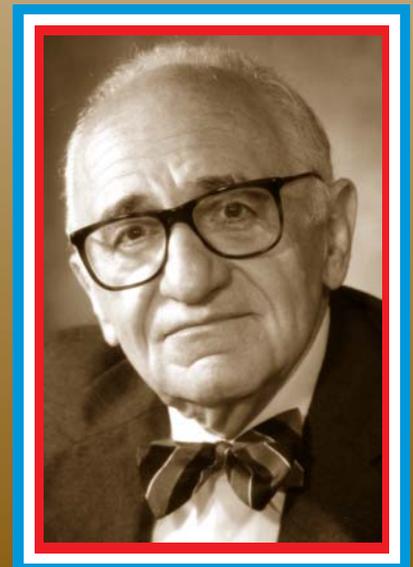
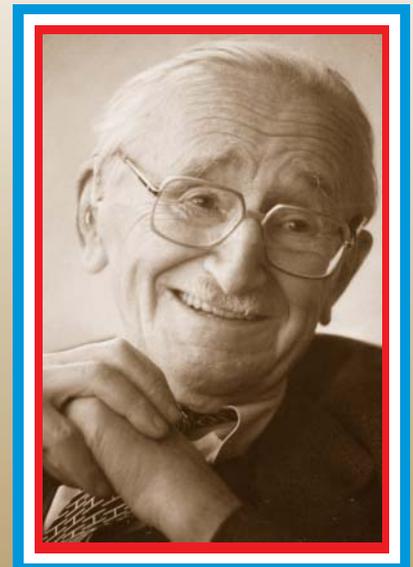
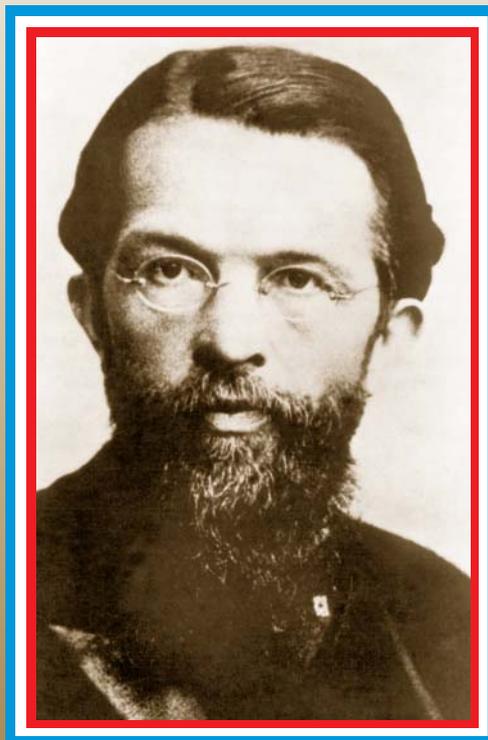
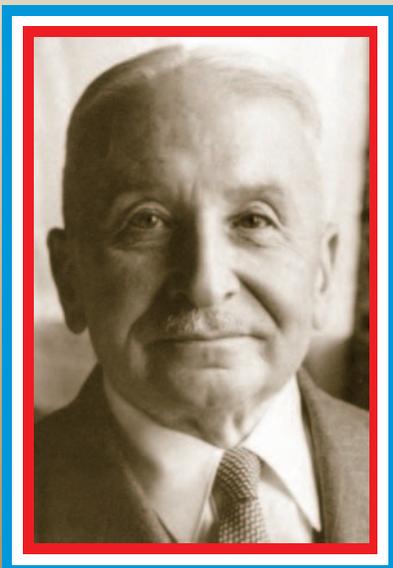


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AUSTRIANA

PART I

THEORY AND DEBATE

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ABOUT THE REPORT'S AUTHOR

AUSTRIAN ANALYSIS

Heinz Blasnik

Heinz Blasnik started out as an independent stocks and bonds trader in the early 1980s, going on to join Austria's first discount brokerage firm as head trader in charge of managed accounts.

In the late '80s, he emigrated to sub-Saharan Africa where he spent the next 10 years running a gemstone export business. Heinz returned to Austria in the late '90s, to study international business economics at Vienna University of Economics and Business Administration.

Working as an independent trader and market analyst for Vienna-based Hedgefund Consultants Ltd, he immersed himself in the literature of the Austrian School, a body of economic theory and political philosophy that receives little attention in the land of its birth.

His analyses and articles discuss the modern economy and markets mainly from the Austrian School viewpoint. Heinz also writes market reports focused on technical analysis and occasionally publishes articles under the pen name 'Pater Tenebrarum' at www.acting-man.com

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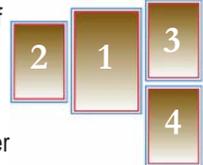
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KEY TO THE COVER



The four major proponents of
Austrian Economics.

- 1: Carl Menger, founder of
the Austrian School.
- 2: Ludwig von Mises, founder
of the Mises Institute.
- 3: Friedrich von Hayek.
- 4: Murray Rothbard.



AUSTRIAN ECONOMICS

Good for your health

“Economics must not be relegated to classrooms and statistical offices and must not be left to esoteric circles. It is the philosophy of human life and action and concerns everybody and everything. It is the pith of civilization and of man’s human existence.”

- Ludwig von Mises, **Human Action: A Treatise on Economics**, 3rd revised ed., Ludwig von Mises Institute, [first published, 1949] 1966, p.878

“The sciences of human action start from the fact that man purposefully aims at ends he has chosen. It is precisely this that all brands of positivism, behaviorism, and panphysicalism want either to deny altogether or pass over in silence.”

- Ludwig von Mises, **Theory and History**, Ludwig von Mises Institute, [first published in 1957] 1985, p.3

It used to be a tradition of the Economics Department at Strathclyde University to take the Honours Year students on a five-day, pre-term trip to the Scottish Universities’ retreat at The Burn, near Edzell in Angus. The Burn itself is a quite magnificent, renovated estate property which housed about 30-40 students and lecturers comfortably. Through its grounds ran the North Esk River where, in September, staff and students could wander down and watch the salmon leaping up the rapids to their spawning grounds. It was – and no doubt still is – a quite magnificent setting for a reading party.

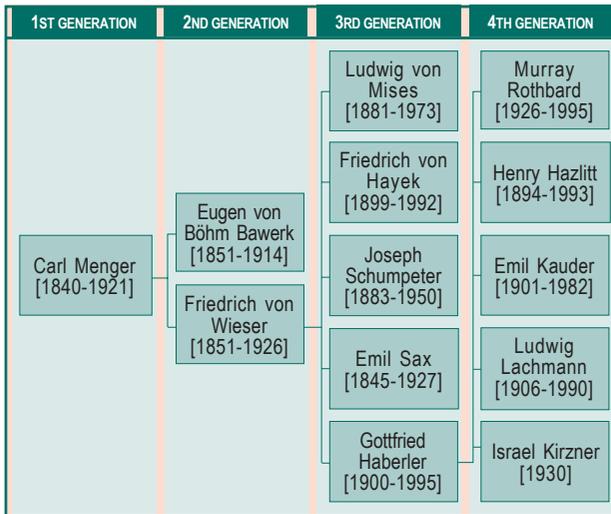
Thirty years ago, as a young research fellow attached to the Fraser of Allander Institute, a centre for research on the Scottish economy based at Strathclyde, I presented an introductory lecture to the Economics Honours Year on the Austrian School

of Economics. The title of the presentation was “Austrian Economics: Good for your health”. It took as its starting point the Austrian family tree as shown in Figure A. As you can see, the founders and adherents of Austrian theory and its traditions have, by and large, been pretty long-lived. On average, the 13 economists included here lived to the ripe old age of 82 (Kirzner is 82 at the moment and still going strong). That fact prompted the title.

I doubt if the couple of years’ students that I presented this talk to would have remembered much of the content. By the time I had graduated to the lecturing and researching ranks the Honours course had morphed into a full-on teaching programme with lectures in a dozen different topic areas and two core Honours Year classes (I had had the luxury of studying at a time when the Honours Year consisted of very little formal teaching, a lot of very small group seminars and an inordinate amount of time for self-study – or not if you were that way inclined. I read countless works by Menger, Böhm-Bawerk, von Mises, Hayek, Lachmann and Rothbard during that year – talk about a nerd!). There was no time allocated to think off-topic or delve into the delights of long-forgotten schools of economics.

