

FALL 1991

Austrian Economics Newsletter

THE 1991 MISES UNIVERSITY: ANOTHER YEAR OF EXCELLENCE IN AUSTRIAN ECONOMICS

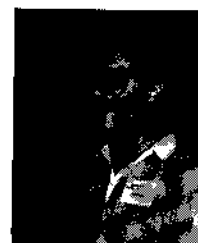
Stanford University was flooded with Austrian school economists from July 7-14, in what has become an annual pilgrimage to present 120 students from all over the world an instructional alternative to mainstream neoclassical thought. The event is the Mises University sponsored by the Ludwig von Mises Institute. Now in its seventh year, the 1991 program was a brilliant success.

"The quality of the students was higher than ever," said Joseph Salerno, professor of economics at Pace University and Mises University faculty member. "They were well read, interested, had excellent questions, and demonstrated outstanding prospects for the future. I don't know where all these young Austrians keep coming from, but it sure was encouraging."

Hans-Hermann Hoppe of the University of Nevada, Las Vegas, agreed. "Because of this program, the Austrian school is beginning to represent a strong voice in economics today. These students were serious about economic science. Their minds were open to new approaches. That's what we need to build the school."

"Times sure have changed," said Murray N. Rothbard, professor of economics at the University of Nevada at Las Vegas and dean of the Mises University. "I remember when you could count the Austrian economists on one hand and the interested students on two. Now we've got an army out there, in both faculty and students. What a pleasure. I wish Mises could have seen this."

These sentiments were echoed by all 17 members of the faculty. In addition to Rothbard, Hoppe, and Salerno, the faculty included Robert Batemarco, Marymount College; Walter Block, Holy Cross College; Roy Cordato, Institute for Research on the Economics of Taxation, and Johns Hopkins University;



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The 1992 Mises University will be held, July 4-11, at Stanford University. For more information contact the Mises Institute, Auburn University, Auburn, AL, 36849-5301; (205) 844-2500; fax (205) 844-2583.

Thomas DiLorenzo, University of Tennessee at Chattanooga; John Egger, Towson State University; Roger Garrison, Auburn University; David Gordon, Ludwig von Mises Institute; Jeffrey Herbener, Washington and Jefferson College; Robert Higgs, University of Seattle; Yuri N. Maltsev, Carthage College; Llewellyn H. Rockwell, Jr., Ludwig von Mises Institute; Justin Raimondo, *The Libertarian-Republican*; Joe Sobran, *National Review*; and Mark Thornton, Auburn University.

The students had much praise for the faculty. "These professors were simply extraordinary," said Matthew McDonald of the University of North Texas. "Without a single exception, this was an assembly of the most powerful minds I've had the pleasure of studying with." Lee Kessler of the University of Pennsylvania added: "I was looking forward to this for a long time, because the Mises University has an outstanding reputation, but this



week surpassed all my expectations."

The conference was open only for full-time students this year, a change from previous years. "The demand is high, and the quality of applicants is excellent," said Rockwell. "Admission standards have become rather competitive. I expect this trend to continue."

With growth comes diversification in both the students' achievement levels and their individual interests. The strategy of the Mises University is to accommodate that diversity. That's why the classes are divided into three levels of advancement and cover all aspects of Austrian economics, from the conventional to the unconventional. Theoretical discussions of money, banking, capital and interest, business cycles, pricing, industrial organization, and more were common. So were methodological and philosophical discussions. But the line-up also included history, economic policy, and critiques of other schools of thought. An added feature this year was a series of classes in public goods, externalities, and the law and economics literature.

Altogether, the Mises University offered 58 classes, 12 small seminars, 4 plenary lectures and discussions, and plenty of time for socializing. This amounts to 146 individual sessions conducted over the course of 7-and-a-half days. Each applicant chose the sessions he or she wanted within a framework that allowed for 40 hours of classroom time, plus seminars and plenary lectures. At any one time, 4 or 5 classes were in session. On two occasions, 12 seminars ran simultaneously.

"The Mises University is more structurally complex than most programs," said Pat Heckman, the Institute's vice president for conferences. "But that's what it takes to give the students what they want. We try to stay on the cutting edge." Perhaps that's why, according to Heckman, the Mises Institute is already receiving applications for next year.



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Most students found it difficult to single out the one most significant intellectual highlight in a week shining with them. But David Fitzsimons of the University of Michigan voted for Rothbard's evening-long survey of American business history, which he described as "the most intellectually compelling public lecture of my academic life."

The students thought the lectures were great, but they also appreciated the time allowed for group discussion, both formal and informal. The formal discussion took place in comfortable settings with about 10 students per group. For two hours, they traded ideas on some particular aspect of economics, discussed what's going on in the profession in some area, or talked about the new research scholars are doing. The informal session took place later, with refreshments being served.

If anyone thinks the Austrian school is static he should attend the Mises University. The school is vibrant and changing all the time, as much in our time as in Menger's and Böhm-Bawerk's.

"You can't overestimate the importance of this program," said DiLorenzo. "Not only is it a highlight for the students, but also for the professors. When you get so many like-minded people together for a week and an opportunity to exchange

ideas, it becomes more than a teaching session. It's an academic conference where you really get things done."

