

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

## Chapter XIV. The Scope and Method of Catallactics

### Chapter Summary

#### 1. The Delimitation of Catallactic Problems

The scope of praxeology—the science of human action—is precise: it is the study of goal-seeking rational behavior. However, the scope of catallactics or specifically "economic" problems is somewhat ambiguous. Economics is mainly concerned with the analysis of how money prices in the real world are formed for all goods and services exchanged on a market. But to do this satisfactorily, economics must be embedded in the broader field of praxeology. In addition, to fully appreciate the functioning of a market economy, the economist must also consider an isolated individual and a socialist community.

#### *The Denial of Economics*

Many utopian reformers deny the existence of economic laws. These critics fail to see that scarcity is a fact of the world, and not a byproduct of social institutions or reactionary doctrines.

#### 2. The Method of Imaginary Constructions

The specific method of praxeology (and economics) is the use of imaginary constructions. For various reasons (to be detailed later), the economist cannot use experiments as the physicist or chemist can to choose among his theories. On the contrary, the economist employs imaginary constructions in a deductive process. He abstracts from the real-world situation the crucial elements in which he is interested, and then either imagines their absence, or tries to pinpoint their exact consequences if present. Precisely because he is imagining a scenario that differs from the actual world, the economist cannot resort to empirical observation to verify or refute his analysis. He must instead examine the validity of each step in the deduction, which leads from the assumptions to the conclusion.

#### 3. The Pure Market Economy

One of the imaginary constructions employed by the economist is the analysis of the pure, unhampered market economy, in which neither the government nor other governments interfere with the voluntary exchange of private property. After working through this analysis, the economist can then proceed to examine the effects of government (or other) interventions into the pure market. Some critics object that this procedure reflects the biases of the orthodox economist, but these critics contradict themselves—they too contrast the (allegedly horrible) operation of a pure market with their own preferred arrangement of government programs. Ironically, when the classical economists extolled the virtues of the "natural" system of a free market, it was because it spontaneously lived up to the ideals of a centrally planned socialist economy.

### ***The Maximization of Profits***

A frequent criticism is that economists erroneously assume that all people act to maximize profit, when in fact there are plenty of people for whom pecuniary gain is less important than other ends. This objection misunderstands praxeology, however. Economics only tells us that, other things equal, a seller seeks the highest price possible, while the buyer seeks the lowest price. Consumers all the time pay more for, say, a steak than for an equally nutritious burger. A worker does not necessarily choose the profession that pays the most, either. These examples are not exceptions to the "rule" of profit maximization, rightly defined, but illustrations of it.

### **4. The Autistic Economy**

In order to understand interpersonal exchange, economics must analyze autistic exchange, i.e., when an isolated individual "exchanges" less satisfactory for more satisfactory conditions, without interacting with other people.

### **5. The State of Rest and the Evenly Rotating Economy**

The plain state of rest is not an imaginary construction; it happens whenever there are no transactions, because no buyer wishes to acquire more units of the good or service at the price necessary to induce a seller to surrender more units. The plain state of rest is only transitory; it will be disrupted whenever preferences change and mutually advantageous exchanges once again exist. (And one common way for preferences to change is for producers to create more of the product, lowering their marginal utility for it and making them willing to sell at a price that was unattractive before the new production.)

On the other hand, the final state of rest is indeed an imaginary construction. It refers to the situation in which all of the effects of a particular disturbance have run their course, and the price in question has reached its final price. If a new report causes half of the smokers to quit cold turkey, a plain state of rest in the cigarette market will soon emerge at a much lower price. However, as cigarette manufacturers scale back their operations and the glut of inventory is reduced to the new level (appropriate for the cut in customers), a new final price will emerge (that may be higher or lower than the previous final price, depending on the specifics).

A final imaginary construction is the evenly rotating economy (ERE), in which all prices have reached their final prices. Since all disturbances have worked their full effects, there is total certainty in the ERE. Production still occurs, as higher-order goods are transformed into lower-order goods; people still go to work and consumers still make purchases. But every day is just like the previous one.

Not only is the ERE imaginary, it is self-contradictory. In a world of perfect certainty, there would be no action. Moreover, in the ERE there would be no need to hold money, and so it is problematic to use the ERE to analyze money prices. Despite these problems, the ERE is indispensable for understanding the difference between interest and profit.