But maybe that last comment isn’t quite accurate. I still have the two paperbacks on my bookshelves today that kick-started my interest in the Austrian School. **The Foundations of Modern Austrian Economics**, edited by Edwin G Dolan, was published in 1976 by Sheed and Ward Inc. (Kansas City) and **New Directions in Austrian Economics**, edited by Louis M Spadaro, was published in 1978 by Sheed, Andrews and McMeel (Kansas City). My Honours Year was 1979-80. If not in the UK, certainly in the US there was a renewed interest in

FIG A Four generations of Austrian School economists: good for your health



Source: Biographical records.

Austrian teaching at that time. Why? Simply because of the failure of Keynesian Economics over the preceding decade when the never-before-considered phenomenon of stagflation reared its ugly head. The only school of thought that could explain its existence – and that remains the case today – was the Austrian School. As we embark on another episode of Keynesian craziness (yes, the last four years are just the start, we probably have another 3-4 years of failure of public spending and easy-money policies to go before they are finally rejected as bad economics (again)), the Austrian School stands at the forefront of explanations as to why the system has gone so badly awry.

During my time as Chief Economist at CLSA Asia-Pacific Markets I was given the freedom to apply Austrian Theory, adapted for market and investment experience, and make forecasts on the back of its business cycle and capital-theory frameworks. While timing downturns and problems in economies has not always been perfect (I am still learning after all) the

general direction of the economic trajectory followed by economies that have flaunted Austrian rules has been pretty accurate. At Asianomics Austrian principles are front and centre in our work.

As a result, over the years there have been numerous requests by clients and others for further reading on Austrian Theory and how it can be applied in investment. Of course, like all academic study areas, theory and application are largely divorced. There are numerous books and articles on Austrian Economics at the theoretical level, but applying the lessons in a way that helps inform the investment process and is relevant to the investment professional is an underdeveloped field. In our own tiny way we tried to bridge that gap a little with *Asianomics* No 2/2009, **GDP – Damaged goods**, [17 March], written by Heinz Blasnik (with a section written by myself on Austrian investing). But that was a one-off study which was aimed at exposing the weaknesses in the current system of National Income Accounting and, more importantly, in the use of GDP forecasts and measures as a way of informing the investment process. We all do it, but there is no reason whatsoever that the aggregate GDP growth rates should move in line or explain deviations in equity markets.

Since then Heinz and I have kept in touch through an email thread to which we both contribute. His insights often refer to True Money Supply (what we refer to as M-Prime in our US recession-watch indicators) and how it is changing in the US and Europe as well as to the weaknesses in current policy settings for placing the real economies in the West back on a sound growth footing. Late last year I asked Heinz if he would consider writing a series of reports for Asianomics which explained in more breadth the Austrian approach, and how it could be applied to

the markets. We agreed on a programme of research and Heinz set off to write on three topics: [1] the theoretical foundations of Austrian economics and how it differs from the Mainstream; [2] short-term versus long-term secular cycles (or how booms and busts are brewed in the confines of central banks), and [3] policymaking and investment conclusions.

In mid-January he sent me his draft on the first of the three topics. To say that it was thorough in its depth would be an understatement. In fact, so deeply researched was it that, when editing, I realised that it would be too much to swallow in one report. Instead, we will be publishing at least five or six *Asianomics* on the subject of Austrian Economics: where it came from, how it differs from the economics you are used to seeing and what it means for investing in the future. I have given this research series the generic name, **Austriana**.

In **Austriana Part I: Debate and Theory**, Heinz goes back to the theoretical and philosophical foundations of the Austrian School. We both felt that it was necessary to establish the core principles of the adherents of Austrian thinking from its founder, Carl Menger, through its most famous disciples, Ludwig von Mises and Friedrich Hayek, to its modern day interpreters (no longer Austrian nationals) such as the late Murray Rothbard, Hans-Hermann Hoppe, Jesus Huerta de Soto, Robert P Murphy and Lew Rockwell, chairman of the Mises Institute. This report may be the one which appeals to readers least because it does cover some ground on the debate between the Austrians and others as well as differences in philosophy and theory. But for those of you who are willing to delve into it, you will find a consistency of thinking and an approach to the social sciences – one which I firmly believe is better than the mathematical formalism that has

tragically engulfed economic thinking and teaching in the last 40 years – which calls into question many of our preconceptions and accepted wisdoms.

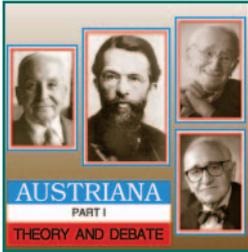
From the very outset, the Austrians were vehemently opposed to socialism. Not on the basis that it was inherently bad but purely on the basis that it is demonstrably bad economics. It cannot work for the simple reason that governments and technocrats do not have the ability to calculate the necessary prices of inputs and outputs that make the living, breathing market system so awesomely efficient. But Left-leaning readers need not fear, Austrian theory is equally scathing when it comes to the economics of neoclassical capitalism – whether Keynesian or monetarist. For non-economists, I suspect – because I have seen it happen so many times – that persevering through these sections on theory and philosophy will transform your view of economics (and economists). Quickly you will be able to grasp why Austrian Economics is so appealing: it is grounded in the real world, it is what we all know intrinsically about the way we live our lives and, above all, it is pure common sense. No mathematical models and no perfectly competitive assumptions are found here.

I hope you enjoy the read. Part II is coming soon on the topic of monetary measurement and the dangers inherent in central banking. And you thought you were safe with LTRO...



Dr Jim Walker
Managing Director
Asianomics Limited

THEORY AND DEBATE



“At a conference in Geneva where Pareto was presenting a paper, Gustav von Schmoller was in the audience and kept noisily interrupting Pareto’s talk by shouting “There are no laws in economics!” The next day, Pareto spotted Schmoller in the streets of Geneva. Pareto approached Schmoller and hid his face, pretending to be a beggar (which was not too difficult since Pareto was a shabby dresser). “Please, Sir,” Pareto said, “Can you tell me where I can find a restaurant where you can eat for nothing?” Schmoller replied, “My dear man, there are no such restaurants, but there is a place around the corner where you can have a good meal very cheaply”. “Ah,” said Pareto triumphantly, unveiling himself, “so there *are* laws in economics!”¹

Although the scientific controversy referred to in this section is almost forgotten today, it is the starting point of a continuing dispute. Carl Menger, the founder of what is now known as the Austrian School of Economics published his work *Principles of Economics* in 1873². Independently of each other, Menger, Leon Walras and W.S. Jevons had all developed the marginal utility theory in the years leading up to the work’s publication, bringing about what is nowadays referred to as the ‘marginal revolution’ in economics.

Menger’s subjectivist economic theory finally

managed to overcome one of the greatest problems that had bedeviled classical economists – namely, the conception of a tenable theory of value. Economists were long stumped by the so-called value paradox. A simple example was used by Adam Smith to illustrate the problem of the ‘use value’ concept: how can it be that diamonds are more valuable than water? After all, human beings need water if they want to survive – a diamond they can do without.

As Menger established, the prices for these goods are not determined by the total quantity of the good in question – it is always a definite amount of water, or a definite number of diamonds that an individual economic actor desires in definite circumstances for the purpose of a definite service they are expected to render. In other words, the value of a good is established by a subjective appraisal based on its marginal utility – it is not ‘intrinsic’ in the good. Value resides in the mind of the person doing the evaluation.

David Ricardo and his contemporaries, for all the great progress their economic theorising had produced, erroneously held that value is a result of the cost incurred in production or the labour expended on producing a good (as an aside, earlier labour theories of value were developed by Aristotle, scholastic philosophers like Saint Thomas Aquinas and the Tunisian historian and economist, Ibn Kaldhoun).

When Karl Marx published the first volume of *Das Kapital* a few years before the publication of Menger's *Principles*, he too relied on the labour theory of value. Marx never attempted to refute the classical economists, but rather built his own economic analysis on the foundations they provided. (Ludwig von Mises called Marx's economics a 'garbled Ricardianism')³.

