

Study Guide to *Human Action* by Robert P. Murphy

Chapter XII. The Sphere of Economic Calculation

Chapter Summary

1. The Character of Monetary Entries

Economic calculation encompasses everything that trades against money. Despite their apparent precision, most of the entries on balance sheets reflect the speculative anticipation of owners regarding future market conditions. Therefore, there is nothing "objective" about them. Even so, economic calculation is as effective as it could be. It cannot give a perfect guide to the future, because the future is inherently uncertain.

2. The Limits of Economic Calculation

Economic calculation can't account for things that do not exchange for money. Even so, by reducing all other items to a common denominator, economic calculation makes decisions easier for "noneconomic" items. For example, if a financial wizard is choosing between a stressful job at a hedge fund that pays \$350,000 per year versus a relaxed life in academia that pays \$150,000, economic calculation allows him to boil down the decision to, "If I started in the academic spot, would I prefer to give up the relative peace for an additional \$200,000 per year?" The fact that money prices do not eliminate all other judgments is surely not a strike against the conveniences that they do render.

Economic calculation only "works" in the setting of acting men in a market economy, making actual decisions. It makes no sense to discuss the "social value" of a particular policy, as if central planners could perform such computations outside of the haggling on real markets. It also makes no sense to compute the "total income" or wealth of an entire nation. When a firm's capitalization is \$1 million, that means (in principle) that if one sold all the assets and paid off all of the liabilities, there would remain \$1 million. But this obviously can't be done for the entire wealth of a large nation, let alone for the world as a whole.

3. The Changeability of Prices

Prices are in constant flux because their underlying determinants—ultimately the subjective valuations of individuals—are always changing. The popular clamoring for stable prices is due to the lamentable desire to pattern economics after the natural sciences.

4. Stabilization

It is understandable why people long for a money with "stable" purchasing power—the terrible experience with government inflation has led to this desire. Nonetheless, the numerous proposals (of various commodity baskets, etc.) for a stable money suffer from insuperable difficulties. These are some of the more important ones:

- (1) Prices are not measured in money; they consist in money. There is no immutable unit of "value" that (even in principle) could be used to define the purchasing power of money.
- (2) The components of a price index change in quality over time; a television set today is not the same thing as a television set in 1950, and thus comparing a dollar today to one in 1950 is arbitrary.
- (3) The relative importance of the components of a price index can change over time, and there is no nonarbitrary way of gauging this effect. For example, if most people became vegan, then the price of milk and eggs should obviously carry a smaller weight in the commodity basket.

5. The Root of the Stabilization Idea

Historically, money that originated on the market (such as gold and silver) were adequate for economic calculation, even though they did not possess an eternally fixed "stable" purchasing power. Government inflations changed this and made it imperative for businesspeople to take into account changes in the value of money in their planning and long-term contracts.

Another factor in the popularity of the stabilization idea was the desire for a secure arena outside the uncertainty of the market. People thought the state (with its tremendous might, consuls, and so forth) could provide a shelter for wealth outside the vicissitudes of pleasing the consumers afresh every day.

Why It Matters

In this chapter, Mises lays out the boundaries of economic calculation and explains that, within their sphere, market prices render all the services needed of them. The tools of economic calculation are inappropriate, though, when people extrapolate into areas outside of the actual market. In particular, economic calculation cannot provide a measure of immutable value, because no such thing exists. The efforts to devise a stable money and to provide a flow of guaranteed income are futile.

Technical Notes

- (1) Mises writes (p. 223) that the term "price level" is misleading. It suggests that changes originating on the "money side" could affect all prices proportionally, but (as we will see in later chapters) this is impossible. Money isn't neutral, and changes in the supply of money will necessarily cause "real" disturbances, not just nominal ones.
- (2) On page 228, Mises critiques the popular claim that war bonds allow the costs of a war to be shunted onto future generations. This is silly because all of the tanks, bombers, etc. consumed by the war effort obviously come out of current production. Of course, a war impoverishes future generations, but only because they inherit a smaller stockpile of capital goods than they otherwise would have.

Study Questions

1. The Character of Monetary Entries

- Can we anticipate future prices by looking at prices of the past?
- Why do we have to distinguish between economic calculation as it is practiced by businessmen planning future transactions and those computations of business facts that serve other purposes?
- Can economic calculation expand our information about the future?

2. The Limits of Economic Calculation

- What are the requirements for economic calculation?
- How can things that don't enter into the items of accountancy and calculation be evaluated and be taken in consideration?
- Why is it nonsensical to reckon national income or national wealth?

Comment: "[P]rices are not measured in money; they consist in money."

3. The Changeability of Prices

Comment: "The popular notions about money and money prices are not derived from ideas formed in the past. It would be wrong to interpret them as atavistic remnants."

- Why are the ideas of price stability fallacious? Why is it so popular?

4. Stabilization

- Why is the conception of stabilization useless in a world of perpetual change?
- Why is it nonsensical to compare baskets of commodities over time in order to define index-number methods? What are the obstacles in regard to technological features of the commodities? Would it be possible to realize it if there weren't these obstacles?
- Why can't other things remain equal if the purchasing power of money changes?
- Does human action imply change? Why?

5. The Root of the Stabilization Idea

- What is meant by, "What economic calculation requires is a monetary system whose functioning is not sabotaged by government interference"?
- What are the problems of government bonds?

- How is the interest for government bonds financed?

Comment: "Financing a war through loans does not shift the burden to the sons and grandsons. It is merely a method of distributing the burden among the citizens."