What were the controversies this year? Banking and methodological exchanges were themes of the week, but so were discussions of history, other schools of thought, and the most appropriate way to interpret and respond to them. "If anyone thinks the Austrian school is static he should attend this program," said Cordato. "The school is vibrant and changing all the time, as much in our time as in Menger's and Böhm-Bawerk's."

What's on the agenda for next year? "We will refine and perfect the course offerings, update them in light of new literature, and give other professors a chance to teach," said Heckman. The academic level of classes will be raised even further, she said, continuing a process which has gone on for years.

Mises University 1992 will also add two new features. First, in the opening session the Mises Institute will show a new documentary about Mises's life and work, produced and directed by Emmy Award winner Sandra Garritano of San Francisco. The people who have seen sneak previews described the film as better than anything on PBS. (It will also be available for showing in classrooms around the world.) The second feature will be two simultaneous panel discussions on various aspects of Austrian school theory and policy.

"Students are well advised to get their applications in soon for next year's conference," Rockwell cautions. It will again be held at Stanford University from July 4-11. Full-time students are encouraged to write Pat Heckman at the Mises Institute (Auburn University, Auburn, Alabama 36849) for a more complete catalog of course listings and an information packet. ▲

THE NEW SUBJECTIVIST REVOLUTION: AN ELUCIDATION AND EXTENSION OF LUDWIG VON MISES' CONTRIBUTIONS TO ECONOMIC THEORY

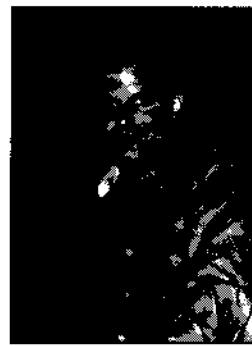
J. Patrick Gunning
Rowman & Littlefield, 1991

REVIEWED BY GEORGE SELGIN

I like to read with pen or pencil in hand, marking passages for emphasis or editorial comment: An asterisk or "NB" marks an especially important passage; a check expresses agreement; a question mark expresses puzzlement at the meaning of a word or sentence or paragraph; an exclamation mark signifies shock or surprise. I stopped marking J. Patrick Gunning's *New Subjectivist Revolution* somewhere in chapter 4, after packing its margins with more question marks than were in this year's census survey and more exclamation points than might be found in a stack of Batman comics.

That was several months ago. I have since taken up the book again, vowing to finish it without the distracting influence of a pen or pencil. But the book's contents remained as perplexing and amazing to me as ever. My hand involuntarily crept toward the pencil jar. This report is really an admission of failure written instead of a proper review.

Why have I failed? One possible explanation is that I have a low threshold for discussions of methodology, having taken an overdose of the stuff in graduate school. I admit to having no desire to write on the subject; I am anxious to escape from what Leland Yeager calls "the curse of methodology." Nevertheless I still retain a healthy interest in the subject. I am, moreover, quite sympathetic toward the methodological views of Ludwig von Mises, which I myself once tried to elaborate and defend. So there is nothing, I think, about the *topic* of Gunning's book that should make me unfit to review it. It is, instead, Gunning's presentation that rubs. Reviewing my marginal notes, I think I have isolated some of the major problems. They are that (1) Gunning is careless in his statements about economic theory; (2) his terminology betrays a misunderstanding of the praxeological method; (3) he fails to appreciate (as Mises himself did) the important difference between methods of *historical* and methods of *theoretical* investigation; (4) in connection with (3), Gunning overstates the role of "intuition" in the Misesian approach to theory;



George Selgin

and (5) Gunning confuses positivism with institutionalism and historicism.

These are the main problems. Minor ones include Gunning's insistence upon coining new expressions when perfectly good old ones exist and his frequent use of the feminine personal pronoun to refer to "the economist"—this an apparent sop to "politically correct" readers who, I think, must constitute a very small percentage of the potential audience for this work. (Most professional economists today are men. As far as I am concerned this is not something to gloat about; nevertheless it is a fact and pronouns should abide by it unless we are to prefer minority to majority rule. Alternatively a true individualist may opt for "he or she," though this construction gets tedious after a while.)

Gunning for Confusion

The central chapters of Gunning's book, grouped together under the mysterious heading "The Method of Contrasting Images of Functions," are more concerned with matters of model building and applied theory than with problems of theory justification *per se*. The problem with these chapters is that they consist mainly of statements that are either banal or wrong. The banal statements might be justified in an introductory economics text, but seem wholly out of place in a work laying emphasis on a particular approach to economics. The wrong statements nullify any gain the banal statements may offer in making the book more accessible to non-economists.