The labour theory of value played right into Marx's assertions about the exploitation of workers by capitalists. However, he completely ignored any further advances in economic theory (he published no further economic writings after the marginal value theory became known. The remaining two volumes of *Das Kapital* were published by Friedrich Engels after Marx's death).

Instead, Marx alleged that economic theory was 'ideological', i.e., that it largely served as a tool of bourgeois propaganda. Marx and Engels even went as far as denying that the logical structure of the human mind was universal: they argued that there was a 'proletarian logic' and a 'bourgeois logic', without ever really explaining why that should be the case. Of course if one assumes this assertion to be true, then the tenets of Marxism can no longer be attacked by logical reasoning, which from the point of view of Marx, Engels and their followers was rather convenient.

The Methodenstreit: Germany vs. Austria

At the time Menger published his *Principles*, the German, or rather Prussian Historicist Economic School was the preeminent current in the social

Photo: Roger Viollet Collection

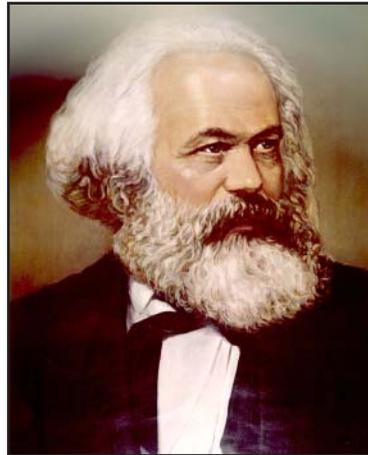
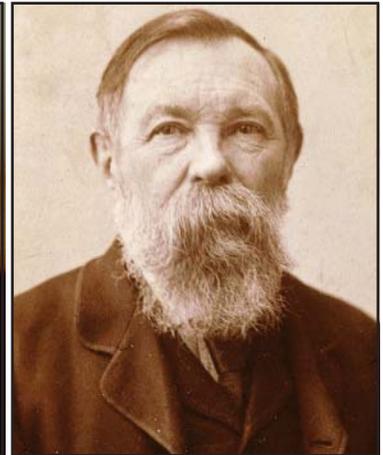


Photo: Alfred Dagli Orti/The Picture Desk



Marx; Engels: the convenience of different logical minds for different social classes.

sciences in Germany (to be precise, this was the 'younger' historical school, which had evolved out of a more-conservative predecessor). Menger's economic theory was a conceptual work – he used rational deduction based on general principles to arrive at theoretical insights regarding economic phenomena, with the aim of constructing a body of universally valid economic laws.

The leader of the Historicist School, Gustav von Schmoller, soon ventured to dispute and criticise Menger's viewpoint, specifically Menger's 1883 work on methodology, *Investigations into the Method of the Social Sciences with Special Reference to Economics* (it has been alleged that Schmoller criticised Menger's work without even reading it – a parallel to Keynes' review of Mises' *Theory of Money and Credit*⁴). Their debate took place in the form of articles that appeared in the leading sociological publications of the time and was eventually termed the 'Methodenstreit' ('the dispute over methods'). It ended when Schmoller simply ceased to reply to Menger's arguments.

Gustav von Schmoller was highly influential in

German academic life – he was a professor of economics in Halle, Strasbourg and Berlin, and from 1899 represented the University of Berlin in the Prussian House of Lords.

Schmoller was also the founder of the ‘Verein für Sozialpolitik’ (the ‘Society for Social Policy’), which advocated interventionist economic policies by the Prussian state, which it advised and the interests of which it defended. The physiologist, Emil du Bois-Reymond, rector of the University of Berlin and president of the Prussian Academy of Science in a speech in 1870 proclaimed that the professors in Berlin represented the ‘intellectual bodyguard of the Hohenzollern’. Supporters of classical liberalism referred to the pro-interventionist German professors led by Schmoller as the ‘Kathedersozialisten’ (‘the socialists of the chair’).

The Historicist view was that there could not be any universally valid, time- and place-invariant economic laws (see his dispute with Vilfredo Pareto quoted above) and that the deductive approach of classical as well as subjectivist economics had to be rejected.

It asserted that economic science had to incorporate the historical, cultural, political and ethical environment of the times and places it considered, in order to construct a comprehensive social science. This in turn could only be achieved by collecting empirical data in sufficient volume to determine the major influences pertaining in these specific environments or historical epochs. The Historicists in fact denied that economics could be deemed to represent a true science on a par with the natural sciences in that they claimed

that it was impossible for it to discover or formulate universally valid laws.

Schmoller specifically criticised the idea that economic actors acted mainly out of self-interest and that such self-interested action could contribute to the commonweal. In his view, economic activity always contained an ethical component in the form of an altruistic ‘interest for the whole’, without which it could not be fully explained. The proper institution for providing the required moral compass and circumscribing economic activity in terms of its ethical orientation was in Schmoller’s view the state – in this particular case, the State of the Hohenzollern.

In short, Historicism was ultimately really a political-ideological movement. It argued in favour of the establishment of an interventionist corporatist-socialistic economic policy and disputed the conclusions of economic science because they didn’t agree with its political programme.

Originally a conservative reaction to the ideas of the Enlightenment, Historicism had at the time of Schmoller joined forces with nationalism and socialism which it regarded as its natural allies in its fight against free trade and capitalism⁵. The aim of its attempt to deny the validity of the methods of economics was to undermine the criticisms leveled by economists against the socialist and interventionist policies it advocated. As Mises pointed out, while trying to undermine its critics by denying that their discipline even amounted to a science, its proponents never demonstrated that socialist and interventionist policies were actually sound⁶.

It should be noted for the sake of completeness that Schmoller himself was not primarily concerned with methodological questions, but saw himself mainly as a social reformer. He felt that Menger's critique of Historicism was apt to impair his and his school's academic standing, so to some extent regarded it as a personal attack. Schmoller also appeared more concerned than Menger about the question of inductive and deductive methods. He also seems to have misunderstood the pursuit of self-interest as aiming exclusively at the maximisation of *monetary* profit.

As Murray Rothbard pointed out many years later, it is their *psychic* profit economic actors want to maximise (obviously a psychic profit can also be achieved by an altruistic deed; the terminology was first used by Frank Fetter in his 1904 work *Principles of Economics*⁷ and subsequently adopted by Rothbard). Although both Historicists and Marxists drew a great deal of inspiration from Hegel's philosophy of history, the latter were quite critical of the former as they saw them mainly as a propaganda arm of the Prussian state (which Marx despised), concerned with mollifying the working class and keeping it from revolt.

Menger termed the Historicist approach 'methodological collectivism'. Methodological collectivism and similar doctrines claiming

The influence of Historicism on German economic policy is felt to this day ...The desirability of this system remains largely undisputed in Germany.

universalism essentially assign an independent will to the collective. However, while every individual in society is part of one or more collectives, it is only individuals that possess a will and therefore the ability to act. Menger, by contrast, held that methodological individualism was the proper procedure for economic science, which put him squarely in opposition with the entire German mainstream at the time.

In his view, the actions of people interacting in exchanges in the marketplace can never be viewed as a 'collective' pursuing its goals (although Menger allowed that certain economic collectives could exist on a small scale, such as for instance a family, a co-operative, a commune – but an entire nation state could not possibly be viewed as having a 'unified will' of its own in economic matters). Rather, it is in the self-interest of individual economic actors to behave in a manner that makes social cooperation possible, since social cooperation under the division of labour is recognised as advantageous by individual actors. Their self-interested actions and choices in turn help to coordinate the economy as a whole, thereby furthering the commonweal by accident rather than by design.

Hegel's philosophy of history held that human history was a succession of stages guided by providence, with the later epochs progressing to a higher, better state than the earlier ones. In the Historicist view, every such historical epoch or stage had its own set of economic laws, valid only for this specific period of history. In addition, economic laws were also regarded as being different in different nations. In short, Schmoller and his colleagues ultimately denied the existence of

universally valid economic laws altogether, hence his clash with Pareto.

This was the *essence* of the ‘Methodenstreit’: whether it was even possible to conceive of laws of economics that have and always will hold true, regardless of historical epoch, race, geographical location, and so forth.

