates over money, it has already captured a vital command post for control over the economy, and has secured a stepping-stone for full socialism. We have seen that a free market in money, contrary to common assumption, would not be chaotic; that, in fact, it would be a model of order and efficiency.

What, then, we have learned about government and money? We have seen that, over the centuries, government has, step by step, invaded the free market and seized complete control over the monetary system. We have seen that each new control, sometimes seemingly innocuous, has begotten new and further controls. We have seen that governments are inherently inflationary, since inflation is a tempting means of acquiring revenue for the State and its favored groups. The slow but certain seizure of the monetary reins has thus been used to (a) inflate the economy at a pace decided by government; and (b) bring about socialist direction of the entire economy.

Furthermore, government meddling with money has not only brought untold tyranny into the world; it has also brought chaos and not order. It has fragmented the peaceful, productive world market and shattered it into a thousand pieces, with trade and investment hobbled and hampered by myriad restrictions, controls, artificial rates, currency breakdowns, etc. It has helped bring about wars by transforming a world of peaceful intercourse into a jungle of warring currency blocs. In short, we find that coercion, in money as in other matters, brings, not order, but conflict and chaos.

[Rothbard’s dissertation provides another view of his work as economic historian. The synopsis in the following article is based on that work: Murray N. Rothbard (1960), “The Panic of 1819: Contemporary Opinion and Policy”, *Journal of Finance*, vol. 15, no. 3 (September), pp. 420-421].

[In its entirety] The Panic of 1819 was America’s first great depression. This study investigates the search for remedies propelled by this new and puzzling disturbance to an economy first beginning to emerge from an undeveloped stage. The work discusses the remedies that were proposed and the resulting controversies and policies pursued.

The reasoning in these debates was on a highly sophisticated level. The disputants showed full familiarity with the European economic literature and were able to make original contributions in their study of American conditions. In fact, the panic served as an impetus for the development of a body of systematic economic thought in America during the 1820’s. Also foreshadowed were many modern theories and proposals: e.g., the relation between the interest rate and the profit rate, the problem of changes in the purchasing power of the dollar, the subjective theory of value, the Austrian theory of over-spending, pump-priming, the stress on velocity of circulation, the theory of hoarding and dishoarding, full-employment policy, the reduction of taxes on consumption to stimulate spending, analysis of the flows of “hot money,” and a “Federal Reserve System.” The currency principle emerged in this discussion before its introduction to the English scene, and it anticipated the hard-money doctrines of the Jacksonian movement.

Arguments centered on proposals for monetary expansion, direct measures for debtor’s relief—such as stay laws to postpone executions on judgments for debt and minimum appraisal laws on debtors’ property—and the protective tariff. Proponents of these measures promised relief from the depression. Stay and minimal appraisal laws would aid debtors and bolster business activity, while monetary expansion would lower interest rates, supply credit, and raise prices. The tariff would receive manufactures, cure unemployment, and supply a home market for agriculture.

The opponents asserted that the measures would only aggravate the depression. The critics of debtors’ relief maintained that creditors would lose confidence, and they further warned that paper money would depreciate. Free traders charged that

the tariff would worsen the existing commercial depression and place tax burdens on consumption. Critics of all legislative relief generally relied on individual “industry” and economy as the only lasting cure for depressions. Some also rested their case on laissez faire philosophy.

The legislative struggles over money and debt were largely waged at the state level, as prevailing constitutional theory focused responsibility for banking and debt on the states. Several western states enacted, over bitter opposition, a program of state inconvertible paper, not directly legal tender but expected to perform the functions of money. Rapid depreciation, caused by inflation and adverse judicial decisions on their constitutionality, led to repeal of these measures and the eventual return to specie payment.

On the federal level, there were quite a few ambitious proposals for national inconvertible paper and contrasting plans for elimination of paper and complete return to specie. No fundamental change aroused much interest in Congress, however. The depression years also saw the rise of an enthusiastic protectionist movement, eager to protect such newly emerging manufactures as cotton and woolen textiles, glass, and iron. The proposed protective tariff of 1820 passed the House and failed in the Senate by only one vote.

While the tariff struggle was waged on geographical lines, the conventional view that debtors’ relief and paper-money conflicts were fought on geographical, occupational, or income-class lines is strictly contradicted. The controversy cut sharply across all these lines. Western legislation was closely fought, and conflicts raged in many eastern states. Wealthy and respectable men were the leaders on both sides.

Entrepreneurship

[Largely due to Mises and Kirzner, the entrepreneur became a central focus of Austrian theory. The basics of this theory can be seen in this excellent survey in Israel M. Kirzner (1998), “Entrepreneurship”, in Peter J. Boettke, ed., *The Elgar Companion to Austrian Economics*, pp. 103-110].

[In its entirety] A solid case can be made for the claim that entrepreneurship has, throughout the history of the Austrian school, been among its central theoretical constructs. In their history of the variety of ways of understanding the essence of entrepreneurship. Herbert and Link (1988, p. 64) refer to the three ‘distinct viewpoints’ in early neoclassical economics (the ‘Austrian, French and British’). They remark that, ‘of the three, the Austrian approach proved most fertile for advancing the theory of the entrepreneur’. In a paper exploring aspects of the history of entrepreneurial theory, Dolores Tremewan Martin (1979, p. 271) observes that ‘much of the modern economic analysis...is devoid of any serious consideration of the role of the entrepreneur...’, but adds in a footnote that ‘the primary exceptions to this general trend in the literature we are found in the writings of the “modern Austrian economists”’.

In the following pages we will briefly examine some highlights in the history of the Austrian theories of entrepreneurship; canvass some contemporary disagreements among Austrians in regard to entrepreneurship; and seek to explain why it was that the Austrians, rather than other schools of marginalist economics, came to assign such importance to the entrepreneurial role.

The entrepreneur in the earlier Austrian tradition

It is well known that it was only in the course of the marginalist revolution that economists came to recognize an analytically distinct role for the entrepreneur. In classical economics – or at least in its dominant British version – there was simply no distinct entrepreneurial function. It was the capitalist upon whom, it appears, the economists implicitly relied to assure fulfillment of the tasks we generally consider to be entrepreneurial. The profit share of income earned by the capitalist, in classical economics, corresponded mainly in fact to what neoclassical economics was to identify as interest on capital. For the classical economists there was no pure entrepreneurial profit, because for them there was no pure entrepreneurial role. It was in the course of the neoclassical development in the theory of market that economists came to recognize the importance of the function played by the entrepreneur who acquires all the resource services – including those of capital – in order to produce the product to be sold to consumers. During the 1880s and 1890s there emerged a small flood of articles dealing with this entrepreneurial role. It was at this time that the American theorists, J. B. Clark and Frederick B. Hawley, developed their separate theories of pure profit (upon the elements of which Frank Knight was later to build his own more nuanced theory). It was soon after this period that the Austrian J. A. Schumpeter introduced his own theory of the entrepreneur, laying the foundation for his characteristic way of seeing and understanding the capitalist process.

The Austrians were prominent participants in this discovery of entrepreneurship. Carl Menger had already, in his 1871 *Grundsätze*, paid some significant attention, at least, to the entrepreneurial function. In characteristic subjectivist fashion, indeed, Menger (1950, p. 160) emphasized in the element of information and the act of will involved in this entrepreneurial function (although, unlike Schumpeter and later Austrians, he saw the exercise of this function as merely a special kind of labor service) during the 1880s his teaching apparently inspired two of his students. Mataja and Gross, each to write his dissertation on the entrepreneurial role. There has been some disagreement among historians of thought concerning the influence exercised by Menger upon subsequent Austrian developments in the theory of entrepreneurship. Streissler (1972, pp. 432f)

has maintained that Schumpeter built his own theory of entrepreneurial innovation largely on Menger's foundations. This seems to contrast sharply with Knight's typically dismissive assessment of the influence of Menger's contribution in this respect. (See also Martin, 1979; Kirzner, 1979, chapter 4, for discussions of Menger's concept of the entrepreneur in the context of the subsequent Schumpeterian and Knightian views). Be this as it may, there seems little ground to doubt that Schumpeter's own emphasis on the entrepreneur was rooted, not his well-known admiration for Walrasian general equilibrium theory, but the subjectivist, Austrian legacy he imbibed from Böhm-Bawerk's seminars.

An assessment by the historian of thought of the state of entrepreneurial theory in the economies of 1914 would recognize the importance of the Austrian contributions, but would certainly not pronounce entrepreneurial theory to be exclusively or even predominantly the providence of the Austrians. The bulk of the prewar literature on entrepreneurship and on entrepreneurial profit was certainly contributed by economists of other schools. Yet general mainstream interest in this bear of this economic theory was to decline sharply following the war. Knight's work would of course represent a magisterial contribution to the identification of the entrepreneurial role and to the understanding of pure entrepreneurial profit. It offered a crystal-clear articulation of the distinction between the utterly certain Walrasian world of perfectly competitive equilibrium and the real world of radical, inescapable uncertainty. But the progress of mainstream neoclassical economics in the succeeding half-century was virtually to ignore the implications of this distinction. Even among Knight's own disciples microeconomics came to mean, in the second half of of [*sic*] the twentieth century, the theory of markets in complete competitive equilibrium, with no possibility of pure profit, and none of the uncertainty which calls forth the special characteristics of the Knightian entrepreneur. It was during this period that understanding of the entrepreneurial role became, if only by default, more or less an exclusively Austrian concern. It was in the economics of Ludwig von Mises that this was most obvious.

Entrepreneurship in mid-twentieth-century Austrian economics

What Mises contributed to the theory of entrepreneurship may not be immediately obvious the superficial reader of his works. Although the index to his *Human Action* (1949) demonstrates the importance of the entrepreneur for Misesian economics, a reader may be excused for concluding that what Mises had to say about the entrepreneur from the was not exactly pathbreaking. The nuances which might separate the Misesian entrepreneur from the Schumpeterian or the Knightian might well appear to be only the marginal significance, but the truth is that it is indeed the role which Mises assigns to the entrepreneur which sets Misesian economics so decisively apart from mainstream mid-twentieth century economics. And the modest revival of the Austrian approach during the two past decades must be seen as recognition of the valuable character of precisely this aspect of the Misesian system.