Because statements can so easily be made to appear banal by being stripped out of context, I will stick mainly to listing examples of wrong statements. A "market economy" is defined as an economy involving production, saving, and monetary exchange. Barter, subsistence, and pure-exchange economies are thus supposedly "non-market" economies (pp. 57–58). This is nonsensical. Money is defined as "[A] common denominator for exchange," i.e., a unit of account (p. 59). Most economists, including most

Austrian economists, would insist that money must also be a medium of exchange, and that this function rather than the unit of account function is most fundamental. On page 61: "In a market economy, everyone occupies positions of monopoly. That is, everyone has some degree of monopoly power over others." This is an unusual view, especially for a self-styled Misesian. Most theorists would link "monopoly power" to a producer's ability to influence a market price; Austrians traditionally take a still narrower view of monopoly, linking it to exclusive factor ownership or legislative barriers to entry. (Also appearing on p. 61 is a statement that would be banal in most any context. It reads, "Monopoly power in a market economy is also affected by what economists have come to call competition." Who, pray, is the audience for this book?) Continuing on page 61: "Competition consists of pricing actions that result in copying or innovating." It would be more correct to say that competition is "copying or innovating" in a market setting. According to Gunning's definition, a firm that raises its product price, and so encourages new entry ("copying"), is acting competitively, whereas one that discourages entry by keeping its price low is not!

Cooperation is identified with "collusion" on p. 109. Surely there are non-collusive forms of cooperation, such as peaceful exchange. If Gunning simply means to *define* cooperation to mean collusion, why doesn't he just stick to using the ordinary term? Collusion ("cooperation") is supposed furthermore to involve the assignment of particular consumers to particular producers. But this is only one, rather unusual, manifestation of collusion in the economist's usual sense. On the same page we are also told that "Competition is [*not* "can be"] defined in terms of both an outcome and a process." This should say "in terms of *either* an outcome *or* a process" since the one, identified with equilibrium, is contrary to the existence of the other. Misesians traditionally insist on the process definition of competition, rejecting the outcome definition.

The reader is told on p. 109 that "Consumer sovereignty literally means that consumers . . . are the agents responsible for determining which goods are produced, which consumers get the goods, which items are factors, how much the factors are paid, and what the rates of return on loans are"! Having foisted this fantastic meaning onto the term "consumer sovereignty", Gunning then hastens to take it back, saying in the next sentence: "Actually, the claim of consumer sovereignty should not be taken so literally." This reader

was at least mollified by the thought that a potential, gross misunderstanding of the meaning of consumer sovereignty had after all been avoided. But that was before he read the next sentence, which states that "Sovereignty applies broadly to individuals acting in their roles as consumers, lenders, and factor-suppliers. Thus, a more apt name is individual sovereignty." More apt, indeed, if one wishes to rob a useful economic concept of its analytical meaning, namely that consumers' wants determine the mix of outputs in a market economy.

These examples are, I trust, sufficient to suggest the general shoddiness of the book's arguments. Yet they are as nothing in comparison with the many instances of statements that conveyed no meaning whatever to this reader. I mention just a few of these; any reader anxious for more will not have to look very hard to find them. Two appear on p. 111. The first refers to a situation, supposedly not special, in which "an increase in the demand for one good, which is accompanied by a decrease in the demand for another good . . . leads robo-ents to expect lower robo-profits in the first industry and higher robo-profits in the second than previously." (I suppose this may merely involve an unintended transposition of "first" and "second", but I am not sure.) A second instance is in the closing sentence of the same page, which argues that "the market value of factors in the market economy is caused by entrepreneurship." I suppose this statement is consistent with the doctrine of "individual sovereignty"; I am certain anyway that it is meaningless in terms of orthodox (subjective) value theory.

Robo-Subjectivism

One does not usually expect to find robots in a book about economics; yet Gunning's book has so many robots in it that it reads like a screenplay for "Lost in Space." There are robot savers, robot consumers, robot factor suppliers—even robot entrepreneurs! There is even a passage in which the she-economist "converts an actor into a maximizing robot" (p. 126).

I think I understand Gunning's reason for talking so much about robots. He wants to emphasize the fact that economic models are, after all, abstractions populated with utility maximizers whose means and ends (utility functions) are assigned to them by a theorist. In this sense, they are "programmed" to illustrate some principle. Although one may understand Gunning's motive, this does not mean that his approach is helpful. In fact, economists are used to talking about "agents" in their models; they also understand that these agents are not flesh and blood

human beings, since the agents' goals and opportunities are specified by the theorist. To this extent, Gunning offers nothing new except the term "robot" in place of "agent." To the Austrian reader, however, Gunning's approach seems more seriously misguided. For he seems to have taken Mises's observation that agents in an evenly-rotating economy do not act because they have no inclination to change their plans, and so function *like* pre-programmed automata, and turned it into a principle for constructing economic models of *acting* individuals! Surely for the Austrian-subjectivist it is meaningless to speak of robot entrepreneurs (or "robo-ents"). Agents act "like robots" when they are either too dull or too satiated to conceive of new ways in which to improve their well-being; once we begin to confront the reality of change as manifested in entrepreneurial innovation the robot metaphor ceases to be applicable. "Robot entrepreneur" is a crude oxymoron.