Menger was an Aristotelian rationalist and held that universally valid laws governing economic phenomena could indeed be discovered by reasoning. Incidentally, it was Schmoller who in his critique of Menger’s book on the methods of the social sciences coined the term ‘Austrian School’. So the Austrian school of economics ironically has to thank one of its fiercest early intellectual opponents for giving it its name. Schmoller intended the term as a slight: to him, everything that originated in Germany was automatically better and more scientific than anything that the smaller ‘provincial’ neighbour Austria could possibly produce.

However, today it is Carl Menger and his ideas that are still remembered, while Schmoller and the Historical school are virtually forgotten, although a number of heterodox economic/philosophical schools have sprung up in modern times that can be regarded as successors of Historicism (specifically Hermeneutics⁸, which denies that there is *any* objective truth or if there is one, it cannot be discovered by us. This relativism is of

Photo: Roger Violette Collection



Bismarck: modern Germany’s Historicist legacy.

course disputed by rationalist economists).

One should mention that in spite of the school’s decline, the influence of Historicism on German economic policy is felt to this day – the modern welfare state was first introduced in Germany by Otto von Bismarck and the so-called ‘social market economy’ (‘Soziale Marktwirtschaft’) – a supposed hybrid of capitalism and socialism – has been the

established economic system of Germany since the end of World War II. The desirability of this ‘third-way’ system remains largely undisputed in Germany today⁹.

The arbitrary and relativistic nature of the Historicist account of economics is ultimately self-contradictory. The Historicist school never revealed how one can differentiate between the different historical stages and the evolution of economic laws within, and more importantly, *between* them. What happens during the transition from one stage to the next? Is there a period of anarchy during which no economic laws whatsoever are operative?¹⁰

Mises relates that the Historicists liked to draw an analogy between the different ‘stages’ of economic history to the art historians’ classification and periodisation of different artistic styles – the various historical epochs would be metaphorically characterised by different ‘economic styles’. However, to Mises, art historians certainly make

no pronouncements about the future – the Historicists however did, since otherwise they could not have recommended economic policies that aimed at altering future conditions. If these conditions were indeed constantly in flux and not subject to unalterable economic laws, then on what basis could one make such recommendations?

So why is it still of importance today to recall this late 19th century dispute? The ‘Methodenstreit’ has never ended as it were – even if it is no longer the Historicist school that is the main opposition, the methods of economic science remain a major point of contention between Austrians and the economic mainstream of today.

FOOTNOTES:¹This anecdote is from a brief [biography of Schmoller](#) (anon.) from the *History of Economic Thought* website

²Menger’s **Principles of Economics** can be downloaded from [mises.org](#): ([principles-pdf](#))

³Ludwig von Mises, **Human Action** p.78 – download link to the scholar’s edition: ([HumanAction-pdf](#))

⁴Shortly before his death, Gottfried Haberler wrote a brief article entitled *Reviewing a book without reading it*. Keynes had reviewed Mises’ **Theory of Money and Credit** in 1914, while admitting in his **Treatise on Money** published 16 years later that he had not enough understanding of the German language to fully assimilate the ideas of the Austrian writers. Haberler’s article is quite funny and can be seen at the end of this interview ([link](#))

⁵See L.v. Mises, **Theory and History**[TaH], p. 198 ff. download link: ([Theory&History – pdf](#))

⁶*ibid.*, p. 200

⁷Frank A. Fetter, **Principles of Economics**, 1904. download link: ([principles-2-pdf](#))

⁸The founder of modern hermeneutics (which must not be confused with the previous theological meaning of the term of ‘interpretation of the Bible’) was the German philosopher Martin Heidegger. Later his pupil Hans-Georg Gadamer became the leader of the movement. See also, [David Gordon: Hermeneutics vs. Austrian Economics](#), 1986

⁹A trenchant critique of the German ‘social market economy’ system adopted after the war has been written by professor Hans Sennholz: **The Economic Comeback of Germany**.

¹⁰Mises, **TaH**, p. 202 ff.

Section 1

MISES ON THEORY & HISTORY

Philosophical discourses

In the first 100 or so pages of his masterpiece, **Human Action**, Ludwig von Mises reviews and discusses the epistemological problems and foundations of economic science in great detail – going *inter alia* over the very problems that were at the centre of the Menger-Schmoller Methodenstreit. His later book on the epistemological questions of the social sciences, **Theory and History**, discusses many of the related topics in even more depth. Unfortunately the work is somewhat neglected today.

Mises proposes a methodological dualism: delineating the boundaries and differences between economic theory and history on the one hand and the natural sciences on the other. He explains where the study of history intersects with theory and where it must by necessity go beyond it, into the realm of what he called ‘understanding’ (the term ‘Verstehen’ was used by the German sociologist Max Weber in this context) – namely, the understanding of the particular circumstances and relevant events and the aims and motives of the leading historically relevant people.

It is not enough for historians to merely collect data, although collecting and examining facts and data is of course an important part of historical research. The historical data must then be interpreted with the aid of theories provided by other scientific disciplines to make them intelligible: theory provides a constraint on such interpretations. Anything that cannot be subjected to a theoretical disquisition – such as the personal value judgments of the historical

actors – requires understanding. The particular circumstances of every historical period are unique and complex, and are subject to the influence of a great many unquantifiable factors.

As an example, a historian studying the era of the Roman emperor Diocletian, would have to examine Diocletian's inflationary currency policy, his price-control edicts and his expansion of state control over agricultural production and distribution in light of what economic theory has to say about such policies and their effects. However, once he considered the person of Diocletian himself – the motivations that impelled him to implement such policies, what he intended and hoped to achieve – the historian would have to cross over into the realm of 'understanding', this is to say the realm of psychology, or as Mises called it more precisely, thymology (in order to differentiate it from clinical psychology).

The laws of economics, according to Mises, take precedence over empirical data and are antecedent to them. This is to say, one can interpret empirical data with the aid of a correct economic theory but one cannot construct a correct theory with the aid of empirical data by means of induction. This startling assertion may at first glance not be immediately self-evident to most readers.

By way of an analogy with the natural sciences one might ask: isn't it the case that if, for instance, physicists were to observe an event that contradicts a tenet of a theory, that this would necessitate a revision of the theory?

For example, if one were to observe an object that is clearly traveling at a speed exceeding the speed of light, would that not falsify a cornerstone of Einstein's theory of relativity? This would undoubtedly be the case, especially if such an observation could be repeated under controlled conditions (rest assured that so far, all such challenges have been decided in Einstein's favour. The theory of relativity remains safe).

Why then is the same not true for economics?

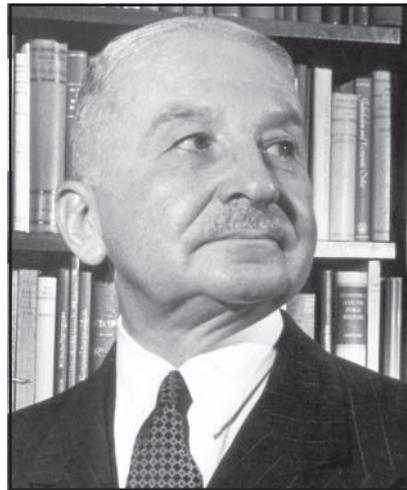
Apriorism as the foundation of the social sciences

When Mises first began to write more extensively about the epistemological foundations of economic science in the 1930s, his ideas were by no means regarded as particularly controversial among economists. This is in contrast to today, where his work on the methodology of the social sciences is in

fact rejected outright by the positivist mainstream 'orthodoxy'.

Mises, in the main, systematised the foundations of economic science as it was conceived by the economists of his time and most of their predecessors. What he did was to make explicit what was already widely accepted but had never before been formulated in such painstaking detail.

Photo: Ludwig von Mises Institute



Mises: pursuit of 'understanding'.

He held that economics was a special branch of a more-comprehensive science he later termed *praxeology* – the science of human action (*Die*

Wissenschaft des menschlichen Handelns). It should be pointed out that Mises was extremely reluctant to introduce new terminology. In his essays of the late 1920s and early 1930s, he generally used the term ‘sociology’ to describe the broader field of the science of human action. Only later did he deem it necessary to adopt the term ‘praxeology’ to distinguish his approach¹¹.