What sets the Misesian system apart from mainstream neoclassical economics is the Misesian portrayal of *the market as an entrepreneurially driven process*:

The operation of [the factor] market is actuated and kept in motion by the exertion of the promoting entrepreneurs, eager to profit from the differences in the market prices of the factors of production and the expected prices of the products... The activities of the entrepreneurs are the element that would bring about the unrealizable state of the evenly rotating economy if no further changes were to occur... The competition between the entrepreneurs...reflects in the external world the conflict which the inexorable scarcity of the factors of production brings about in the soul of each consumer. It makes effective the subsumed decisions of the consumers as to what purpose the nonspecific factors should be used for and to what extent the specific factors of production should be used. (1947, pp. 331, 335)

It was in the course of the famed inter-war debate on the possibility of economic calculation under socialism Mises's entrepreneurial view of the market process came to be crystallized and subsequently clearly articulated. As Lavoie has emphasized, it was appreciation for the entrepreneurial character of the market process which enabled the Austrians to see the fallacy of quasi-market 'solutions' (such as those of Lange and Lerner) to the calculation problem. This writer has argued that Hayek's important contributions to the calculation debate, although couched in terms of utilization of knowledge rather than in terms of entrepreneurial discovery, ultimately reflect, at least implicitly, a similar understanding of the market process.

In fact the novelty of the Misesian perception of the market as a continuing process of entrepreneurial competition is mute evidence of the drastic decline, in mid-twentieth-century mainstream economic thought, of the awareness of the entrepreneurial role. As Baumol has observed, the entrepreneur had virtually disappeared from the theoretical literature. And it was indeed the Misesian emphasis on the entrepreneurial role which inspired subsequent Austrian interest in the theory of entrepreneurship.

The Misesian entrepreneur further explored

Much of this subsequent Austrian interest has been reflected in the present writer's work seeking to articulate more definitively the essential characteristics of the Misesian entrepreneur, and to demonstrate how central these characteristics must be for an understanding of the competitive process. As one writer has put it, the 'leitmotif' of this work has been that 'the exploitation of the gains from trade will not take place automatically. To achieve the advantages of co-ordination through ex-

change requires first that these potential gains are noticed. The entrepreneurial role is to be “alert” to as yet unexploited gains from trade’ (Ricketts, 1992, p. 67).

Mainstream economics has of course always assumed that exploitation of gains from trade *will* take place automatically, as soon as the gains exceed the relevant costs. This assumes that all opportunities for winning pure gain are instantly perceived and exploited. It follows that the market outcomes, at any given instant, must necessarily be understood as embodying the fulfillment of the most exacting conditions for equilibrium. Each economic agent in the market must, at each instant, therefore be assumed *not* to be grasping for pure profit (since all opportunities for pure profit have *already* been grasped and eliminated). This has forced mainstream microeconomics into a straitjacket in which all decisions being made in the instant are, somehow, automatically fully coordinated (‘pre-reconciled’) with every other decision being made in the system. This has restricted modern microeconomics to strictly defined states of equilibrium. This has, in turn, had the consequence that the notion of *competition* has had to mean, not any process during which competing market participants struggle to get ahead of one another, but a state of affairs which is both unnecessary and inconceivable.

By liberating economics from the assumption that all opportunities for pure gain already have been captured, this Misesian-inspired perspective on markets permits us to see market processes as ones in which such opportunities – hitherto overlooked – come to be perceived and exploited. This has opened up an entirely fresh dimension for economic activity, a dimension necessarily missing from an equilibrium-bound microeconomics. This new dimension is that of entrepreneurial *alertness* and entrepreneurial discovery. Whereas traditional economics has operated in a framework in which outcomes can be attributed to either (a mix of) (a) deliberate maximizing choice, or (b) pure luck, in this entrepreneurial perspective draws our attention to a third possible (and, in general, necessary) source for observed outcomes. This third source is *discovery*, in which unfocused, unspecified, purposefulness, – a generalized intentness upon noticing the useful opportunities that may be present within one’s field of vision – in fact yields discovered opportunities (which may then be subsequently exploited in maximizing choice fashion). Such discovery cannot itself be characterized as rational, maximizing choice (in the way in which deliberate cost-conscious *search* activity has been treated in the theory of information literature) because, prior to the moment of discovery, the potential discoverer is perceived not to have any specific search objective or search procedure in mind and is (therefore) not seen as weighing the likely benefits of a successful find against the costs of necessary search. (In fact his discovery may consist in *realizing* that he *has* before him a promising opportunity for profitable search.) Nor can a discovered opportunity be entirely attributed to pure luck. Although, to be sure, the objective existence of the opportunity itself (prior to its discovery but at a point in space and time likely to result in discovery) may (disregarding the philosophical reservations one may have concerning the ‘existence’ of an unperceived opportunity) be seen as entirely a matter of luck, its discovery must, at least in part, be attributed to the alertness of the discoverer.

The notion of entrepreneurship as the alertness necessary for the discovery of opportunities has had important implications for the positive understanding of market processes, and for ethical judgments concerning the moral status of market outcomes. The positive theory of the competitive market process has come, in this line of modern Austrian economics, to mean the sequence of market trades and acts of production which can be attributed to the succession of entrepreneurial discoveries generated by disequilibrium conditions. To compete means, in this framework, to perceive an opportunity to serve the market better (than it is currently being served by one’s competitors). This view of the function of the entrepreneur has been central to the modern Austrian appreciation of free markets, and to its understanding of the perils of interventionist public policies.

These Austrian insights concerning the role of entrepreneurial discovery have also revealed the *discovered* character of pure entrepreneurial profit. This has permitted an ethical view of the possible justice of such profit in a manner not open to mainstream economics (for which pure profit is likely to appear enjoyed by the entrepreneur strictly as a matter of his good luck). This insight has been explored in Kirzner (1989).

Entrepreneurship: some contemporary Austrian debates

Although the central features of a Misesian entrepreneurship are, by and large, accepted within modern Austrian economics, certain features emphasized in this writer’s expositions of it (as outlined in the preceding section) have been challenged during recent years by a number of Austrian economists, as well as by others. (One line of modern Austrian work, *not* dealt with in this section, is that identified with the late Ludwig Lachmann. That work has sharply questioned the equilibrative character of entrepreneurship which is central to the Misesian view.) We may group these debates around two related themes.

Creativity

The ‘alertness’ view of entrepreneurship appears to separate entrepreneurship from any genuinely creative activity. To be alert to an opportunity would appear not to include anything except noticing that which is *already* fully developed, merely waiting to be grasped. A number of modern Austrians have been unhappy with such implications. See also Ricketts (1992).

Uncertainty

The ‘alertness’ view of entrepreneurship has been understood by its critics effectively to abstract from uncertainty. To define entrepreneurship in terms of *seeing* opportunities, it is held by the critics, seems to identify it exclusively with success: to define it in terms apparently impervious to the very possibility of entrepreneurial loss. Yet surely such possibility of loss cannot be separated from the exercise of entrepreneurship. As soon as entrepreneurship is extended from simultaneous arbitrage to intertemporal arbitrage, uncertainty inevitably enters the picture. All this has suggested to the critics that the essence of entrepreneurship be sought in such qualities as *imagination* (White, 1976) or *judgement* (High, 1982).

In his more recent writings the present writer has attempted to meet some of these criticisms. He has of course agreed that uncertainty is inseparable from the entrepreneurial function in the context of ongoing time; so that it is indeed the case that the futurity of entrepreneurial activity must entail both judgement and imagination. Entrepreneurial alertness, in regard to opportunities the profitability of which lies in the future, cannot be exercised without imagination of that which does not yet exist, and without judgement concerning which of today’s active forces is likely, in the course of time, to dominate the others. To concur warmly in these valid and important observations is not, however, to retreat from the insight that the essence of all entrepreneurial action is the perception of opportunities – offering profit in the present, the near future, or the distant future. To recognize that alertness in a world of uncertainty may call for good judgement and lively imagination does not, surely, affect the centrality of the insight that entrepreneurship refers, not to the deliberate exploitation of perceived opportunities, but to the alert perception of opportunities available for exploitation.

Rather similar considerations relate to the criticisms which see the emphasis on alertness as being blind to the role of creativity in the entrepreneurial role. Surely, such criticisms run, what the entrepreneur does, in so many cases, is not so much to perceive a given opportunity as to imaginatively *create* that which nobody had hitherto dreamed of. To such criticisms it seems appropriate to respond that, while the opportunity to be discovered is often indeed opportunity to be created, this truth should not obscure the more fundamental insight is simply that for any entrepreneurial discovery creativity is never enough; it is necessary to *recognize* one’s own creativity. In other words, an essential ingredient in each successful creative innovation is it’s innovator’s vision of what he can creatively accomplish.

The point in these responses in the critics is that, while the entrepreneur operates under uncertainty, and therefore displays imagination, judgement and creativity, his role is not so much the *shouldering* of uncertainty as it is his ability to *shoulder uncertainty aside* through recognizing opportunities in which imagination, judgement and creativity can successfully manifest themselves.

Austrian economics and the entrepreneurial role

The centrality of the entrepreneur in Austrian economics, virtually since its inception in 1871, appears to be no accident. If one accepts *subjectivism* as being the unifying thread which has characterized the Austrian economic tradition throughout its history, then the centrality of the entrepreneurship seems eminently understandable. Mainstream economics, with a lesser emphasis on subjectivism, has been prone to presuming that the mere objective presence of the possibilities for gains from trade is sufficient to ensure their exploitation. Economic agents are presumed to maximize in terms of the opportunities which exist, without any concerning regarding any possible gap between the opportunities which exist and the opportunities which are perceived to exist. Market prices are interpreted as the outcomes consistent with a state of the world in which all market participants are maximizing in respect of the opportunities objectively inherent in the actions of all their fellow participants. There is no need, in such an analytical scheme, for any role specifically geared to ensuring that the opportunities perceiving in fact tend to correspond to what is objectively available. There is no need for any role specifically geared to explaining any process through which market outcomes might tend to come to express actual (as against possibly erroneously perceived) mutual possibilities – since no possibility of such a gap is entertained.

It is in a consciously subjectivist mode of analysis, such as that of the Austrian tradition, in which the possibility is taken seriously that agents may be seeking to maximize within erroneously perceived frameworks, that scope for entrepreneurship can easily come to be recognized. Within such a tradition an emphasis upon knowledge and ignorance, imagination and discovery has indeed emerged naturally and organically. Despite the changes over time in Austrian entrepreneurial constructs, and despite contemporary Austrian marginal disagreements concerning the essential entrepreneurial functions, it seems reasonable to attribute the perennial Austrian interest in the entrepreneur to the tradition’s consistent subjectivist thrust.

Socialism

[One of the principal tenets in Austrian economics is the critique of socialist systems. Rothbard’s expertise as an economic historian is nowhere better demonstrated than in his analysis of the development of Marxian thought, where he masterfully weaves together historical, economic, and theological facts. Murray N. Rothbard (1990), Karl Marx: Communist as Religious Eschatologist”, *The Review of Austrian Economics*, vol. 4, pp. 123-179].