Moreover from the Austrian (subjectivist) perspective, it is surely incorrect to speak of actors behaving in a manner consistent with economic theory only in so far as they have first been "converted" into robots by the theorist. This point of view seems to regress to the concept of "economic man" that dominated classical method but is rejected by (most) Austrians. In the Austrian view, real-world actors really *do* behave according to economic principles. If the theorist cannot account for some actual behavior, he or she does not conclude that the behavior in question is insufficiently robot-like; rather, he or she concludes that the perceived means and desired ends of the individual in question have not been properly understood—that a renewed attempt at *verstehen* is called for. Economic models that abstract from certain kinds of change and opportunities in order to elucidate certain principles do not need to "convert" agents into robots: It is sufficient for the models to assume a correct environment of means and ends to give rise to some particular pattern of *action* that is the logical outcome of constrained maximization (or constrained attempts to remove felt uneasiness). If, having created a certain economic environment and specified particular ends, Gunning still has to convert agents in his models into robots in order to get them to behave "economically," then there is something wrong with his concept of economic behavior.

Misunderstanding *Verstehen*

I refer to *verstehen*—the method of "common sense" or intuitive understanding in the social sciences—with some trepidation, for I recognize

that the role of *verstehen* in economics is widely misunderstood. This is evident in Gunning's book; it is, indeed, the most serious problem in Gunning's treatment of subjectivist method. Gunning's book is rife with references to Schutz and Weber; and it is apparent that he views Mises's method as an extension of the methods endorsed by these writers. To derive economic theories, the economist is, according to Gunning, supposed to put himself in the place of some particular actor, asking how he—meaning the economist—would act in the same situation. Thus "To understand entrepreneurship, the economist must interchange positions with the hypothetical entrepreneur and ask how he would act under similar circumstances." Elsewhere there are repeated references to the economist's reliance upon "intuition and experience" in deriving economic laws. All of this shows a serious neglect of the distinction between theory and history that Mises was anxious to stress. *Verstehen* is a tool for historical inquiry, i.e., for understanding concrete actions of real individuals under particular circumstances. Interpretation of such historical actions necessarily requires the imputation of some specific ends and perceived means to the agents involved; there can be no question of any complete account of an historical event relying solely upon apriorism, deductive reasoning, and abstraction. Yet the latter tools are *essential* in constructing economic *theories*—theories that will be applicable to numerous historical events, and which therefore cannot be based upon appeal to *verstehen*. Theory does not, in other words, endeavor to explain particular, concrete choices of particular agents. It strives to provide a general framework for understanding particular actions—a "pure logic of choice."

In some passages Gunning seems to recognize the difference between the method of theory and the method of history. Thus on pp. 1–2 he observes that "the theorist is not interested in the specific wants, abilities, or knowledge that individuals possess." The same point is reiterated at some length and quite accurately on pp. 24 and 25. Yet Gunning does not seem to recognize that *verstehen* is after all a tool for historical analysis and "applied" economics, *not* a tool of economic theory.

Gunning's confusion appears compounded when he writes (p. 37) that "[w]hen economists interpret historical events they do not construct ideal types." On the contrary, in doing history or applied economics especially an economist cannot dispense with ideal types, for the application of a theory to particular events is largely a matter of interpreting actual choices using ideal types of agents as well as

institutions as a basis for understanding their real-world counterparts. Ideal typification is a crucial counterpart to the method of *verstehen*.

Subjective-"Isms"

A final problem with Gunning's book is its failure accurately to distinguish between positivism, historicism, and institutionalism. They are, after all, distinct. Yet Gunning's discussions and definitions create quite another impression. Witness the pastiche of "isms" offered on pp. 22-23, where Gunning writes that positivism "has manifested itself in three ways. The first is the use of mathematical modelling and statistical definitions of economic phenomena to make predictions about the future. The second is the institutionalist opposition to isolating economic phenomena from the specific political, cultural, and physical environment. The third is historical positivism, which is like institutionalism but that also advocates 'holism'." In his first appendix Gunning expands on this conflation by stating that positivism "defines [sic] economic phenomena to include all behavior that is related to production and exchange for money, as it takes place in a particular culture, in a particular physical environment, and under a particular set of laws." I do not deny that positivism and institutionalism have certain things in common; but to treat them as if they are one and the same seems to me inexcusable. ▲

WHAT SHOULD 'AUSTRIAN' ECONOMISTS DO?

BY JAMES P. PHILBIN

In a 1964 essay, James Buchanan asked: "What Should Economists Do?"¹ I would like to attempt to answer his query, but from an Austrian school perspective.

In the unhampered market or free society, the economist has a limited role. A free society is distinguished from the hampered market by the absence of the legalized institution of coercion—the state. The free society is characterized by mutually beneficial exchanges between individuals, the absence of taxation, and the abolition of a monopoly justice and police system. In a free society, an economist would mostly have an "educational" role to perform. The primary task would be the elucidation of the general theory of human action. Economists who could successfully forecast future consumer wants would quickly leave their meager-paying academic posts and move to the stock and commodity markets where successful fore-

casting reaps substantial fortunes.² Entrepreneurs have a need for estimates of future product demand, but have little use for economic modelling. Another task would be to explain the art of entrepreneurship along with the other phenomenon of the market process such as production and exchange, the role of money, and time preference.