Mises decided to do this because he felt that the word ‘sociology’ had become tainted. It had become synonymous with the theories of the man who had originally coined the term, Auguste Comte, a follower of the French Utopian socialist Henri de Saint-Simon¹². As Jörg Guido Hülsmann notes in his introduction to **Epistemological Problems of Economics**, a collection of Mises’ late 1920s and early 1930s epistemological essays¹³:

‘[...] at the beginning of the 1920s, the term “sociology” had no precise meaning other than “general social science.” There certainly was no such thing as a coherent body of tenets taught under this epithet. But after the death of Max Weber in 1920, German sociology slowly but steadily came under the influence of anti-theorists and of anti-economists in particular.

Rather than analysing human action in non-market contexts and thereby closing the gaps that economic science could not fill, sociologists increasingly saw the essence of their task in displacing economics

It is the essence of human beings (unlike stones, atoms and planets) that they act; that they have goals and purposes, and that they try to achieve those goals.

through some other account of market phenomena. The word “sociology” thus became shorthand for anti-economics. It was this event that eventually prompted Mises to draw terminological consequences.’⁶

Praxeological reasoning deals with human action and its categories. It discusses the means rather than the ends and determines whether the means chosen are useful for attaining the ends aimed at. Economic science is not called upon to make value judgments regarding the ends aimed at – it must be *wertfrei* (value free) and strictly utilitarian, it is not normative. Importantly, Mises stated that there was no difference between ‘economic’ and ‘non-economic’ action. All action aims at the attainment of certain ends and requires the employment of means. Preferring and setting aside, or in a word, choice, impelled by the desire to achieve more satisfactory conditions are fundamental categories of purposive human action. The actual ends aimed at are of no importance in this context.

As noted above, Mises said that the field of economics is a branch of the more encompassing science of praxeology – however, one might wonder with Roderick Long “considering how broadly the Austrians define economics, it’s not clear what other branches of praxeology there could be”¹⁴.

He advocates a methodological dualism in the sciences. The science of human action is teleological, as it concerns the *purposive actions* of rational human beings. The natural sciences, by contrast, study the causal relations between objects that are not acting purposively in observational reality. As Murray Rothbard writes in the preface to **Theory and History**¹⁵:

‘At the heart of Mises and praxeology is the concept with which he appropriately begins **Theory and History**, methodological dualism, the crucial insight that human beings must be considered and analysed in a way and with a methodology that differs radically from the analysis of stones, planets, atoms, or molecules.

Why? Because, quite simply, it is the essence of human beings that they act, that they have goals and purposes, and that they try to achieve those goals. Stones, atoms, planets, have no goals or preferences; hence, they do not *choose* among alternative courses of action. Atoms and planets move, or are moved; they cannot choose, select paths of action, or change their minds. Men and women can and do.

Therefore, atoms and stones can be investigated, their courses charted, and their paths plotted and predicted, at least in principle, to the minutest quantitative detail. People cannot; every day, people learn, adopt new values and goals, and change their minds; people cannot be slotted and predicted as can objects without minds or without the capacity to learn and choose.²

The starting point of economic science, to Mises, is an axiom that can be discovered by inner reflection – it does not require any further proof, but is true *a priori* – **the action axiom**. The action axiom states that man acts in a purposive way in order to substitute a less-satisfactory for a more-satisfactory state; what impels him to act is the desire to remove a felt uneasiness. In acting, man must make choices, and employ means to achieve his ends. All the categories of action are already implicit in the action axiom. The truth of the axiom in turn is given by the logical structure of the human mind. As Mises writes in **The**

Task and Scope of the Sciences of Human Action¹⁶:

“As thinking and acting men, we grasp the concept of action. In grasping this concept we simultaneously grasp the closely correlated concepts of value, wealth, exchange, price, and cost. They are all necessarily implied in the concept of action, and together with them the concepts of valuing, scale of value and importance, scarcity and abundance, advantage and disadvantage, success, profit, and loss. The logical unfolding of all these concepts and categories in systematic derivation from the fundamental category of action and the demonstration of the necessary relations among them constitutes the first task of our science. The part that deals with the elementary theory of value and price serves as the starting point in its exposition. There can be no doubt whatever concerning the aprioristic character of these disciplines.”

FOOTNOTES: ¹¹The term ‘praxeology’ was first used in 1890 by Alfred Espinas, in **Les Origines de la technologie** (there are earlier mentions of praxeology, e.g. by Louis Bourdeau in **Théorie des sciences: Plan de Science intégrale** [Paris, Germer Bailliére, 1882], but not in its current definition). ‘Praxeology’ should not be confused with the similar-sounding, but slightly differently spelled ‘praxiology’, which has a different meaning.

¹²Comte is widely held to have been the first to mention ‘sociology’, but the term was independently coined earlier by Abbé Sieyès in 1780 in an unpublished manuscript.

¹³The quote is from the introduction to a collection of Mises’ writings on epistemology from the late 1920s and early 1930s, **Epistemological Problems of Economics [EPE]**. The book contains *inter alia* an interesting critique and refinement of Menger’s and Böhm-Bawerk’s theory of value. Download link: ([epe – pdf](#)).

¹⁴See Roderick Long, **Wittgenstein, Austrian Economics, and the Logic of Action**, 2002. Download link: ([long, wittgenstein – pdf](#)).

¹⁵Mises, **Theory and History**, from the preface by Murray Rothbard.

¹⁶*The Task and Scope of the Sciences of Human Action* is one of the essays collected in **EPE**.

Section 2

A PRIORISM

Economics and knowledge

In his methodological work, Mises employed the terminology of the German philosopher Immanuel Kant, who wrote extensively about *a priori* cognition derived from pure reason. Kant defined the *a priori* as “a way of gaining knowledge without appealing to some particular experience – a method of establishing transcendental and logical truths”¹⁷.

What we know to be true *a priori* are statements, the truth of which it is impossible to deny without leaving the realm of the rational and without coming into conflict with the laws of logic.

An essential point about knowledge is that although scarce means are required to acquire it, it ceases to be a scarce good once it has been acquired – the services it renders are inexhaustible. As such it is different from ends and means, both of which are scarce and subject to economising.

Mises notes on this fact in **Human Action**¹⁸: “It does not lose anything from its capacity to produce however often it is used; its productive power is inexhaustible; it is therefore not an economic good. Acting man is never faced with a situation in which he must choose between the use-value of a known formula and any other useful thing.”

Mises, to Hans-Hermann Hoppe, goes one step beyond Kant by connecting *a priori* reasoning with the real world in which we live, as purposive action as such constitutes such a bridging: First, the human

mind rationally conceives of a course of action – then the human body acts.

It is by acting in the real world that we continually *confirm* the truths imparted by the logical structure of the mind. The rules of logic are as much rules of thinking as they are of reality, as they cannot be negated or undone. One could for instance *say* that ‘if I paint the barn red, it won’t be red’, but this would be revealed as contradictory once the act of painting the barn red has been consummated: it will be red.

In short, our logical understanding of the law of contradiction (a thing cannot be ‘A’ and ‘non-A’ at the same time) conforms to reality. If an actor wants to improve the barn by painting it red, he will first conceive of doing so and then act. Along similar lines, no action is conceivable that could undo the workings of any of the other logical operators in reality.

‘In the beginning was the deed’

Action requires some experience and understanding of the causality that works in the real world (such as the laws of physics) – this experience of the external world is what guides our definitive courses of action. And yet, it is reason from which we derive our knowledge about actions. As Mises observes in the following extract from **The Task and Scope of the Science of Human Action**¹⁹:

“However, what we know about our action under given conditions is derived not from experience, but from reason. What we know about the fundamental categories of action – action, economising, preferring, the relationship of means and ends, and everything else that, together with these, constitutes the system of human action – is not derived from experience. We conceive all this from within, just as we conceive

logical and mathematical truths, *a priori*, without reference to any experience. Nor could experience ever lead anyone to the knowledge of these things if he did not comprehend them from within himself. As an *a priori* category the principle of action is on a par with the principle of causality. It is present in all knowledge of any conduct that goes beyond an unconscious reaction. “In the beginning was the deed.” In our view the concept of man is, above all else, also the concept of the being who acts. Our consciousness is that of an ego which is capable of acting and does act. The fact that our deeds are intentional makes them actions. Our thinking about men and their conduct, and our conduct toward men and toward our surroundings in general, presuppose the category of action.”