[pp. 123-124] **Marx as Millennial Communist**

The key to the intricate and massive system of thought creative by Karl Marx is at bottom a simple one: *Karl Marx was a communist*. A seemingly trite and banal statement set alongside Marxism's myriad of jargon-ridden concepts in philosophy, economics, and culture, yet Marx's devotion to communism was his crucial focus, far more central than the class struggle, the dialectic, the theory of surplus value, and all the rest. Communism was the great goal, the vision, the desideratum, the ultimate end that would make the sufferings of mankind throughout history worthwhile. History is the history of suffering, of class struggle, of the exploitation made by man by man. In the same as the return of the Messiah, in Christian theology, will put an end to history and establish a new heaven and a new earth, so the establishment of communism would put an end to human history. And just as for post-millennial Christians, man, led by God's prophets and saints, will establish a Kingdom of God on Earth (for pre-millennials, Jesus will have many human assistants in setting up such a kingdom), so, for Marx and other schools of communists, mankind, led by a vanguard of secular saints, will establish a secularized Kingdom of Heaven on earth.

In messianic religious movements, the millennium is invariably established by a mighty, violent upheaval, an Armageddon, a great apocalyptic war between good and evil. After this titanic conflict, a millennium, a new age, of peace and harmony, of the reign of justice, will be installed upon the earth.

Marx emphatically rejected those utopian socialists who sought to arrive at communism through a gradual and evolutionary process, through a steady advancement of the good. Instead, Marx harked back to the apocalyptics, the post-millennial coercive German and Dutch Anabaptists of the sixteenth century, to the millennial sects during the English Civil War, and to the various groups of pre-millennial Christians who foresaw a bloody Armageddon at the last days, before the millennium could be established. Indeed, since the apocalyptic post-mills refused to wait for a gradual goodness and sainthood to permeate mankind, they joined the pre-mills in believing that only a violent apocalyptic final struggle between good and evil, between saints and sinners, could usher in the millennium. Violent, worldwide revolution, in Marx's version, to be made by the oppressed proletariat, would be the inevitable instrument for the advent of his millennium, communism.

In fact, Marx, like the pre-mills (or "millenarians"), went further to hold that the reign of evil on earth would reach a peak just before the apocalypse ("the darkness before the dawn").

[pp. 126-127] Not realizing that what Marx really meant has no necessary connection with what Marx undeniably said. To witness Marx surrounded by his friends is, however, a joy of an entirely different order. For it is fairly clear that none of them really knows what Marx really meant; they are even in considerable doubt as to what he is talking about; there are hints that Marx himself did not know what he is doing.

[p. 127] Perhaps the mistake the world and most of the critics have made is just that they have not sufficiently regarded Marx as a prophet—a man above logic, uttering cryptic and incomprehensible words, which every man may interpret as he chooses.

[pp. 129-130] But the Way Out offered by the reabsorptionists is different. First, it is a way offered only to man-as-species and not to any particular individuals; and second, the way is a religiously determined and inevitable Law of History. For there is one good aspect of creation, for the reabsorptionists: that God and man each get to fulfill their faculties and expand their respective potentials through history. In fact, history is a process in which these potentials are fulfilled, in which God and man both perfect themselves. Then, finally, and here we come to *eschatology*, the science of the Last Days, there will eventually be a mighty reunion, a reabsorption, in which man and God are at last not only reunited, but reunited on a higher, on a perfected level. The two cosmic blobs—God and man (and presumably Nature, too)—now meet and merge on a more exalted level. The painful state of creation is now over, alienation is at last ended, and man returns Home to be on a higher, post-creation level. History, and the world, have come to an end.

A crucial feature of reabsorption is that all this "perfecting" and "reuniting" obviously takes place only on a species-collectivist level. The individual man is nothing, a mere cell in the great collective organism man; only in that way can we say that "man" progresses or fulfills "himself" over the centuries, suffers alienation from "his" pre-creation state, and finally "returns" to unity with God on a higher level. The relation of the Marxian goal of communism is already becoming clear; the "alienation" eliminated by the inevitable communist end of history is that of the collective species man, each man finally being united with other men and with Nature (which, for Marx, was "created" by the collective species man, who thereby replaces God as the creator).

[p. 135] It is easy to see how the reabsorptionist-Hegelian doctrine of unity-good, separation-bad, helped form the Marxian goal of communism, the end-state of history in which the individual is totally absorbed into the collective, thus attaining the state of true collective-man "freedom." But there are also more particular influences. Thus, the Marxian idea of early or primitive communism, happy and integrated though undeveloped, and then burst apart by rapacious, alienated if developing capitalism, was prefigured by Hegel's historical outlook. Following his friend and mentor the Romantic writer Friedrich Schiller, Hegel, in an article written in 1795, lauded the alleged the homogeneity, harmony, and unit of ancient Greece, supposedly free of the alienated division of labor. The consequent *aufhebung*, though leading to the growth of commerce, living

standards, and individualism, also destroyed the wonderful unity of Greece and radically fragmented man. To Hegel, the next inevitable stage of history would reintegrate man and the State.

The State was critical for Hegel. Again foreshadowing Marx, it is now particularly important for man—the collect organism—to surmount unconsciousness blind fate, and “consciously” to take control of his “fate” by means of the State.

Hegel was quite insistent that, in order for the State to fulfill its vital function, it must be guided by a comprehensive philosophy, and indeed by a Great Philosopher, to give its mighty rule the necessary coherence. Otherwise, as Professor Plant explains, “such a state, devoid of philosophical comprehension, would appear as merely arbitrary and oppressive imposition of the freedom of individuals.” But, on the contrary, if armed with Hegelian philosophy and with Hegel himself as its great leader, “this alien aspect of the progressive modern state would disappear and would not be seen as an imposition but a development of self-consciousness.”

Armed, then, with such philosophy and such a philosopher, the modern, especially the modern Prussian, State could take its divinely-appointed stand at the apex of human history and civilization, as God on earth. Thus: “The modern State, ... when comprehended philosophically, could therefore be seen as the highest articulation of Spirit, or God in the contemporary world.

[p. 155] It is instructive to understand the attitude of all Marxist historians toward Münster and the other millennialist movements of the early sixteenth century. The Marxists have always understandably lauded these movements and regimes, (a) for being communist, and (b) for being revolutionary movements from below. Marxists have invariably hailed these movements as forerunners of their own.

[pp. 163-164] The 1830s and 1840s saw the burgeoning of messianic and chiliastic communist and social groups throughout Europe: notably in France, Belgium, Germany and England. Owenites, Cabetists, Fourierists, Saint Simonians, and many others sprouted and interacted, and we need not examine them or their nuanced variations in detail. While the Welshman Robert Owen was the first to use the word “socialist” in print in 1827, and also toyed with “communionist” the new word “communist” finally caught on as the most popular label for the new system. It was first used in popular printed work in Etienne Cabet’s utopian novel, *Voyage in Icaria* (1839), and from there the word spread like wildfire across Europe, spurred by the recent development of a regular steamboat mail service and the first telegraphy. When Marx and Engels, in the famous opening sentence of their *Communist Manifesto* of 1848, wrote that “A spectre is haunting Europe—the spectre of Communism,” this was a bit of a hyperbolic rhetoric, but still not far off the mark. As Billington writes, the talismanic word “communism” “spread throughout the continent with a speed altogether unprecedented in the history of such verbal epidemics.

[pp. 170-171] In contrast to the non-militant variety, which expresses a simple disbelief in God’s existence, but to hate Him and wage war for His destruction. Such a spirit was all too clearly revealed in the retort of militant atheist and anarcho-communist Bakunin to the famous pro-theist remark of Voltaire: “If God did not exist, it would be necessary to create Him.” To which the demented Bakunin retorted: “If God did not exist, it would be necessary to destroy Him.” It was this hatred of God as creator greater than himself that apparently animated Karl Marx.

When Marx came to the University of Berlin, the heart of Hegelianism, he found the doctrine regnant but in a certain amount of disarray. Hegel had died in 1831; the Great Philosopher was supposed to bring about the end of History, but now Hegel was dead, and History continued to march on. So if Hegel himself was not the final culmination of history, then perhaps the Prussian State of Friedrich Wilhelm III was not the final stage of history either. But if he was not, then mightn’t the dialectic of history be getting ready for yet another twist, another *aufhebung*?

So reasoned groups of radical youth, who, during the late 1830s and 1840s in Germany and elsewhere, formed the movement of the Young, or Left, Hegelians. Disillusioned in the Prussian State, the Young Hegelians proclaimed the inevitable coming apocalyptic revolution that would destroy and transcend that State, a revolution that would *really* bring about the end of history in the form of national, or world, communism. After Hegel, there was one more twist of the dialectic to go.

[pp. 175-177] In short, in the stage of communalization of private property, what Marx himself considers the worst features of private property will be maximized. Not only that: but Marx concedes the truth of the charge of anti-communists then and now that communism and communization is but the expression, in Marx’s words, of “envy and a desire to reduce all to a common level.” Far from leading to a flowering of human personality, as Marx is supposed to claim, he admits that communism will negate that personality totally. Thus Marx:

In completely negating the *personality* of man, this type of communism is really nothing but the logical expression of private property. General *envy*, constituting itself as a power, is the disguise in which *greed* reestablishes itself and satisfies itself, only in *another way*. ... In the approach to *woman* as the spoil and handmaid of communal lust is expressed the infinite degradation in which man exists for himself.

Marx clearly did not stress this dark side of communist revolution in his later writings. Professor Tucker explains that “these vivid indications from the Paris manuscripts of the way in which Marx envisaged and evaluated the immediate post-

revolutionary period very probably explain the extreme reticence that he always later showed on this topic in his published writings.”

But if this communism is admittedly so monstrous, a regime of “infinite degradation,” why should anyone favor it, much less dedicate one’s life and fight a bloody revolution to establish it? Here, as so often in Marx’s thoughts and writings, he falls back on the mystique of the “dialectic”—that wondrous magic wand by which one social system inevitably gives rise to its victorious transcendence and negation. And in this case, by which total evil—which turns out, interestingly enough, to be the post-revolutionary dictatorship of the proletariat and *not* previous capitalism—becomes transformed into total good, a never-never land absent the division of labor and all other forms of alienation. The curious point is that while Marx attempts to explain the dialectic movement from feudalism to capitalism and from capitalism to the first stage of communism in terms of class struggle and the productive material forces, both of these drop out once raw communism is achieved. The allegedly inevitable transformation from the hell of raw communism to the alleged heaven of higher communism is left totally unexplained; to rely on *that* crucial transformation, we must fall back on pure faith in the mystique of the dialectic.

Despite Marx’s claim to be a “scientific,” scorning all other Socialists whom he dismissed as moralistic and “utopian” it should be clear that Marx himself was even more in the messianic utopian tradition than were the competing “Utopians.” For Marx not only sought a desired future society that would put an end to history he claimed to have found the path toward that utopia inevitably determined by the “laws of history.”