It is in the interventionist society that the economist's role expands.³ The economist can be an aid to the entrepreneur and the individual by analyzing the effects of state intervention in the market economy. The increased demand for the services of economists is described by Rothbard: "In a hampered market economy, indeed, the economist often becomes useful to the businessman—where chains of economic reasoning become important, e.g., in analyzing the effects of credit expansion or an income tax and, in many cases, in spreading this to the outside world."⁴ Thus, interventionism makes the economist useful outside academia, for he can provide the important service of unmasking the real effects of state action in the marketplace.

Ludwig von Mises says clearly the subject matter of economics is means not ends. Ends are values that individuals hope to attain through action. The selection of values by individuals falls into the realm of ethics, a discipline that deals with what kind of ends individuals should adopt. Economic science is "neutral" in regard to ends.⁵ The economist can only determine if the means employed by individuals are appropriate for attaining the desired ends. For example, suppose an individual wants to amass a fortune. An economist can only address the means by which the individual must employ to attain his end. The economist can demonstrate that in the free market the only way to increase wealth is by serving consumers better than one's competitors. Whether an individual should become a millionaire or be a volunteer in the Peace Corps is not in the domain of economics.

Nobel Laureate
James Buchanan
delivering a
speech at Auburn
University.



If economics is a *wertfrei* science, why have economists over time participated in the formulation of state policy?⁶ Public policy is hardly value free. Political decisions are value judgments by those in control of the state apparatus. State action involves the use of confiscated wealth by elected officials or dictators to achieve some ends. Economists who advocate or construct policy, whether *laissez faire* or statist, are not employing economics as a value-free science.

Mises made a valiant and commendable attempt during his lifelong crusade for the free market to justify, on utilitarian grounds, value-laden statements in economics. Although this attempt was admired by his most devoted followers, its weakness was nonetheless revealed.⁷

An obvious reason why many economists engage in public policy despite their supposed value-free profession is that both the economist and the state mutually benefit. The obvious gain to an economist from the "exchange" can be an increase in prestige, income, or position. State gains are more difficult to decipher. Ostensibly, the state obtains the advice of an "expert" for the formulation of policy; however, this is not all, for the state profits on a far more essential, though surreptitious, level. A necessary requirement for the state maintaining its monopoly of force is to convince the public that its rule is legitimate and it is working in their interest. The courting of the intelligentsia is a strategic ingredient in this process.⁸

By soliciting the advice of the economist,⁹ the state appears to attain the counsel of an independent arbitrator in formulating legislation (even if it is often ignored). Whether the advice is heeded or ignored is immaterial to the real significance of the action, for what the state needs is legitimacy—which it achieves by having a supposedly value-free scientist confer on, or construct its policy. The economist acting as a disinterested scientist knowingly or unknowingly contributes to this legitimatizing process. Both economist and the state profit, while the unsuspecting public has been duped into believing that public policy has been somehow "tested" by value-free scientists.

What is generally overlooked by both the social scientist and the citizenry is that once an economist endorses or collaborates on legislation the economist is *necessarily* making a value judgment.¹⁰ For example, Milton Friedman in the mid-1960s proposed the concept of a negative income tax as a "reform" measure for the welfare state.¹¹ The idea was to guarantee a minimum level of income for each adult member of society. As an economist and a supposed practitioner of value-free science, Friedman's proposal violated the bounds of eco-

nomics as a science of means not ends. Economic science is only equipped to elucidate the effects of what a negative or a general income tax would lead to—the depletion of capital, coerced exchanges, an increase in state power. Friedman's proposal was not advanced by a concerned citizen hoping to mitigate the inefficiency of the welfare bureaucracy. On the contrary, the negative income tax was initiated by Milton Friedman, a future Nobel Prize winning "value-free" economist.¹²

By no means is Friedman the only economist guilty of such a digression. One only has to look at such bureaucracies as the Federal Reserve or the President's Council of Economic Advisors as examples of economists intimately involved in the formulation of state policy. These economists typically present themselves to the public as disinterested analysts. Once an economist endorses a policy, however, he implicitly adopts its ends.

The same is true of an economist who advises a businessman. A fashionable slogan that many academics are fond of using to describe themselves is "business economist." Such a term is misleading, for it creates a false impression about the function of the businessman in the market, and that of the economist as scholar. A businessman is a capital-owning forecaster, who arranges scarce factors of production in order to satisfy the future demands of consumers for profit. Economists are primarily pedagogues who teach and expound upon the fundamental tenets of economics. Those academics who regard themselves as business economists are usually neither. Most are engaged in some sort of economic modeling which is of little, if any use to the entrepreneur. Mises recognized the unhealthy hybrid of the term "business economist" prevalent in academia:

What is wrong with the discipline that is nowadays taught in most universities under the misleading label of economics is not that the teachers and authors of the textbooks are either not businessmen or failed in their enterprises. The fault is with their ignorance of economics and their inability to think logically.¹³

In cases where a business economist designs models for the entrepreneur, the economist, like the "disinterested" public policy analyst, is necessarily adopting the ends of the entrepreneur.¹⁴ The businessman hires the economist in order to make profit—an end. The economist devises his model or gives advice on the basis of helping the entrepreneur reach *this* goal. So, just as the public policy advisor adopts the state's ends the business economist adopts the entrepreneur's.