Photo: AFP



Kant statue, Kaliningrad: reasoned truth.

Mises then illuminates the foregoing further by citing the example of money – without a prior *conceptual* understanding of media of exchange, we could not grasp their significance; moreover, to Mises, what he proposes should by no means be controversial – he is not attempting to introduce an entirely new approach. He merely systematises and makes explicit what has always been true:

“Unaided by praxeological knowledge we would never learn anything about media of exchange. If we approach coins without such preexisting knowledge,

we would see in them only round plates of metal, nothing more. Experience concerning money requires familiarity with the praxeological category *medium of exchange*.

“Experience concerning human action differs from that concerning natural phenomena in that it requires and presupposes praxeological knowledge. This is why the methods of the natural sciences are inappropriate for the study of praxeology, economics, and history.

“In asserting the *a priori* character of praxeology we are not drafting a plan for a future new science different from the traditional sciences of human action. We do not maintain that the theoretical

science of human action should be aprioristic, but that it is and always has been so.”

For the dedicated reader and student of philosophy, **Appendix 2** extends the debate on Austrian *a priorism* and its philosophical genesis. Meanwhile, in the following section, we take a look at Mises’ objections to the strain of thought that has become the touchstone of modern mainstream economics – logical positivism.

FOOTNOTES: ¹⁷See: Glossary of Kant’s Technical Terms, by Stephen Palmquist, available at: <http://www.hkbu.edu.hk/~ppp/ksp1/KSPglos.html>

¹⁸L. v. Mises, **Human Action**, p.126

¹⁸L. v. Mises, **Epistemological Problems of Economics**, p.14

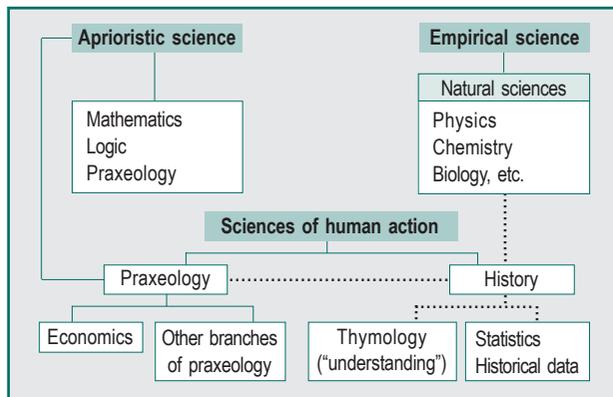
Section 3

ECONOMICS vs NATURAL SCIENCE

Practical problems

Mises proposes two forms of methodological dualism: the dualism between natural sciences and social sciences on the one hand, and within the social sciences, a methodological dualism between praxeology and historical research. These forms are depicted in Figure 1. The dotted lines show which fields of knowledge must be employed in historical research.

FIG 1 Methodological dualism in science: a schematic



Source: Mises, *Human Action*.

The decisive and insurmountable problem faced by econometricians is that they are dealing with a complex body of data describing the past that is not circumscribed by any fixed constants that could be used as yardsticks for such measurements. There are no constants in economics – valuations do not remain unchanged – the only constant, if you will, is perpetual change. Every new datum that emerges rearranges the price structure anew.

Future states of knowledge meanwhile will impel actors to alter their actions. This in turn means that it is simply not possible to make precise economic predictions of a *quantitative* nature.

This does not mean that it is entirely impossible to make economic predictions; but that they must take into account the uncertainty attending the future and are *constrained*²⁰ by our *a priori* knowledge of human action and the economic theorems deduced from the action axiom. In one sense predictions can only be as clearly established as the axioms they are based on: for instance, we can state with certainty that if the supply of some good increases, then *ceteris paribus*, its price will fall. The extent of the fall cannot be predicted with certainty (this type of prediction of future prices involves ‘understanding’, *see also below*).

Empiricists claim that one can study the economic data of the past, and by means of applying mathematical operations on the range of possible cause-effect relations that these data seemingly reveal, proceed to try out various methods of prediction. Say there is an effect ‘X’ and a number of possible causes A, B, C, D, E and so forth as well as conceivable combinations of such causes. The empirical method consists of making predictions based on an array of potential causes and then waiting to see which one of them turns out to be correct. The result then either confirms or falsifies the original hypotheses and thus imparts information about reality to us. In their world, predictions that fail merely require a further tweaking of the underlying hypotheses and another period of waiting for confirmation or falsification.

Of course in the positivist tradition, such a process

of falsification still does not allow one to do anything but regard a ‘confirmed’ hypothesis as only tentatively true. A later measurement may still falsify it. This is valid for the natural sciences but in the field of human action we must account for the fact that people have their own volition. It is not knowable what people will learn in the future and to what changes in their conduct this future knowledge may lead. Rothbard remarks in his preface to **Theory and History**:

“[...] in the words of the original motto of the Econometric Society, “Science is prediction.” And to become a “hard” or “real” science, economics must treat individuals not as unique creatures, each with his or her own goals and choices, but as homogenous and therefore predictable bits of “data.”

As Mises reminds us, the work of the classical economists and their predecessors – although not free of flaws – did humanity a great service by discovering that the activities of men were not *only* circumscribed by the laws of nature, but also by economic laws. A political leader, no matter how powerful he may be, cannot decree that gravity be suspended or that there shall henceforth only be sunshine every day. The laws of nature cannot be influenced or altered by purposive action on the part of human beings, regardless of their political power.

These classical economists discovered that there are similar limitations as to what the worldly authorities can hope to achieve in terms of economic policy – economic laws circumscribe what is possible just as effectively as natural laws do. Mises mentions Ricardo’s law of comparative

advantage, or more broadly, the law of association, as a pertinent example, as it unmasked the fallacies of Mercantilist and protectionist ideas²¹.

One can certainly not hope to increase prosperity by enacting laws that restrict production. There may be other political goals that are held to require that production be restricted but increasing prosperity cannot be among them.

These insights led to the adoption of classical liberalism and (more or less) *laissez faire* capitalism in the 19th century, which greatly enhanced the accumulation of capital and led to a marked increase in wealth. Looking back, if not for the great advancements during the age of liberalism (that is, libertarianism as we know it, not liberalism as now understood in America and the West generally), we would probably be much poorer today than we actually are.

Had the interventionism practiced by Herbert Hoover and FDR’s New Deal been adopted 50 or 60 years earlier and the ‘Gilded Age’ never happened, the US would likely never have been able to attain a standard of living remotely comparable to today’s. Although it is not possible to quantify by how much and in what ways economic progress would have been retarded, one should not underestimate how indebted we are to this distant period of history and the vast accumulation of capital it enabled.

One is tempted to quip that if Keynes had been born a century earlier and attained a comparable influence over economic policy the producers of buggy whips may well still be doing a brisk business today.

The positivist approach to the social sciences is based on the desire of adopting a methodological monism – *all* science is supposed to work according to the precepts of the natural sciences. Mises referred to this tendency as ‘panphysicalism’, i.e., the notion that all sciences should adopt the methods of physics.

Let us return to the question of the role of empirical observations in the natural sciences and why they are indeed useful to validate (at least provisionally) or falsify the hypotheses in that branch of knowledge. The methodology of natural sciences, at least in the initial step, is to erect a hypothesis, whether based on observations or thought experiments then, if possible (in modern theoretical physics this is not always immediately possible), such hypotheses are subjected to testing in controlled experiments. If the observation of cause and effect confirms the hypothesis, the regular sequences of events and the constants discovered then become part of the body of natural laws.

Karl Popper’s demand that a hypothesis must be able to survive attempts at falsification is a basic requirement of the natural sciences. In the Popperian sense there can actually be no ‘confirmation’, only falsification and non-falsification. It is in principle conceivable that the natural laws observed in the present time period will turn out to only be valid for the current phase

One cannot collate economic statistics and hope to discover in them a regularity in the sequence of events comparable to that established in physics.

of the universe’s evolution. This remote possibility has however no pragmatic value. The causal relationships between inanimate objects established by the natural sciences work in practice and they serve as the basis for rational human conduct. Our machines would not work unless the natural laws upon which their working depends had been correctly established.