But a utopian, and a fierce one, Marx certainly was. A hallmark of every utopia is a militant desire to put an end to history, to freeze mankind in a static state, to put an end to diversity and man’s free will, and to order everyone’s life in accordance with the utopian’s totalitarian plan. Many early communists and socialists set forth their fixed utopias in great and absurd detail, determining the size of everyone’s living quarters, the food they would eat, etc. Marx was not silly enough to do that, but his entire system, as Professor Thomas Molnar points out, is “the search of the utopian mind for the definitive stabilization of mankind or, in gnostic terms, its reabsorption into the timeless.” For Marx, his quest for utopia was, as we have seen, an explicit attack on God’s creation and a ferocious desire to destroy it.

[p. 178] In this allegedly inevitable process, of arriving at the proletarian communist utopia after the proletarian class become conscious of its true nature, what is supposed to be Karl Marx’s own role? In Hegelian theory, Hegel himself is the final and greatest world-historical figure, the Man-God of man-gods. Similarly, Marx in his own view stands at a focal point of history as the man who brought to the world the crucial knowledge of man’s true nature and of the laws of history, thereby serving as the “midwife” of the process that would put an end to history.

Interventionism

[Like the critique of socialism, Austrians saw grave economic dangers in practicing interventionist policy. Rothbard has done a lot with respect to this issue, demonstrating that consumption taxes are no better than any other kind of taxes. Murray N. Rothbard (1994), “The Consumption Tax: A Critique”, *The Review of Austrian Economics*,].

[pp. 76-77] One reason, therefore, that an economist cannot claim that the income tax, or any other tax, is better from the point of view of the taxed person, is that total revenue collected is often a function of the type of tax imposed. And it would seem, that from the point of view of the taxed person, the less extracted from him the better. Even indifference curve analysis would have to confirm that conclusion. If someone wishes to claim that a taxed person is disappointed at how *little* tax he is asked to pay, that person is always free to make up the alleged deficiency by making a voluntary gift to the bewildered but happy taxing authorities.

A second insuperable problem with an economist’s recommending any form of tax from the alleged point of view of the taxee, is that the taxpayer may well have particular subjective evaluation of the form of tax, apart from the total amount levied. Even if the total revenue extracted from him is the same for tax A and tax B, he may have very different subjective evaluations of the two taxing processes. Let us return, for example, to our case of the income as compared to an excise tax. Income taxes are collected in the course of a coercive and even brutal examination of virtually every aspect of every taxpayer’s life by the all-seeing, all-powerful Internal Revenue Service. Each taxpayer, furthermore, is obliged by law to keep accurate records of his income and deductions, and then, painstakingly and truthfully, to fill out and submit the very forms that will tend to incriminate him into tax liability. An excise tax, say on whiskey or on movie admissions, will intrude directly on no one’s life and income, but only into the sales of the movie theater or liquor store. I venture to judge that, in evaluating the “superiority” or “inferiority” of different modes of taxation, even the most determined imbibor or moviegoer would cheerfully pay far higher prices for whiskey or movies than neoclassical economists contemplate, in order to avoid the long arm of the IRS.

[p. 79] Let us now consider the merits or demerits of a consumption as against an income tax, setting aside the question of bureaucratic power. It should be first noted that the consumption tax and the income tax each carry distinct philosophical implications. The income tax rests necessarily on the ability-to-pay principle, namely the principle that if a goose has more feathers the more ripe it is for the plucking. The ability-to-pay principle is precisely the creed of the highwayman, of taking

where the taking is good, of extracting as much as the victims can bear. The ability-to-pay principle is the philosophical embodiment of the memorable answer of Willie Sutton when he was asked, perhaps by psychological social worker, why he robbed banks. "Because," answered Willie, "that's where the money is."

The consumption tax, on the other hand, can only be regarded as a payment for permission-to-live. It implies that man will not allowed to advance or even sustain his own life, unless he pays, off the top, a fee to the State for permission to do so. The consumption tax does not strike me, in its philosophical implications, as one whit more noble, or less presumptuous, than the income tax.

[pp. 87-88] We conclude with the observation that there has been far too much concentration on the *form*, the type of taxation, and not enough on its total amount. The result has been endless tinkering with *kinds* of taxes, coupled with neglect of a far more critical question: *how much* of the social product should be siphoned away from the producers? Or, how much income should be retained by the producers and how much income and resources coercively diverted for the benefit of non-producers?

It is particularly odd that economists who proudly refer to themselves as advocates of the free market have in the recent years led the way in this mistaken path. It was allegedly free market economists for example, who pioneered in and propagandized for, the alleged Tax Reform Act of 1986. This massive change was supposed to bring us "simplification" of our income taxes. The result, of course, was so simple that even the IRS, let alone the fleet of tax lawyers and tax accountants, has had great difficulty in understanding the new dispensation.

[p. 90] J. B. Say's policy recommendation was crystal clear and consistent with his analysis and that of the present paper. "The best scheme of [public] finance is, to spend as little as possible; and the best tax is always the lightest." What conclusion can be more fitting for April 15?

[Kirzner has prepared a good synopsis of how the economic calculation debate solidified the main differences between the Austrian School and mainstream neoclassical (or socialist) economics. Israel M. Kirzner (1988), "The Economic Calculation Debate: Lessons for Austrians", *Review of Austrian Economics*, vol. 2, no. 1, pp. 1-18, and reprinted as chapter 6 of his book, *The Meaning of Market Process*, New York: Routledge, 1992, pp. 100-118].

[p. 10] Between 1932 and 1940, however, the eyes of Mises and Hayek were, at least partially, opened. The work of the socialist economists, particularly Durbin, Dickinson, Lange, and Lerner, was based on an understanding of how the market system works, which revealed and expressed primacy of equilibrium in the workings of that system. In confronting the arguments of these writers, based on this understanding, that a nonmarket price system can be devised for the socialist economy, Mises and Hayek felt called upon to draw attention to the primacy of the entrepreneurial/competitive process that they themselves associated with the market system.

Certainly, the mathematicization of mainstream microeconomics that was occurring (as Walrasian ideas became merged with the Marshallian tradition) during this period helped crystallize the equilibrium emphasis that came to characterize the mainstream theory. What helped crystallize the process emphasis of the Austrians was the dramatic use made by the socialist economists of mainstream price theory, to refute the Misesian challenge—a challenge that Mises had believed to be based solidly on that very mainstream theory of price. It was this confrontation, one now sees, that provided much of the impetus for Mises' repeated attacks, in later years, against the misuse of mathematics in economics, the misuse of equilibrium analysis, and the misunderstandings embodied in mainstream treatments of competition and monopoly.

It would be a mistake to suppose that the crystallization of Austrian process view was completed by the early forties. In the writings of neither Mises or Hayek were the differences between their own approach and that of the neoclassical mainstream clearly stated. I can attest to the difficulties that the graduate student studying under Mises in the midfifties had in achieving a clear understanding of precisely what separated the two approaches. It was extremely tempting at that time to set down the Mises-Hayek approach as simply old-fashioned, imprecise, and nonrigorous. In helping the student appreciate the foundations of the Austrian approach, Hayek's papers cited in the preceding section were especially helpful. But the gradually achieved clarification of the Austrian process approach—a clarification still not completed—can be traced back unerringly to those first reactions by Mises and Hayek to the contentions of the brilliant socialist writers of the thirties.

[p. 12] Yet as early as 1937, Hayek was already beginning to draw attention to the economic problem raised by dispersed knowledge. He asserted that the "central question of all social sciences [is]: How can the combination of fragments of knowledge existing in different minds bring about results which, if they were to be brought about deliberately, would require a knowledge on the part of the directing which no single person can possess?" In 1940, Hayek applied this insight to criticize the socialist economists in the calculation debate. The "main merit of real competition [is] that through its use is made of knowledge divided between many persons which, if it were to be used in a centrally directed economy, would all have to enter the single plan." But it was in 1945 that Hayek emphatically denied what he had himself apparently previously accepted—that the economic problem facing society was that of achieving the solution to an optimum problem, that of achieving the best use of society's available means:

The economic problem of society is thus not merely a problem of how to allocate “given” resources—if “given” is taken to mean given to a single mind which deliberately solves the problem set by these “data.” It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge which is not given to anyone in its totality.

[The fall of communism in Eastern Europe showed that Mises, Hayek, and other Austrians had been right all along, and Rothbard was keen to recapitulate the victory. He gives a synopsis of the debate and keys in on the main fallacies and the men who promoted the, suggesting in the end that formerly communist nations should take their cue in policies of privatization from the Austrians rather than the mainstream, and many economists in those countries are doing just that. Murray N. Rothbard (1991), “The End of Socialism and the Calculation Debate Revisited”, *Review of Austrian Economics*, vol. 5, no. 2, pp. 51-76].

[pp. 51-53] At the root of the dazzling revolutionary implosion and collapse of socialism and central planning in the “socialist bloc” is what everyone concedes to be a disastrous economic failure. The peoples and the intellectuals of Eastern Europe and the Soviet Union are crying out not only for free speech, democratic assembly, and *glasnost*, but also for private property and for free markets. And yet, if I may be pardoned a moment of nostalgia, for-and-a-half-decades ago, when I entered graduate school, the economics Establishment of that era was closing the book on what had been two decades the famed “socialist calculation debate.” And they had all decided, left, right, and center, that there was not a thing economically wrong with socialism: that socialism’s only problems, such as they might be, were *political*. Economically, socialism could work just as well as capitalism.

Mises and the Challenge of Calculation

Before Ludwig von Mises raised the calculation problem in his celebrated article in 1920, everyone, socialists and non-socialists alike, had long realized that socialism suffered from an *incentive problem*. If, for example, everyone under socialism were to receive an equal income, or, in another variant, everyone was supposed produce “according to his ability” but receive “according to his needs,” then, to sum it up in the famous question: Who, under socialism, will take out the garbage? That is, what will be the incentive to do the grubby jobs, and, furthermore to do them well? Or, to put it another way, what would be the incentive to work hard and be productive *at any job*?

The traditional socialist answer held that the socialist society would transform human nature, would purge it of selfishness, and remold it to create a New Socialist Man. That new man would be devoid of any selfish, or indeed any self-determined, goals; his only wish would be to work as hard and as eagerly as possible to achieve the goals and obey the orders of the socialist State. Throughout the history of socialism, socialist *ultras*, such as the early Lenin and Bukharin under “War Communism,” and later Mao Tse-tung and Che Guevara, have sought to replace material by so-called “moral” incentives. This notion was properly and wittily ridiculed by Alexander Gray as “the idea that the world may find its driving force in a Birthday Honours List (giving to the King, if necessary, 165 birthdays a year). At any rate, the socialists soon found that voluntary methods could hardly yield them the New Socialist Man. But even the most determined and bloodthirsty methods could not avail to create this robotic New Socialist Man. And it is a testament to the spirit of freedom that cannot be extinguished in the human breasts that the socialists continued to fail dismally, despite decades of systemic terror.