Rothbard has suggested that to combat the inconsistency of economists making policy recommendations, they should explain the ethical basis for such advice.¹⁵ For instance, if an economist advocates that the Federal Reserve should increase the money supply, he must first state from his own personal standpoint (based on whatever ethical position) why an increase is needed. In addition, the policy advocate must explain why he believes the government should have control over the money supply. Critics of such a policy, like Austrian economists, can refrain from making their ethical biases known because their objections are grounded in praxeology. Austrian economists describe the effects of an increase in the money supply: redistribution of wealth, inflation, distortion of the structure of production. Those who elucidate the effects of an increase in the money supply are not making value judgments.

Rothbard considers policy recommendations by economists who fail to cite an ethical position a "treasonable" offense in a profession that is supposedly value free:

I contend . . . that it is the responsibility of any scientist, indeed any intellectual, to refrain from any value judgment whatever *unless* he can support it on the basis of a coherent and defensible ethical system . . . those economists who, on whatever grounds, are not prepared to think about and advance an ethical system should strictly refrain from any value pronouncements or policy conclusions at all.¹⁶

William Rappard, in a tribute to Mises, concurred with Rothbard: "[E]conomists who invoked the authority of their intellectual discipline to urge upon society measures calculated to reform it were impostors. Reforms could only be means to an end. Economics dealt, and could legitimately deal, only with means."¹⁷ Thus, to follow the dictates of the discipline and remain "pure," praxeologists qua praxeologists must refrain at all times from making value judgments or policy suggestions. This includes measures (abolition of taxes, a gold standard, elimination of monopoly privileges) that would lead to prosperity, liberty, and justice. These are ends no matter how socially beneficial.

Austrians can promote their ends without violating value-free science by showing how the effects of interventionist policies can lead to socialism and war. Ludwig von Mises was the quintessential example of an economist who managed to wage a constant, yet largely unsung struggle for his ideals despite a hostile intellectual climate.¹⁸ He did so both as a praxeologist, and as a "citizen." As a citizen, Mises

was an indefatigable spokesman for the free market. He was an advisor to statesmen along with being a teacher and advocate of laissez faire to laymen.¹⁹ As an intellectual, Mises believed that it was imperative that the truths of his science become generally known. Despite unfavorable conditions, Mises as both praxeologist and concerned humanitarian was able to promote a philosophy while remaining value free.

Economists can thus promote their own ends, but must first drop the mantle of science in which they are wrapped and do so as private citizens. By doing so their pronouncements will be less revered by their fellowmen, yet they will not violate the parameters of their science. Most important, they will not be tools in the state apparatus that uses the social scientist to entrench and extend its hegemony through the manipulation of value-free science.

The economist's primary function is the elucidation of the principles of praxeology. As a forecaster, the economist is of little use to the entrepreneur. However, the praxeologist can be helpful to both the entrepreneur and the public by demonstrating the effects of state intervention on the market. Austrians have also made a strong case for economic science that is value free. Therefore if economists want to participate in, or suggest, policy, they must first declare an ethical base.

Notes

¹James Buchanan, "What Should Economists Do?" *Southern Economic Journal* 30 (January 1964): 213-22.

²Murray N. Rothbard, *Power and Market: Government and the Economy*, 2nd ed. (Kansas City: Sheed Andrews and McMeel, 1977), p. 257.

³Ibid.

⁴Ibid, p. 258.

⁵Lionel Robbins, *An Essay on the Nature and Significance of Economic Science*, 2nd ed. (London: Macmillan, 1952), p. 24.

⁶See Ludwig von Mises, *Notes and Recollections*, trans. Hans F. Sennholz (South Holland, Ill.: Libertarian Press, 1978), pp. 71-92.

⁷Murray N. Rothbard, "Praxeology, Value Judgments, and Public Policy," in *The Foundations of Modern Austrian Economics*, ed. Edwin G. Dolan (Kansas City: Sheed & Ward, 1976), p. 89.

⁸Murray N. Rothbard, *For A New Liberty: The Libertarian Manifesto*, rev. ed. (New York: Collier Books, 1978), pp. 54-69.

⁹The economics profession is but one sector of the intelligentsia in which the state seeks "advice." See Harry Elmer Barnes, *The Court Historians Versus Revisionism* (Hollywood, Calif.: Sons of Liberty Press, 1984).

¹⁰Rothbard, "Praxeology, Value Judgments, and Public Policy," p. 96.

¹¹Kurt R. Leube, ed., *The Essence of Friedman* (Stanford, Calif.: Hoover Institution Press, 1987), pp. 57-68.

¹²Rothbard, "Praxeology, Value Judgments, and Public Policy," p. 92.

¹³Ludwig von Mises, *The Ultimate Foundation of Economic Science: An Essay on Method*, 2nd ed. (Kansas City: Sheed Andrews and McMeel, 1978), p. 78.

¹⁴Rothbard, "Praxeology, Value Judgments, and Public Policy," p. 96.