In **Theory and History**, Mises discusses the question of determinism in the context of the natural sciences and notes that some objections have been raised against it on the grounds that in quantum mechanics there is no longer a strictly unidirectional cause-effect vector observable, but instead probabilities of the form ‘event A can cause either B or C’ (such as e.g. the 50% probability that an electron will adopt either right or left-hand spin if acted upon by a magnetic field). However, Mises says that this in no way impinges on the deterministic character of natural law: what quantum mechanics introduces are natural laws governed by class probabilities but this does not mean that they are not deterministic²².

In the natural sciences it is possible to set up controlled and repeatable experiments. Although it is true that an experiment that confirms a hypothesis say, 300 times, might contradict it after the 301st iteration of the experiment and that the laws of nature as understood by the natural sciences can therefore not be termed entirely ‘fixed’ but are rather hypotheses with only a tentative truth value. This empirical method of confirming or falsifying hypotheses is not only an entirely valid procedure, but in fact the only sensible one.

And since the phenomena examined by the natural sciences are repeatable and have constant relations that can be objectively measured, it is also possible to formulate more or less exact quantitative predictions on the basis of natural laws.

What economic science can and cannot do

It is simply not possible to subject economic laws to controlled experiments. Economic science is therefore not deterministic in the same sense that the natural sciences are. One cannot collate economic statistics and hope to discover in them a regularity in the sequence of events comparable to that established in physics – even though a certain regularity may vaguely suggest itself over certain periods of time. Economic history is always describing unique situations – every past constellation of the totality of the market data only ever happens once. The factors influencing it are unquantifiable.

By way of example of how empiricist modelers work, in 2009 two prominent Keynesians, Alan Blinder (a former member of the Federal Reserve board and today economics professor at Princeton University) and Mark Zandi (chief economist of Moody's Investor Services), produced a study²³ based on an econometric model which they claimed proved that the Obama Administration's 'stimulus programme' had created more than 6 million jobs – and that the unemployment rate would have been considerably higher than it actually turned out to be without the deficit-spending programme.

However, we cannot subject the validity of their conclusions to experimental testing. It is not possible to go back in time and play through the

same period of history again *without* the stimulus programme. Nor can the empirical evidence from some *other* period possibly serve as incontestable corroboration or refutation, given that every single slice of economic history is unique.

We can approach economic history only as historians, using economic theory and understanding to interpret the observed events. Quantitative assertions of the type made by Blinder and Zandi make no sense (their model purportedly precisely 'calculated' the number of jobs 'rescued' by the stimulus programme). The fact is, we will never be able to know how many jobs would have been created in the *absence* of stimulus spending.

What Blinder and Zandi pass over is what we could call the 'broken window effect' (first explained by the French economist Frederic Bastiat in the 18th century): government had to take the resources it used in allegedly 'creating jobs' from the private sector, where these resource consequently were no longer available for use. One cannot ascertain how they *would* have been employed.

In fact, as several economists critical of their methods noted, they apparently constructed the model in a manner that ensured that it would end up spitting out their already preconceived conclusions. They wanted to 'prove' that Keynesian stimulus 'works', so they built a model that *appears* to show that it does by means of employing Keynesian assumptions. In essence, the model assumes from the outset that stimulus spending must work as expected, and once its arithmetic operations have been concluded, that is the answer one gets: it works.

In an op-ed article in *The Wall Street Journal*²⁴, Blinder wrote:

“Try to imagine any government spending a massive sum like \$862 billion without creating or saving millions of jobs. More specifically, suppose peak-year spending from the stimulus bill was about \$300 billion – which is roughly correct – and that our hapless government just sprinkled its purchases around at random. On average, each job in our economy accounts for about \$100,000 worth of GDP. (We are a highly productive bunch!) So \$300 billion worth of additional GDP should be the product of about three million more jobs. Do we really believe the stimulus produced only a small fraction of that — or none at all?”

Not only did Binder fail to touch upon how the money that was spent was raised, i.e. where it came from, he neglected to mention that when the government spends \$300 billion, then this amount is in fact *added* to GDP. We may concede that government spending could temporarily increase employment – in fact, when taken to its extreme, in a complete command economy, unemployment will generally be non-existent. The question of whether any of this employment is economically sensible or sustainable is an entirely different question however. A former research assistant of Blinder’s, Arnold Kling, published a detailed critique²⁵.

His conclusion was as follows:

“I do not think we will ever know what would have happened to the economy without the fiscal stimulus and the large monetary interventions. My

guess is that the overwhelming majority of economists would agree that we will never know the answers to those questions. **However, in the competition for public attention, Blinder and Zandi have two advantages. First, they support a narrative in which government experts did the right thing, which is comforting to government experts and all who believe in them. Second, at a tactical level, their use of an esoteric computer model along with those two decimals of precision, they intimidate journalists and other laymen.**

“I know that they think this is for a good cause. They really believe that the stimulus and TARP were good policies that got a bad rap. But in my view that does not justify this unseemly exercise in propaganda dressed up as research.” (Emphasis added).

Here it should be mentioned that the creation of hypothetical models, as such, is of course a perfectly legitimate procedure in the treatment of economic questions. The theorems deduced from the action axiom allow us to construct all sorts of imaginary worlds that differ in essential aspects from the real world. Such a process of creating artificial constructs could be the autistic economy of an isolated actor – the evenly rotating economy that never experiences any change, a world without capital goods, or one with only specific or only non-specific capital goods and so forth.

The point of such mental constructs is to help with illuminating specific parts of economic theory by creating a simple setting in which certain aspects of the ever-changing, dynamic real world are

missing – for example, the evenly rotating economy, in which no change ever occurs, is an indispensable tool to explain price determination, allocation to production factors and capital formation.

The hypothetical construct of ‘equilibrium’ in which there is no change from the current state allows one to analyse the effect of disturbances in the system in a step-by-step procedure. Mises points out that there is a danger in creating such constructions – an example would be the construction of a market with only direct exchange, which by removing the ‘veil of money’ shows that what is exchanged are always economic goods²⁶.

For instance, the role of the pool of real funding in economic activity is easier understood when money is disregarded, as money is only the medium of exchange. The danger inherent in this construction, as Mises points out, is that money was seen by many economists as something to be inserted later and representing a perfectly neutral factor; the assumed neutrality of money implies that when the money supply increases the effects on prices are evenly distributed, which is a serious error. Nevertheless, the use of such imaginary constructions is necessary for the explanation of economic concepts.

FOOTNOTES: ²⁰Hans-Hermann Hoppe, **Economic Science and the Austrian Method**, p. 43-44.

²¹L. v. Mises, **Human Action [HA]**, p. 160 ff.

²²L. v. Mises, **Theory and History [TaH]**, p. 86.

²³Alan S. Blinder, Mark Zandi, *How the Great Recession Was Brought to an End*, 2010. Download link: ([Bl&Za, study](#)).

²⁴Alan S. Blinder, ‘[Government to the Economic Rescue](#)’ article in *The Wall Street Journal* [June 2010].

²⁵Arnold Kling, ‘[How the Blinder-Zandi Study Was Done](#)’.

²⁶L. v. Mises, **HA**, p. 203 ff.

Section 4

RESISTANCE TO MISES

Interventionism rules

Why have Mises’ methodological insights become controversial? There are two major reasons for why the Misesian approach to economic science is rejected by today’s economic mainstream.

One is the widely accepted notion that positivism of the Popperian variety and the associated methodological monism of the sciences is the only valid ‘scientific’ procedure and that economic science must follow the methodological approach of the natural sciences. This ‘scientist’ reorientation of the social sciences has been famously criticised by Friedrich Hayek in his Nobel Prize lecture (entitled *The Pretence of Knowledge*²⁷).

The other, arguably more important reason is political. The system of economic thought deduced by the Austrian economists concludes that central economic planning and interventionism are futile. Mises was always at pains to present his economic theorising as ‘*wertfrei*’ and purely utilitarian.

However, again and again he points out that the popular interventionist policies pursued by governments cannot achieve the aims their proponents themselves assert they want to achieve. Since he sees no alternative to the unhampered market economy with regards to delivering rising standards of living and smooth economic progress, his view implies that there simply is nothing to do for economic planners.

Once one concludes that the economy is better off without planners, the planners are of course out of a job, which serves to explain their resistance.