But the uniqueness and the crucial importance of Mises’s challenge to socialism is that it was totally unrelated to the well-known incentive problem. Mises in effect said: All right, suppose that the socialists have been able to create a mighty army of citizens all willing to do the bidding of their masters, the socialist planners. What exactly would those planners tell their army to do? How would they know what products to order their eager slaves to produce, at what stage of production, how much of the product at each stage, what techniques or raw material to use in that production and how much of each, and where specifically to get all this production? How would they know their costs, or what process of production is or is not efficient?

Mises demonstrated that, in any economy more complex than the Crusoe or primitive family level, the socialist planning board would simply not know what to do, or how to answer any of these vital questions. Developing the momentous concept of *calculation*, Mises pointed out that the planning board could not answer these questions because socialism would lack the indispensable tool that private entrepreneurs use to appraise and calculate: the existence of a market in the means of production, a market that brings about money prices based on genuine profit-seeking exchanges by private owners of these means of production. Since the very essence of socialism is collective ownership of the means of production, the planning board would not be able to plan, or to make any sort of rational economic decisions. Its decisions would necessarily be completely arbitrary and chaotic, and therefore the existence of a socialist planned economy is literally “impossible” (to use a term long ridiculed by Mises’s critics).

[p. 54] The Lange-Bergson Orthodox Line went about as follows: Mises, in 1920, had done an inestimable service to socialism by raising the problem of economic calculation, a problem which socialists had not generally been aware. Then Pareto and his Italian disciple Enrico Barone had shown that Mises’s charge, that socialists calculation was impossible, was incorrect, since the requisite number of supply, demand, and price equations existed under socialism as under a capitalist system. At that point, F. A. Hayek and Lionel Robbins, abandoning Mises’s extreme position, fell back on a second line of de-

fense; that, while the calculation problem could be solved *theoretically*, in practice it would be too difficult. Thereby Hayek and Robbins fell back on a practical problem, or one of degree of efficiency rather than of a drastic difference in kind. But now, happily, the day has been saved for socialism, since Taylor-Lange-Lerner have shown that, by jettisoning utopian ideas of a money-less or price-less socialism, or of pricing according to a labor theory of value, the socialist Planning Board can solve these pesky equations simply by the good old capitalist method of trial and error.

[pp. 56-57] Set aside the obvious absurdity of trusting a coercive governmental monopoly to act somehow as if it were in “perfect competition” with parts of itself. Another grievous flaw in the Lange model is thinking that general equilibrium, a world of certainty where there is no room for the driving force of entrepreneurship, can somehow be used to depict the real world. The actual world is one not of changeless “givens” but of incessant change and systemic uncertainty. Because of this uncertainty, the capitalist entrepreneur, who stakes assets and resources in attempting to achieve profits and avoid losses, become the crucial actor in the economic system, an actor who can in no way be portrayed by a world of general equilibrium. Furthermore, it is lubricous, as Hayek pointed out, to think of general equilibrium as the only legitimate “theory,” with all other areas or problems dismissed as mere matters of practicality and degree. No economic theory worth its salt can be worthwhile if it omits the role of the entrepreneur in an uncertain world. The Pareto-Barone-Lange, etc. “equations” is not simply excellent theory that faces problems in practice; for in order to be “good,” a theory must be useful in explaining real life.

Another grave flaw in the Lange-Taylor trial-and-error approach is that it concentrates on consumer good pricing. It is true that retailers, given the stock of a certain type of good upward or downward. But, as Mises pointed out in his original 1920 article, consumers goods are not the real problem. Consumers, these “market socialists” are postulating, are free to express their values by using money they had earned on a range of consumers’ goods. Even the labor market—at least in principle — can be treated as a market with self-owning suppliers who are free to accept and reject bids for their labor and to move to different occupations. The real problem, as Mises has insisted from the beginning, is in all the intermediate markets for land and capital goods. Producers have to use land and capital resources to decide what the stocks of the various consumer goods should be. Here there are a huge number of markets where the State monopoly can only be buyer and seller for each transaction, and these intra-monopoly, intra-state transactions permeate the most vital markets of an advanced economy—the complex lattice-work of the capital markets. And here is precisely where calculational chaos necessarily reigns, and there is no way for rationality to intrude on the immense number of decisions on the allocation of prices and factors of production in the structure of capital goods.

[p. 63] Mises points out that while the government may be able to know what ends it is trying to achieve, and what goods are most urgently needed, it will have no way of knowing the other crucial element required for rational economic calculation: valuation of the various means of production, which the capitalist market can achieve by the determination of money prices for all products and their factors.

Mises concludes that, in the socialist economy “in place of the economy of the ‘anarchic’ method of production, recourse will be had to the senseless output of an absurd apparatus. The wheels will turn, but will run to no effect.

[p. 66] It is no accident, in short, that Hayek and the Hayekians dropped Mises’s term “impossible” as embarrassingly extreme and imprecise. For Hayek, the major problem for the socialist planning board is its lack of *knowledge*. Without a market, the socialist planning board has no means of knowing the value-scales of the consumers, or the supply of resources or available technologies. The capitalist economy is, for Hayek, a valuable means of disseminated knowledge from one individual to another through the pricing “signals” of the free market. A static, general equilibrium economy would be able to overcome the Hayekian problem of dispersed knowledge, since eventually all data would come to be known by all, but the ever-changing, uncertain data of the real world prevents the socialist planning board from acquiring such knowledge. Hence, as is usual for Hayek, the argument for the free economy and against statism rests on an argument from ignorance.

But to Mises the central problem is not “knowledge”. He explicitly points out that *even if* the socialist planners knew perfectly, and eagerly wished to satisfy, the value priorities of the consumers, and *even if* the planners enjoyed a perfect knowledge of all resources and all technologies, they *still* would not be able to calculate, for lack of a price system of the means of production. The problem is not knowledge, then, but calculability.

[p. 72] Lange’s naive enthusiasm for the magical planning qualities of the computer in its early days can only be considered a grisly joke to the economists and the people in the socialist countries who have seen their economies go inexorably from bad to far worse despite the use of computers. Lange apparently never became familiar with the computer adage, *GIGO* (“garbage in, garbage out”). Nor could he have become familiar with the recent estimate of a top Soviet economist that, even assuming that the planning board and its computers could learn the correct data, it would take even the current generation of computers 30,000 years to process the information and allocate the resources.

[pp. 75-76] Curiously enough, Lange, during his years as socialist planner in Poland, never got around to erecting the statue to Mises at the Ministry of Socialization in Warsaw. Perhaps socialist planning was not successful enough to accord

Mises that honor—or perhaps there were not enough resources to build the statue. In any case, the opportunity has been lost. The countries of Eastern Europe now stand in the rubble wrought by what used to be called in the 1930s “the great socialist experiment.” Emerging gloriously out of the rubble of the collapse of socialism are a myriad of Misesian economists, to whom socialism is little more than a grisly joke. Even as early as the 1960s it was a common quip among economists that, at international economic conferences, “the Western economists talk about the glories of planning while the eastern economists talk about the virtues of free market.” Now Misesian economists are springing out of the ruins of socialism in Poland, Lithuania, Czechoslovakia, Hungary, Yugoslavia (especially Croatia and Slovenia) and the Soviet Union. Neither socialist planning nor Marxism-Leninism hold any charms for the economists of the once-socialist nations.

In all of these countries, the giant statues of Lenin are being unceremoniously toppled from the public squares. Whether or not the coming free societies of Eastern Europe choose to replace them with statues of Ludwig von Mises, as the prophet of their liberation, one thing seems certain: there will be no statues erected to Oskar Lange in Cracow or Warsaw. It is hard to see how even cunning of Reason and the Hegelian dialectic can make Lange out to be a prophet or an important contributor to the laissez-faire Polish economy of the future. Perhaps the closest approach was a bitter quip pervading Eastern Europe during the revolutionary year in 1989: “Communism can be defined as the longest route from capitalism to capitalism.”

[One of the dominant ideas in Kirzner’s work has been the application of Hayek’s “knowledge problem”, i.e. the idea that social knowledge is so dispersed and fragmented that central planners cannot hope to acquire enough knowledge to successfully plan an economy by central committee. In this paper, Kirzner applies this theme, demonstrating that social welfare analysis via Paretian optimality schemes is futile, also noting that the corollary notion of society as an economic actor with preferences is specious. Israel M. Kirzner (1988), “Welfare Economics: A Modern Austrian Perspective”, Walter Block and Lew Rockwell, eds., *Man, Economy, and Liberty: Essays in Honor of Murray N. Rothbard*, Ludwig von Mises Institute: Auburn, Alabama, and reprinted as chapter 11 of his book, *The Meaning of Market Process*, New York: Routledge, 1992, pp. 180-192].

[pp. 180-183] Among the most notable of Murray Rothbard’s many contributions to the literature of modern Austrian economics is surely the major paper on utility and welfare theory that he wrote for the 1956 Mises Festschrift (Rothbard 1956). This writer can personally attest to the excitement engendered by the lucid manner in which this paper deployed Austrian insights to illuminate fundamental theoretical issues (concerning which contemporary economics was floundering) and by the characteristic edition which Rothbard poured into that single essay. Whether not one fully accepted Rothbard’s conclusions, it was impossible not to glimpse the power of Misesian thinking which that paper so excellently exemplified. The present chapter, written thirty years later, seeks to re-examine a small part of the terrain covered by Rothbard’s essay. In offering a modern Austrian perspective on welfare economics we shall be emphasizing some of the basic Austrian tenets that Rothbard so rightly insisted on thirty years ago. While our perspective may not entirely dovetail with some of Rothbard’s conclusions, we venture to hope that our observations concerning welfare economics be judged to be in the same subjectivist, methodologically individualistic tradition that Rothbard’s work has so valuably carried forward for so many years.

Some Observations Concerning Welfare Economics

Welfare economics, in its numerous incarnations, has sought to offer criteria by which it might be possible scientifically to evaluate the economic merits of specific institutions, pieces of legislation or events. Such evaluation would have to transcend the narrow economic concerns of specific individuals whose interests might be involved, and to express, somehow, a perspective flowing from the economic interests of all individuals in society. As we shall see, Austrian economists have been particularly sensitive to all the difficulties that must beset such an undertaking. Indeed, many of the difficulties have been recognized again and again by the economic profession at large, and it is for these reasons, of course, that welfare economics has undergone so many attempted reconstructions ‘from the ground up’.