¹⁵Murray N. Rothbard, "Value Implications of Economic Theory," *The American Economist* (Spring 1973): 35.

¹⁶Rothbard, "Praxeology, Value Judgments, and Public Policy," p. 93.

¹⁷William E. Rappard, "On Reading von Mises," in *On Freedom and Free Enterprise: Essays in Honor of Ludwig von Mises*, ed. Mary Sennholz (Princeton, N. J.: D. Van Nostrand, 1956), p. 18.

¹⁸Murray N. Rothbard, "Ludwig von Mises and the Paradigm for Our Age," *Modern Age* (Fall 1971): 370-79.

¹⁹Murray N. Rothbard, "Mises and the Role of the Economist in Public Policy," in *The Meaning of Ludwig von Mises: Contributions in Economics, Epistemology, Political Philosophy and Sociology*, Jeffrey M. Herbener, ed. (Boston: Kluwer, forthcoming), p. 197. ▲

Book Review

CAPITALISM

Arthur Seldon
Oxford: Basil Blackwell, 1990

REVIEWED BY GERARD RADNITZKY

Dr. Samuel Johnson put it succinctly: "Political liberty is good only so far as it produces private liberty." Why this is so is spelled out in Seldon's latest book. Arthur Seldon as a Founder President and Editorial Director of the London Institute of Economic Affairs, the oldest and most prominent of the market-oriented "think tanks", has for 30 years performed a decisive service in the transformation of public opinion in Great Britain to favor the open market economy. This book is the quintessence of his work and the intellectual autobiography of a life dedicated to the idea of the open society.

Economists call the free private market economy "capitalism." A politico-economic system is less capitalist and more socialist the larger the sector of collective decisions in the market. All existing systems thus contain elements hostile to their main character: Capitalist systems have socialist state sectors; socialist systems have capitalist market sectors.

A comparison (or contrast) of capitalism and socialism is significant only when comparing both as they are with all their faults or as they could be in an ideal form. Socialists like to contrast imperfect capitalism with perfect socialism. Arthur Seldon's latest book invites us to make significant comparisons between capitalism and socialism; and he then asks us to reflect on capitalism as it could be strengthened by its yet unrealized potential.

In the competitive market in tracts on capitalism (Michael Novak, Charles Murray, Milton Friedman, to name only a few of the best selling authors), *Capitalism* ranks as a catechism for the advanced, interesting for the specialist yet understandable by the layman. Its message is that capitalism is superior to all other systems for welfare and freedom. The main line of argument is

given in the following paragraphs.

The market has many advantages over the political process. It allows individuals to express their personal preferences. The freedom of the common man is much greater in the market, where one man has *many* choices ("votes") *every* day, than in the political process, where he has only *one* choice (vote) among *few* alternatives (candidates) *every* 1,000th day.

The principle of private property is indispensable for ensuring responsible exchange and trade. Only when success brings personal rewards and failure personal penalty can responsibility be learned. Only thus can effective motivation be created. Extensive private property is the best way to tame the Leviathan of government and check its kleptocratic appetite.

Capitalism promotes specialization by competition. If the consumer can *compare* alternative goods and services, fewer people are inclined to produce those in which they do not excel. Incentives to effort produce innovation and improvement in quality. The prices emerging in competitive markets perform the function of signals to what and how much to produce; without them the information cannot be found. Because socialism lacks free-market prices it cannot promote welfare.

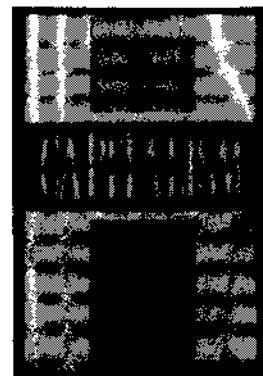
"Selfish" people can serve themselves only by serving the wants of others in the market. "Even bad men are led by the market process to do good, but good men are induced by the political process to do harm" (p. 10). The capitalist system promotes moral behavior; people risk their own money. The political process enables people to buy votes with other people's money.

An order based on a market economy requires only a minimal state that protects private property. Property rights can be respected in a "state of nature," but the legal framework of a private rights society makes it much easier. The more tasks are solved by the market, the less important is the political process.

Seldon rejects the myth of "active citizenship": The typical citizen has more important matters to attend to. He leaves essential government tasks to specialists. But here there is danger. Governments tend



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to over-regulation (as in health standards and financial transactions) because the risks of under-regulation are more obvious and therefore less rewarding in votes; but for the general welfare too little regulation is better than too much because it suppresses new enterprise in services and industries.

Governments tend to raise taxes and increase spending as far as possible. But for general welfare too little government is better than too much—because it is easier to enlarge government where essential than to reduce it where excessive.

Most undesirable features of existing capitalism are caused by the political process. Politicians tend to politicize economic problems, bureaucrats to bureaucratize them, and group interests to gain at the financial expense of others. The result is paternalistic social democracy.

The market is the best way not only to economic growth and efficiency but also to improve the well-being of the poorest. Involuntary poverty is better cured by easing free movement from industries and regions with lower to those with higher incomes than by redistributing income by the methods of the political process, which blunt incentives and repress growth.