## 6. The Stationary Economy

A stationary economy is one in which the wealth and income of the individuals remain constant. (An ERE is stationary, but a stationary economy need not be an ERE.) A progressing economy is one in which per capita wealth and income increase, while the opposite happens in a retrogressing economy. In a stationary economy, aggregate profits equal aggregate losses, while profits exceed losses in a progressing economy and vice versa in a retrogressing one.

## 7. The Integration of Catallactic Functions

Economics speaks of the entrepreneur or the laborer, in reference to their economic function. In the real world, the same person can be a capitalist, laborer, and entrepreneur. Economics also uses the terminology for functional distribution, namely that the laborer receives wages, the entrepreneur earns profits or losses, the landowner earns rents, and the capitalist earns originary income.

### Why It Matters

In this very important chapter, Mises explains the subject matter of catallactics, which is a subset of the field of praxeology; this is what most people have in mind when they talk of economics. Mises also discusses the specific method that the theoretical economist must use, namely imaginary constructions. Finally, Mises describes some of the more important imaginary constructions, especially the evenly rotating economy. In essence, in this chapter Mises lays out the boundaries of his subject and describes the tools he will use to analyze it.

### Technical Notes

- (1) Mises uses the term catallactics to mean "economics in the narrower sense" (p. 235). He defines catallactics as "the analysis of those actions which are conducted on the basis of monetary calculation" (p. 235). Other writers might define catallactics as the study of exchange, which at first blush is broader than Mises's definition (since exchange can occur even if there is no money). However, the two definitions are in practice virtually identical, because Mises writes that a "market in which there is direct exchange only is merely an imaginary construction" (p. 235).
- (2) Mises's illustration (p. 245) of the plain state of rest—namely, the daily close of a stock market—is rather unfortunate, for the market closes at a preordained time, and in principle there could be frustrated buyers and sellers who don't exchange simply because of the closing bell. To make matters worse, Mises justifies his choice by pointing out (in footnote 9) that he is disregarding the fluctuations in stock prices over the course of the trading day. A better choice would have been a market in which prices remain fairly stable; then a period in which no sales took place (even though the market is "open") would constitute a plain state of rest.
- (3) Of the evenly rotating economy (ERE) Mises writes, "The plain state of rest is disarranged again and again, but it is instantly reestablished at the previous level" (p. 248). Recall that in the plain state of rest, no exchanges occur. Yet in the ERE we

know that the producers of fifth-order goods sell their wares to the producers of fourth-order goods, and so on. Therefore it must be the case (as Mises claims) that the plain state of rest is constantly (but predictably) upset in the ERE.

## Study Questions

### 1. The Delimitation of Catallactics Problems

- How does economics classify actions?
- What is the field of study of catallactics?
- What is economics? What should it examine?
- How does scarcity influence human action?

### 2. The Method of Imaginary Constructions

Comment: "An imaginary construction is a conceptual image of a sequence of events logically evolved from the elements of action employed in its formation."

- Why must we use imaginary constructions in praxeology?

### 3. The Pure Market Economy

- Is the market obstructed by institutional factors?
- In what sense can we say that men are always seeking the maximization of profit?
- In which sense is it absolutely adequate to speak of selfishness when it comes to the question of human action?
- Why do the terms *fair* or *unfair* imply value judgments?
- Does a pure market economy exist? Does the answer affect the conduct of economics?

### 4. The Autistic Economy

- Why must economics study the situation of an isolated economic actor?

### 5. The State of Rest and the Evenly Rotating Economy

- What is the plain state of rest? Why isn't it an imaginary construction?
- What is the final state of rest?
- What distinguishes the market price from the final price?
- What distinguishes the final state of rest from the evenly rotating economy?

- What is the driving force of the whole market system?
- Why is it not necessary to hold cash in a world without change and certainty?
- Why is the mathematical method to which Mises refers not suited to convey any knowledge?

#### **6. The Stationary Economy**

- What distinguishes the stationary economy from the evenly rotating economy?

#### **7. The Integration of Catallactic Functions**

- What is the role of the promoter in economics?
- What is the role of the entrepreneur in the stationary economy?
- Is the socialist system compatible with the concept of a stationary economy? Is it relevant?