We shall briefly survey the more important of these attempts from a perspective that seeks consistently to apply the following (related) Austrian concerns.

1. Methodological individualism: we shall refuse to recognize meaning in statements concerning the ‘welfare of society’ that cannot, in principle, be unambiguously translated into statements concerning the individuals in society (in a manner which does not do violence to their individuality).
2. Subjectivism: we shall not be satisfied with statements that perceive the economic well-being of society as expressible in terms (such as physical output) that are unrelated to the valuations and choices made by individuals.
3. An emphasis on process: we shall be interested in the economic well-being of society not merely in terms of its level of economic well-being (however defined) but also in regard to the ability of its institutions to stimulate and support those economic processes upon which the attainment of economic well-being depends.

Welfare Economics – Some Highlights of Its Past

1. During the period of classical economics it was, of course, taken for granted that a society was economically successful strictly in so far as it succeeded in achieving increased wealth. Adam Smith’s *Inquiry into the Nature and Causes of the Wealth of Nations* expressed this approach to the economics of welfare simply and typically. It was taken for granted that a

given percentage increase in a nation's physical wealth (with wealth often seen as being able to be seen as consisting of bushels of 'corn') meant a similar percentage increase in the nation's well-being. From this perspective a physical measure of a nation's wealth provides an index of that nation's economic success, regardless of its distribution. A bushel of wheat is a bushel of wheat. Clearly this notion of welfare offends the principles of methodological individualism and subjectivism; it was swept away by the marginalist (subjectivist) revolution of the late nineteenth century.

2. Marshall and Pigou sought to preserve certain central elements of the classical approach, while avoiding the trap which sees well-being as identified with (or directly proportional to) physical wealth itself. They focused attention not on goods themselves, but on *utility* of these goods. In principle a nation's physical wealth itself, given its pattern of distribution, correspond to a given level aggregate utility. Moreover they believed this aggregate to be measurable, in principle, by the 'measurable rod of money'. They sensed no problem in conceiving of 'aggregate utility'; they thought of utility as something that could be compared and aggregated across individuals. They certainly did not see the utility as associated uniquely with an individual act choice; rather, they saw it as a kind of psychological shadow that closely followed physical wealth. (Its central advantage over wealth, as an index of well-being, was that it incorporated the refinement of distinguishing marginal utility. It was no longer acceptable to consider a bushel of wheat to be identical, welfare-wise, with every bushel of wheat: the, the margin of consumption by the individual must be considered. But it was still considered valid to treat one dollar's worth of utility as entirely equivalent to a second dollar's worth of utility.)

This approach to welfare economics is clearly unacceptable to economists who have absorbed the Misesian (and Rothbardian) lessons concerning the true meaning of utility in economic analysis. Utility, for Austrians, is not a quantity of psychological experience; it is merely an index of preferability as expressed in acts of choice. To attempt an aggregate utility is not merely to violate the tenets of methodological individualism and subjectivism (by treating the sensations of different individuals as being able to be added up), it is to engage in an entirely meaningless exercise: economic analysis has nothing to say about sensations; it deals strictly with choices and their interpersonal implications.

3. The approach to welfare economics that has, of course, been central to economics for the past half-century is that which revolves round the notion of Pareto optimality. A change is seen as enhancing the economic well-being of society if it renders some of its members better off (in their estimation) without rendering any others worse off. This approach certainly avoids the problems of interpersonal comparisons of utility, and would thus seem to be consistent both with the methodological individualism and with the subjectivism that Austrians insist upon. Several points, however, need to be noticed.

While the notion of Pareto optimality is indeed concerned with the individual members of society it none the less reflects a supra-individual conception of society and its well-being...A Pareto-optimal move is considered to advance the well-being of society considered as a whole...[Nevertheless,] [t]o transfer this important concept of individual allocative choice to society as a whole is, at best, to engage in metaphor. Society, as such, neither possesses goals of its own nor deliberately engages in allocative choice.

[pp. 183-184] Hayek focused on the circumstances of dispersed knowledge. The relevant information that 'society' would have to possess in order to solve its economic problem is widely dispersed. Society is thus simply not in a position to address its supposed economic problem...For once it is recognized that the relevant information is inevitably and definitely dispersed among many minds, it is impossible to avoid the conclusion that the notion of social efficiency is correspondingly devoid of meaning...Hayek's insight into the subjectivism of knowledge and information has thus decisively dislodged the foundations of Paretian welfare economics, at least insofar as those foundations have been held to support the concept of social choice and social efficiency.

[Rothbard early pointed out the problems associated with the trend toward using statistics and statistical methods in economics. He viewed it as a dangerous avenue that would yield greater intervention. Murray N. Rothbard (1960), "The Politics of Political Economists: Comment", *The Quarterly Journal of Economics*, vol. 74, no. 4 (November), pp. 659-665].

[pp. 659-660] In the course of his interesting discussion of "The Politics of Political Economists," Professor Stigler challenges the alleged view of Professor Mises that "economic statistics, or more generally quantitative economics — generates a radical political viewpoint." Stigler asserts that the empirical student acquires a "real feeling" for the functioning of an economic system, and "has had the complexities of the economy burned into his soul." Without going into the question of Mises' precise viewpoint on this issue, I think it important to note that Stigler has overlooked several fundamental considerations.

In the first place, statistics are desperately needed for any sort of government planning of the economic system. In a free market economy, the individual business firm has little or no need of statistics. It need only know its prices and costs. Costs are largely discovered internally within the firm and are not the general data of the economy which we usually refer to as "statistics." The "automatic" market, then, requires virtually no gathering of statistics; government intervention, on the other hand, whether piecemeal or fully socialist, could do literally nothing without extensive ingathering of masses of statistics. Statistics are the bureaucrat's only form of economic knowledge, replacing the intuitive, "qualitative" knowledge of the entrepreneur, guided only by the quantitative profit-and-loss test. Accordingly, the drive for government intervention, and the drive for more statistics, have gone hand in hand.

The enormous expansion of governmental activity in the gathering and disseminating of statistics in the last twenty-five years, is surely more than coincidentally related to the similar expansion of the role of government in regulating and manipulating the economy.

[p. 661] As early as 1863, Samuel E. Ruggles, American delegate to the International Statistical Congress in Berlin, declared that “statistics are the very eyes of the statesman, enabling him to survey and scan with clear and comprehensive vision the whole structure and economy of the body politic.”

[p. 663] Suffice it then to say that a leading cause of the proliferation of governmental statistics is the need for statistical data in government economic planning. But the relationship works also in reverse: the growth of statistics, often developed originally for its own sake, ends by multiplying the avenues of government intervention and planning. In short, statistics do not have to be developed originally for politico-economic ends; their own autonomous development, directly or indirectly, opens up new fields for interventionists to exploit. Each new statistical technique, whether it be flow of funds, inter-industry economics, or activity analysis, soon acquires its own sub-division and application in government.

[After the collapse of communism in Eastern Europe, and the vindication of Mises and Hayek, Austrians were critical of the methods employed to bring about privatization. A good example of this theme may be seen in Murray N. Rothbard, (1992), “How and How Not to Desocialize”, *Review of Austrian Economics*, vol. 6, no. 1, pp. 65-77].

[pp. 65-66] How *not* to go about desocialization may be highlighted by the story of a friend of mine, who told me recently about a Soviet colleague in his department, who came to the United States to study diligently the problem of how to create a futures market in the U.S.S.R. He has been stymied by the fact that he cannot seem to figure out what laws or edicts the Soviet state should lay down, so as to replicate the futures market in the United States. In short, he cannot find a way to plan a futures market. Here then is a crucial point: *you cannot plan markets*. By their very nature, you can only set people free so that they can interact and exchange, and thereby develop markets themselves. Similarly, several of the socialist countries, seeing the importance of the capital markets in the West, have been trying to develop stock exchanges, but with little success. First, again, because stock markets cannot be planned, and, second, because, as we will see further, you cannot have markets in titles to capital if there are still virtually no private *owners* of capital in existence.

[pp. 76-77] The dimensions of the proffered Rothbard Plan for desocialization should now be clear: (1) Enormous and drastic reductions in taxes, government employment, and government spending. (2) Complete privatization of government assets: where possible to return then to the original expropriated owners of their heirs; failing that, granting shares to productive workers and peasants who had worked on these assets. (3) Honoring complete and secure property rights for all owners of private property. Since full property rights imply the complete freedom to make exchanges and transfer property, there must be no government interference in such exchanges. (4) Depriving the government of the power to create new money, best done by a fundamental reform that at one and the same time liquidates the central bank and uses its gold to redeem its notes and deposits at a newly defined unit of gold weight of existing currencies. All this could and should be done in one day, although the monetary reform could be done in steps taking a few days.

One point we have not specified: precisely how low should taxes or government employment or spending be set, and how complete should be the privatization? The best answer is that of the great Jean-Baptiste Say, who should be known for many other things than Say’s law: “The best scheme of [public] finance is, to spend as little as possible; and the best tax is always the lightest.” In short, that government is best that spends and taxes and employs the least, and privatizes that most.

A final point: I have been criticized libertarian colleagues for proposals of this sort because they involve action by government. Isn’t it inconsistent and statist for a libertarian to advocate any government action whatever? This seems to me a silly argument. If a thief has stolen someone’s property, it is scarcely upholding “robber-action” to advocate that the robber disgorge his stolen property and return it to its owners. In a socialist state, the government has arrogated to itself virtually all property and power of the country. Desocialization, and a move to a free society, necessarily involves the action of that government’s surrendering its property to its private subjects, and freeing those individuals from the government’s network of controls. In a deep sense, getting rid of the socialist state requires that state to perform one final, swift, glorious act of self-immolation, after which it vanishes from the scene. This is an act which can be applauded by any lover of freedom, act of government though it may be.

[In another towering piece of economic history, Rothbard traces some little known elements of political and religious life, including things like the lesbian-laced women’s movement, that contributed to the rise of the welfare state in America. Murray N. Rothbard, (1996), “Origins Of The Welfare State In America”, *Journal of Libertarian Studies*, vol. 12, no. 2 (Fall), pp. 193-232].

[pp. 193-194] Standard theory views government as functional: a social need arises, and government, semi-automatically, springs up to fill that need. The analogy rests on the market economy: demand gives rise to supply (e.g., a demand for cream cheese will result in a supply of cream cheese on the market). But surely it is strained to say that, in the same way, a demand for postal services will spontaneously give rise to a government-monopoly Post Office, outlawing its competition and giving us ever-poorer service for ever-higher prices.

Indeed, if the analogy fails when even a genuine service (e.g., mail delivery or road construction) is being provided, imagine how much worse the analogy is when government is not supplying a good service at all, but is redistributing income and wealth.