The common people stand to gain more from capitalism as it could be with less political management than from socialism which requires extensive political management. It is easier to even up differences in purchasing power in the market than differences in the "cultural" skills required by the political process. Socialism has not removed inequalities, it has merely institutionalized them.

For the Third World the fastest way out of its misery is to introduce capitalism. For relatively wealthy countries the fastest way to the economic backwardness of the "Third Way" (favored by some in Western and in Eastern Europe) between the rejected communist socialism and the liberal market capitalism that has raised living standards for the masses is to implement discredited "social democratic" values.

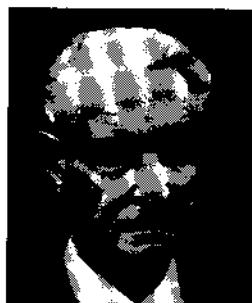
Capitalism as we know it is by no means free of fault. But it can be corrected. In socialism every improvement—necessarily capitalistic—makes it less socialist. The market mechanism is far more self-correcting than the state: It is easier to escape from a commercial monopoly than from a political monopoly. Only state protection creates long-lived monopoly. Concentration in state industries (railways, postal services, telecommunications, and so on) is always uneconomic—at the cost of the consumer whom they also deprive of freedom of choice and of innovation. As the state monopolist fears no

loss of buyers from competition, it has no incentive to respect consumer preferences.

The market is indestructible. If it is forbidden it seeks more welcoming environments or the so-called underground economy, where it often stimulates production. But only in the minimal state with private property can capitalism fully realize its wealth-enhancing potential.

Capitalism is in no sense a one-sided hagiography of the capitalist system. The author undertakes a painstaking examination of the criticisms leveled at its economic working and moral foundations—especially from social-democratic thinking. There are signs that the social-democratic era is slowly ebbing, and there is a renaissance of liberal political thought—"liberal" in the sense of classical liberalism. So says Milton Friedman in discussing the change from the "Fabian tide" to the "Hayekian tide." The Thatcher Revolution of 1979 is such a sign; so is Reaganomics whose economic creed has inspired many books and given the Republicans three election victories.

Does the book not have any faults? It is not easy to criticize a book if you agree with its contents and admire its presentation. Perhaps passages like, e.g., "the market . . . is a surer way to an egalitarian ambience . . . than the enforcement of equality by the state" (p. 197) or "the equalizing power of the capitalist market" (p. 197) may puzzle a hasty reader. Seldon claims that the market has shown its strength not only as a source of prosperity but also as an equalizer. Yet, the market produces a distribution of income and wealth that does not tend towards more and more equality of outcomes. Competition functions as both a discovery process and a selection process, and sometimes luck plays a decisive role. Inequality of outcomes is inevitable, and it is also indispensable as an incentive to effort. Seldon rightly argues that upward mobility for the lower income strata exists only thanks to the market. Propping up low incomes—which requires redistribution—does less harm than distorting prices (e.g., through rent control) or augmenting the set of publicly provided goods and services—a clandestine form of



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redistribution. However, each of them violates the efficiency conditions. Even when propping up low incomes there must be a tradeoff between more equality of outcomes and integrity of property rights or between actual level of consumption and the growth rate of consumption. This is often denied. The classical and very popular form of denying it is the doctrine of a "Social Market Economy" (roughly corresponding to what Ludwig von Mises labeled 'hampered market economy'). The share of taxes of all sorts (including covert taxes) in the GNP is a rough measure of inefficiency. One could wish to have a more extensive analysis of the redistribution problem.

In a few places the author mentions the "Swedish Model" and similar cases where the German idea of a "social market" has been carried to the extreme—with predictable results. For instance, on page 208 Arthur Seldon correctly observes: "Nor has political democracy in Sweden ensured liberty in the intimate elements of everyday living . . ." Indeed, the paternalistic welfare state has steadily and drastically reduced freedom of choice in the name of equality. One would have wished to have these issues elaborated, including an analysis of the startling fact that the radical egalitarian policy that the Swedish social democrats have been able to impose on the country for almost half a cen-

tury has not led to a more equalized society—on the contrary has increased inequalities. Seldon's conceptual instruments would have provided him with excellent means for explaining this paradoxical effect. However, such criticism may appear pedantic.

For most of the industrialized countries the book could not be more timely. Their electronic media, their "intellectual" (the 'chattering classes') in schools and universities, their official churches, and so forth, are skeptical or ignorant of the free, private market economy, and there are socialists in all parties. The German Federal Republic is a good example: From 1949 to the late 1950s it was a paragon of a free-market economy, since then it has steadily moved towards corporatism. It is to be hoped that the European Community will realize that integration of diverse economies cannot be accomplished as a political and bureaucratic process, but can only occur as a result of the withdrawal of the state and its agents, i.e., by delegating the task of integration to markets. So far capitalism has not been allowed to show what it can do, to deploy its potential for fostering prosperity and liberty. This is one of the main theses of Seldon's book. It is heartening that *Capitalism* has been awarded first prize in the contest for the book published in Britain in 1990 that "best contributes to public understanding of the political economy of a free society." ▲

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