When the government, in short, takes money at gun point from A and gives it to B, *who* is demanding *what*? The cream-cheese producer is on the market is using his resources to supply a genuine demand for cream cheese; he is engaged in coercive redistribution. But what about the government's taking from A and giving the money to B? Who are the demanders, and who are the suppliers? One can say that the subsidized, the "donees," are "demanding" this redistribution; surely, however, it would be straining credulity to claim that A, the fleeced, is also "demanding" this activity. A, in fact, is the reluctant supplier, the coerced donor; B is gaining at A's expense. But the really interesting role here is played by G, the government. For apart from the unlikely case where G is an unpaid altruist, performing this action as an uncompensated Robin Hood, G gets a rake-off, a transaction. G, the government, in other words, performs his act of "redistribution" by fleecing A for the benefit of B and himself.

Once we focus on this aspect of the transaction, we begin to realize that G, the government, might not just be a passive recipient of B's felt need and economic demand, as standard theory would have it; instead, G himself might be an active demander and, as full-time, paid Robin Hood, might even have stimulated B's demand in the first place, so as to be in on the deal. The felt need, then, might be on the part of Robin Hood himself.

[pp. 198-200] If it wasn't industrialism or mass movements of the working class that brought the welfare state to America, what was it? Where are we to look for the casual forces? In the first place, we must realize that the two most powerful motivations in human history have always been ideology (including religious doctrine), and economic interest, and that joining of these two motivation can be downright irresistible. It was these two forces that joined powerfully together to bring about the welfare state.

Ideology was propelled by an intensely held religious doctrine that swept over and controlled virtually all Protestant churches, especially in "Yankee" areas of the North, from 1830 on. Likewise, a growing corollary ideology of statism and corporate socialism spread among intellectuals and ministers by the end of the 19th century. Among the economic interests promoted by the burgeoning welfare state were two in particular. One was the growing legion of educated (and often over-educated) intellectuals, technocrats, and the "helping professions" who sought power, prestige, subsidies, contracts, cushy jobs from the welfare state, and restrictions of entry into their field via forms of licensing. The second was groups of big businessmen who, after failing to achieve monopoly power on the free market, turned to government—local, state, and federal—to gain it for them. The government would provide subsidies, contracts, and, particularly, enforced cartelization. After 1900, these two groups coalesced, combining two crucial elements: wealth and opinion-molding power, the latter no longer hampered by the resistance of a Democratic Party committed to *laissez-faire* ideology. The new coalition joined together to create and accelerate a welfare state in America. Not only was this true in 1900, it remains true today.

Perhaps the most fateful of the events giving rise to and shaping the welfare state was the transformation of American Protestantism that took place in a remarkably brief period during the late 1820s. Riding in on a wave from Europe, fueled by an intense emotionalism of revival meetings held through the country by the Rev. Charles Grandison Finney. This new Protestantism was pietist, scorning liturgy as papist or formalistic, and equally scornful of the formalisms of Calvinist creed or church organization. Hence, denominationalism, God's Law, and church organization were no longer important. What counted was each person's achieving salvation by his own free will, by being "born again," or being "baptized in the Holy Spirit." An emotional, vaguely defined pietist, non-creeded, and ecumenical Protestantism was to replace strict creedal or liturgical categories.

The new pietism took different forms in various regions of the country. In the South, it became personalist, or salvational; the emphasis was on each person's achieving this rebirth of salvation on his own, rather than via social or political action. In the North, especially in Yankee areas, the form of the new Protestantism was very different. It was aggressively evangelical and postmillennialist, that is, it became each believer's sacred duty to devote his energies to trying to establish a Kingdom of God on Earth, to establishing the perfect society in America and eventually the world, to stamp out sin and "make America holy," as essential preparation for the Second Advent of Jesus Christ. Each believer's duty went far beyond mere support of missionary activity, for a crucial part of the new doctrine held that he who did not try his very best to maximize the salvation of others would not himself be saved. After only a few years of agitation, it was clear to these new Protestants that the Kingdom of God on Earth could only be established by government, which was required to bolster the salvation of individuals by stamping out occasions for sin. While the list of sins was unusually extensive, the PMPs (postmillennial pietists) stressed in particular the suppression of Demon Rum, which cloud men's minds to prevent them from achieving salvation such salvation; slavery, which prevented the enslaved from achieving such salvation; any activities on the Sabbath except praying or reading the Bible; and any activities of the Anti-Christ in the Vatican, the Pope of Rome and his conscious and dedicated agents who constituted the Catholic Church.

The Yankees who particularly embraced this view were an ethno-cultural group descending from the original Puritans of Massachusetts, and who, beginning in rural New England, moved westward and settled upstate New York ("the Burned-Over District"), northern Ohio, northern Indiana, northern Illinois, and neighboring areas. As early as the Puritan days, the Yan-

kees were eager to coerce themselves and their neighbors; the first American public schools were set up in New England to inculcate obedience and civic virtue in their changes.

[p. 203] If postmillennial Protestantism provided a crucial impetus toward state dictation over society and the economy, another vital force on behalf of the partnership of government and industry was the zeal businessmen and industrialists eager to jump on the bandwagon of state privilege. Vital to the Republic coalition, then, were the big railroads, dependent on government subvention and heavily in debt, and the Pennsylvania iron and steel industry, almost chronically inefficient and in perpetual need of high tariffs to protect them from import competition. When industrialists, as was often the case, were at one and the same time Yankee postmillennial pietists seeking to impose a perfect society, and also inefficient industrialists seeking government aid, the fusion of religious doctrine and economic interest became a powerful force in guiding their actions.

[p. 203] Of all Yankees in behalf of statist "reform," perhaps the most formidable force was the legion of Yankee women, in particular those of middle- or upper-class background, and especially spinsters whose busybody inclinations were not fettered by the responsibilities of home and hearth. One of the PMPs' favorite reforms was to bring about women's suffrage, which was accomplished in various states and localities long before a constitutional amendment imposed it on the entire country. One major reason: it was obvious to everyone that, given the chance to vote, most Yankee women would be quick to troop to the ballot-box, whereas Catholic women believed their place to be at home and with the family, and would not bother about political considerations. Hence, women's suffrage was a way of weighting the total vote toward the postmillennialists and away from the Catholics and High Church Lutherans.

[p. 205] A critical but largely untold story in American political history is the gradual but inexorable secularization of Protestant postmillennial pietism over the decades of the middle and late 19th century. The emphasis, almost from the beginning, was to use government to stamp out sin and to create a perfect society, in order to usher in the Kingdom of God on Earth. Over the decades, the emphasis slowly but surely shifted: more and more away from Christ and religion, which came ever-vaguer and woollier, and more and more toward a Social Gospel, with government correcting, organizing, and eventually planning the perfect society. From paternalistic mender of social problems, government became more and more divinized, more and more seen as the leader and molder of the organic social whole. In short, Whigs, Know-Nothings, and Republicans were increasingly becoming Progressives, who were to dominate the polity and the culture after 1900; a few of the more radical thinkers were openly socialist, with the rest content to be organic statist and collectivists. And as Marxism became increasingly popular in Europe after the 1880s, the progressives prided themselves on being organic statist middle-of-the-roads between old-fashioned dog-eat-dog laissez-faire individualism on the one hand, and proletarian socialism on the other. Instead, the progressive would provide to society a third way in which Big Government, in the service of the joint truths of science and religion, would all classes into one organic whole.

[pp. 212-213] Not only that, but by the late 19th century, as the 1860 cohort came of age, there arose greater and more specialized opportunities for female activism on behalf of statism and government intervention. The older groups, the Women's Crusades, were short-run activities, and hence could rely on short bursts of energy by married women. However, as female activism became professionalized, and became specialized into social work and settlement houses, there was little room left for any women except upper-class and upper-middle-class spinsters, who answered the call in droves. The settlement houses, it must be emphasized, were not simply centers for private help to the poor; they were, quite consciously, spearheads for social change and government intervention and reform.

The most prominent of the Yankee progressive social workers, and emblematic of the entire movement, was Jane Addams (b. 1860). Her father, John H. Addams, was a pietist Quaker who settled in northern Illinois. John H. Addams was a lifelong Republican, who attended the founding meeting of the Republican Party at Ripon, Wisconsin in 1854, and served as a Republican State Senator for 16 years.

Graduating from one of the first all-women colleges, the Rockford Female Seminary, in 1881, Jane Addams was confronted by the death of her beloved father. Intelligent, upper class, and energetic, she was faced with the dilemma of what to do with her life. She had no interest in men, so marriage was not in the cards; indeed, in her lifetime, she seems to have had several intense lesbian affairs.

After eight years of indecision, Jane Addams decided to devote herself to social work, and founded the famed settlement house, Hull House, in the Chicago slums in 1889. Jane was inspired by reading the highly influential English art critic John Ruskin, who was an Oxford professor, Christian socialist, and bitter critic of laissez-faire capitalism. Ruskin was the charismatic leader of Christian Socialism in England, which was influential in the ranks of the Anglican clergy. One of his disciples was the historian Arnold Toynbee, in whose honor Canon Samuel A. Barnett, another Ruskinian, founded in the settlement house Toynbee Hall in London in 1884. In 1888, Jane Addams went to London to observe Toynbee Hall, and there she met Canon W.H. Freemantle, close friend and mentor of Canon Barnett, and this visit settled the matter, inspiring Jane Addams to go back to Chicago to found Hull House, along with her former classmate and intimate lesbian friend Ellen Gates Starr. The major difference between Toynbee Hall and its American counterparts is that the former was staffed by male social workers

who stayed for a few years and then moved on to build their careers, whereas the American settlement houses almost all constituted lifelong careers for spinster ladies.

Jane Addams was able to use her upper class connections to acquire fervent supporters, many of them women who became intimate and probably lesbian friends of Miss Addams. One staunch financial supporter was Mrs. Louise de Koven Bowen (b. 1859), whose father, John de Koven, a Chicago banker, had amassed a great fortune. Mrs. Bowen became an intimate friend of Jane Addams; she also became the treasurer, and even built a house for the settlement. Other society women supporters of Hull House included Mary Rozet Smith, who had a lesbian affair with Jane Addams, and Mrs. Russell Wright, the mother of the future-renowned architect Frank Lloyd Wright. Mary Rozet Smith, indeed, was able to replace Ellen Starr in Jane Addams's lesbian affection. She did it in two ways; by being totally submissive and self-deprecating to the militant Miss Addams, and by supplying copious financial support to Hull House. Mary and Jane proclaimed themselves "married" to each other.

[p. 225] As we can see from the case of Henry Bruere, after Yankee women pioneered in welfare and social-work organizations, men began to follow suit.

The Rockefellers and Social Security

[p. 227] The Rockefellers and their intellectual and technocratic entourage were, indeed, central to the New Deal. In a deep sense, in fact, the New Deal itself constituted a radical displacement of the Morgans, who had dominated the financial and economic politics of the 1920s, by a coalition led by the Rockefellers, the Harrimans, Kuhn Loeb, and the Lehman Brothers investment-banking firms.

[pp. 227-228] Here, too, was the end product of a gradual but sure process of secularization of the messianic ideal of the postmillennial pietists. Perhaps it is only fitting that a movement that began with postmillennial Yankees harridans going out into the streets and trying to destroy saloons would conclude with Wisconsin social scientists, technocrats, and Rockefeller-driven experts manipulating the levers of political power to bring about a top-down revolution in the form of the welfare state.

[p. 231] The American Association for Labor Legislation was particularly important in developing for the Social Security system. This leftist social-welfare outfit, founded by Commons and headed for decades by his student John B. Andrews, was financed by Rockefeller, Morgan, and the other wealthy corporate liberal financial and industrial interests. The AALL was the major developer of disability and health insurance proposals during the 1920s, and in 1930 turned to work on model state bills for unemployment insurance. In 1932, Wisconsin adopted the AALL's plan and, under the force of AALL lobbying, the Democratic Party incorporated it into its platform. In developing Social Security, key CES Technical Board and Advisory Council posts were staffed with AALL members. Not only that, but in early 1934, Secretary Perkins asked none other than Paul Rauschenbush, the AALL's Washington lobbyist, to draft a bill for Social Security which became the basis for further discussions in the CES. The AALL was also closely associated with Florence Kelley's National Consumers League.

[p. 231] We can conclude by noting, with historian Irwin Yellowitz, that all these reform organizations were dominated and funded by "a small group of wealthy patricians, professional men, and social workers. Wealthy women, including some from New York society, were indispensable to the financing and staffing.

Anarchism: The Rothbardian Austrian Political Tradition

[Rothbard was a great economic historian. He was notorious for being able to uncover less remembered or unknown facts, such as in the case of Edmund Burke. Rothbard was able to write about history in such a vivid way, powerfully displaying his strong disposition to anarchy, and making a compelling case for it too. Of course, neither Mises nor Hayek were anarchists and so, with his strong views, Rothbard headed his own political tradition within the Austrian school and the Libertarian movement in the USA. Murray N. Rothbard (1958), "A Note on Burke's Vindication of Natural Society", *Journal of the History of Ideas*, vol. 19, no. 1 (January), pp. 114-118].

[p. 115] Burke, in obvious disgust, goes on to chronicle some of the notable "butcheries" in which states have indulged. "All empires have been cemented in blood" and in mutual attempts at destruction. And Burke wittily deduces that Hobbes' observations of ordinary human action, but from his study of the actions of men when banded together into states.

The catalog of murders is impressive enough; and Burke estimates that, from ancient times, thirty-six million people have been slaughtered by governments. But Burke is not content to stop there. Why, he asks, why does evil center in States? He finds the answer in the nature of the State itself. All "political society" rests on subordination on the one hand, and tyranny on the other.

[p. 115] Democracy is not only tyrannical, but bound to succumb to hatred of superior individuals. The rule of the people tends to be warlike and despotic, and to make heavy use of taxes and subsidies.

[p. 116] The government is, one day, arbitrary in a single person; another, a juggling confederacy of a few to cheat the prince, and to enslave the people, and the third, a frantic and a manageable democracy. The great instrument of all these changes... is party...;the spirit which actuates all parties is the same; the spirit of ambition, of self-interest, of oppression, and treachery.

The *Vindication* contains much rhetoric about in inequality between the rich and the poor. Close examination reveals, however, that Burke is writing not about social classes but about social castes, i.e., he is referring to the artificial inequalities of wealth resulting from state actions and not to the inequalities resulting from free action. Burke is denouncing the slavery, poverty, and vices introduced by “political society.”

It should be clear from this work that by “political society,” Burke did not signify “society” in general. This is no Rousseauian call for a return to the jungle, either earnestly or satirically. Burke’s attack is leveled not against *society*—the framework of peaceful human interrelations and exchanges, but against *states*—those uniquely coercive elements in human relations. His argument rests on a belief that when we observe the nature of man, we find that states are *anti-social* institutions.

[Rothbard not only proffered privatization, he was a vigilant anarchist, or what he called an “anarcho-capitalist”, who called for the outright and immediate elimination of the state. For Rothbard, the government is merely a band of criminals given legal sanction to loot people and defy private property rights. In this piece, he defends his point of view at the expense of political philosopher Robert Nozick, who was trying to find some justification for a very limited government. Murray N. Rothbard, (1977), “Robert Nozick and the Immaculate Conception of the State”, *Journal of Libertarian Studies*, vol. 1, no. 1, pp. 45-57].

[pp. 45-46] Robert Nozick’s *Anarchy, State, and Utopia* (New York; Basic Books, 1974) is an “invisible hand” variant of a Lockean contractarian attempt to justify State, or at least a minimal State confined to the functions of protection. Beginning with a free-market anarchist state of nature, Nozick portrays the State as emerging, by an invisible hand process that violates no one’s rights, first as a dominant protective agency, then to an “ultra-minimal state,” and then finally to a minimal state.

Before embarking on a detailed critique of the various Nozickian stages, let us consider several grave fallacies in Nozick’s conception itself, *each of which* would in itself be sufficient to refute his attempt to justify the State.

First, despite Nozick’s attempt (6-9) to cover his tracks, it is highly relevant to see whether Nozick’s ingenious logical construction has ever indeed occurred in historical reality: namely, whether any State, or most or all States, have *in fact* evolved in the Nozickian manner. It is a grave defect in itself, when discussing an institution all too well grounded in historical reality that Nozick has failed to make a single mention or reference to the history of actual States. In fact, there is no evidence whatsoever that any State was founded or developed in the Nozickian manner. On the contrary, the historical evidence cuts precisely the other way: for every State where the facts are available originated by a process of violence, conquest and exploitation: in short, in a manner which Nozick himself would have to admit violated individual rights. As Thomas Paine wrote in *Common Sense*, on the origin of kings and of the State:

“could we take of the dark covering of antiquity and trace them to their first rise, we should find the first of them nothing better than the principle ruffian of some restless gang; whose savage manners or pre-eminence in subtlety obtained him the title of chief among plunderers; and who by increasing in power and extending his depredations, overawed the quiet and defenseless to purchase their safety by frequent contributions.

Note that the “contract” involved in Paine’s account was of the nature of a coerced “protection racket” rather than anything recognizable to the Libertarian as a voluntary agreement.

Since Nozick’s justification of existing States—provided they are or become minimal — rests on their alleged immaculate conception, and since no such State exists, then none of them can be justified, *even* if they should later become minimal. To go further, we can say that, *at best*, Nozick’s model can *only* justify a State which indeed did develop by his invisible hand method. Therefore it is incumbent upon Nozick to join anarchists in calling for the abolition of all existing States, and *then* to sit back and wait for his alleged invisible hand to operate. The only minimal State, then, which Nozick *at best* can justify is one that will develop out of a future anarcho-capitalist society.

Secondly, *even if* an existing State had been immaculately conceived, this would *still* not justify its present existence. A basic fallacy is endemic to all social contract theories of the State, namely, that *any* contract based on a promise is binding and enforceable. If, then, *everyone* — in itself of course a heroic assumption — in a state of nature surrendered all or some of his rights to a State, the social contract theorists consider this promise to be binding forevermore. A correct theory of contracts, however, termed by Williamson Evers the “title-transfer” theory, states that only valid (and therefore binding) contract is one that surrenders what is, in fact, philosophically *alienable*, and that *only* specific titles to property are also alienable, so that their ownership can be ceded to someone else. While, on the contrary, *other* attributes of man: specifically, his self-ownership over his own will and body, and the *rights* to person and property which stem from that self-ownership, are “inalienable” and therefore cannot be surrendered in a binding contract. If no one, then, can surrender his own will, his body, or his rights in an enforceable contract, *a fortiori* he cannot surrender the persons or the rights of his posterity. This is what the

Founding Fathers meant by the concept of rights as being “inalienable”, or, as George Mason expressed it in his Virginia Declaration of Rights:

“...all are by nature equally free and independent, and have certain inherent natural rights, of which when they enter into a state of society, they cannot, by any compact, divide or divest their posterity”.

Or, as Evers writes, “all philosophical defenses of human rights to life, liberty, and estates... are founded upon the natural fact that each human is proprietor of his own will. To take right like those of property and contractual freedom that are based on a foundation of the absolute self-ownership of the will and then to use those derived rights to destroy their own foundation is philosophically invalid”.

Thus, we have seen (1) that no existing State has been immaculately conceived — quite the contrary; (2) that therefore the only minimal State could be *possibly* be justified is one that would emerge *after* a free-market anarchist world had been established; (3) that therefore Nozick, on his own grounds, should become an anarchist and then wait for the Nozickian invisible hand to operate afterward, and finally (4) that *even if* any State had been founded immaculately, the fallacies of social contract theory would mean no present State, even a minimal one, could be justified.

[pp. 56-57] Finally, a grave flaw permeates the entire discussion of rights and government in the Nozick volume: that, as a Kantian intuitionist, he *has no* theory of rights. Rights are simply emotionally intuited, with no groundwork in natural law — in the nature of man or of the universe. At bottom, Nozick has no real argument for the existence of rights.

To conclude: (1) no existing state has been immaculately conceived, and therefore Nozick, on his own grounds, should advocate anarchism and then wait for his State to develop; (2) even if any State had been so conceived, individual rights are inalienable and therefore no existing State could be justified; (3) every step of Nozick’s invisible hand process is invalid: the process is all too conscious and visible, and the risk and compensation principles are both fallacious and passports to unlimited despotism; (4) there is no warrant even on Nozick’s own grounds, for the dominant protective agency to outlaw procedures by independents that do not injure its own clients, and therefore it cannot arrive at an ultraminimal state; (5) Nozick’s theory of “not-productive” exchanges is invalid, so that the prohibition of risky activities and hence the ultraminimal state falls on that account alone; (6) contrary to Nozick, there are no “procedural rights”, and therefore no way to get from his theory of risk and non-productive exchange to the compulsory monopoly of the ultra-minimal state; (7) there is no warrant, even on Nozick’s own grounds, for the minimal state to impose taxation; (8) there is no way, in Nozick’s theory, to justify the voting or democratic procedures of any State; (9) Nozick’s minimal state would, on his own grounds, justify a maximal State as well; and (10) the only “invisible hand” process, on Nozick’s own terms, would move society from his minimal State back to anarchism.

Thus, the most important attempt in this century to rebut anarchism and to justify the State fails totally and in each of its parts.