The state and its bureaucracies in turn need apologists for interventionism because they want to expand their power. Consider Mises' disdain for econometric methods. The Federal Reserve alone employs several hundred economists most of whom are econometricians. This vast research staff produces the economic forecasts the central bank uses in its monetary policy decision-making process.

On the side it also helps with the central bank's public relations by publishing apologias that exonerate the Fed whenever the economy suffers a bust or other negative economic consequences threaten to be attributed to Fed policy. As we know from experience, the economic forecasts are regularly so wide of the mark as to be virtually useless. In other words, there are several hundreds of individuals busy with a well-paid job that in no way can elucidate anything about the economy nor help it in any way, a theme we shall return to in the next part of **Austriana**.

The Blinder-Zandi study mentioned above was chosen to demonstrate this principle: unless there is demand for interventionism, there is also no demand for such studies and their authors.

Hence the myth that the market economy is 'faulty' and in need of 'steering' and correction by committees of taxpayer-financed wise men advised by *etatiste* public intellectuals is propagated at every opportunity. In editorials in the popular press (such

as e.g. the *New York Times*) the 2008 financial crisis was attributed to an alleged obsession of policymakers with '*laissez faire*' economics that had gotten out of hand and had kept the necessary regulations from being implemented.

No-one seemed to notice how utterly absurd such assertions are in light of a monetary system based on legal tender and administered by a central bank at the centre of a fractionally reserved banking cartel and a government the spending of which amounts to 27% of GDP – which is actually one of the less egregious percentages in the Western world.

Readers interested in the interplay between modern-day public intellectuals and the statolatry (or state-worship) of today's regulatory democracies are advised to read Hans-Hermann Hoppe's excellent essay *Natural Elites, Intellectuals and the State*²⁸.

Mises and his followers have been accused by critics that their preference for classical liberalism proves that their economic theorising is not, as Mises always stresses, value-free.

As Rothbard clarifies, Mises the citizen may well be partial to classical liberalism, but that does not impinge on the purely utilitarian character of his economic theory: economics is about analysing the means employed to achieve the ends aimed at. It does not make any judgment about the ends themselves.

FOOTNOTES: ²⁷F. A. Hayek, 'The Pretence of Knowledge', Nobel Prize Lecture, 1974.

²⁸H.H. Hoppe, [Natural Elites, Intellectuals, and the State](#).

Appendix 1

THE ACTION AXIOM

Further thoughts

That this proposition – the axiom of action – is true *a priori* and need not be subjected to empirical observation or testing to prove its validity *a posteriori*, i.e. similar to the method employed in the natural sciences, can be shown quite easily by considering the attempt to deny its truth.

This is simply not possible, as the attempt itself would have to be categorised as an action, employing means to achieve an end, resulting in profit or loss. The attempt to deny the action axiom would in short involve all the categories of action that the axiom itself implies. To deny the validity of the action axiom would be patently absurd.

The same therefore holds for all categories of action and the economic theorems that can be deduced from the action axiom by means of discursive reasoning, unless the reasoning can be shown to be faulty.

By way of example, consider the law of marginal utility: if a unit of a good is added to a homogenous supply of units of the same good of equal serviceability, then its value is smaller than the value of previously acquired units, as it can only be used to serve an end that is held to be less valuable than the least valued end that could be satisfied previously. This law can ultimately be traced back to the fact that

everyone prefers what satisfies him more over what satisfies him less¹.

That acting humans prefer what satisfies them *more* over what satisfies them *less* is not something that requires experimental proof or empirical observation – it is clearly true *a priori*.

As an aside to the law of diminishing marginal utility, it should be pointed out that the so-called ‘tipping point’ reasoning that asserts that there are exceptional cases where marginal utility *increases* instead of *decreasing* when an additional unit is added to a homogeneous supply of a good is incorrect. An example for this error is the following (this example is actually taken from Wikipedia, a sign that there is an urgent need to revise some of the economics entries found there):

“However, it [the law of diminishing marginal utility] will not always hold. [...] For example, bed sheets, which up to some number may only provide warmth, but after that point may allow one to effect an escape by being tied together into a rope.”

This idea is based on erroneous reasoning². The decisive point is that bed sheets used for providing warmth are a *different good* than bed-sheets tied together to form a rope. The former is the good providing the service of ‘provision of warmth’ – the latter provides the service of ‘means of escape’, i.e., once they are tied together, the bed sheets are no longer bed sheets, but a rope. In other words, it is the end aimed at, the utility provided, that defines the character of these superficially homogeneous goods.

The marginal utility of ‘bed sheets as a rope’ per the above example can only be conceived in connection with a supply of units of ten bed sheets that have been tied together as ropes – in other words one needs to treat each set of ten bed sheets as *one unit* of a good.

As Mises puts it in **Human Action**³: “It [the law of marginal utility] does not deal primarily with the value of things, but with the value of the services a man expects to get from them”. There are no exceptions – the law of diminishing marginal utility always holds.

Economic theorems are derived from the incontestable action axiom and its categories by means of employing formal logic. It is not possible to inquire – at least as far as any scientific inquiry is concerned – as to what lies *beyond* them. They are, to use Mises words, “the ultimate givens”.

Mises states that although thinking is tied up with physiological processes, it seems highly unlikely that a materialistic explanation of human thought will ever be forthcoming⁴. In **Ultimate Foundations of Economic Science**⁵, Mises says to this point:

“For a doctrine asserting that thoughts are in the same relation to the brain in which gall is to the liver, it is not more permissible to distinguish between true and untrue ideas than between true and untrue gall.”

As long as no tenable materialistic explanation of human thought exists (such as, for example, which chemical/electrical processes produce

definitive thoughts), scientific inquiry cannot go beyond the ultimate givens in the field of human action.

As Mises notes in **Theory and History**, when the natural sciences encounter such givens in nature, there is nothing further they can say about them, until still further causes that give rise to them are discovered and a new ultimate given is encountered – they are concerned with causality, but not the final causes.

Theoretical physics may well have reached the boundaries beyond which no further definitive progress can be made (a number of hypotheses await experimental verification or falsification, but it appears that theory has advanced to the point where experimental testing, if it will be possible at all, certainly won’t be possible in the near future. Some aver that this has created a ‘crisis of faith’ in physics⁶).

FOOTNOTES: ¹See Hans-Hermann Hoppe, **Economic Science and the Austrian Method**, a collection of lectures and essays by Hoppe on praxeology. Download link: ([hoppe, esam-pdf](#))

²Murray Rothbard, **Man, Economy and State [MES]**, 1962. Rothbard used the example of eggs required to bake a cake: if four eggs are needed to bake a cake, is not the marginal utility of the fourth egg higher than that of the first three eggs? No, because the four eggs required to bake a cake are actually one unit of the good that renders the services required to bake a cake. Download link: ([rothb, MES-pdf](#)).

³L. v. Mises, **Human Action**, p. 124-125.

⁴L. v. Mises, **Theory and History**, p. 97 ff.

⁵L. v. Mises, **Ultimate Foundations of Economic Science, an Essay on Methods[Ult]**, 1962. Download link: ([Mises, Ult-pdf](#)). Mises refers to a quote by Karl Vogt, in **Köhlerglaube und die Wissenschaft**, 1855.

⁶See, Alan P. Lightman’s, *The accidental universe: Science’s crisis of faith*, published in *Harper’s Magazine* [21 December 2011], available at <http://harpers.org/archive/2011/12/0083720>

Appendix 2

AUSTRIAN SCHOOL PHILOSOPHY

Genesis and debate

Regarding the debate over Austrian apriorism and whether its character is more Kantian or Aristotelian, Geoffrey Alan Plauché's **On Praxeology and the Question of Aristotelian Apriorism**¹ is especially interesting. As Plauché mentions, although Rothbard declared himself to be more in tune with the Thomist and Aristotelian tradition, he unfortunately never had occasion to delve into the subject in more depth (Plauché himself however makes a valuable contribution in his paper).

Rothbard's declaration to this effect can be found in his essay *In Defense of Extreme Apriorism*² and he shall have the last word:

‘Now the crucial question arises: how have we obtained the truth of this axiom [the action axiom]? Is our knowledge *a priori* or empirical, “synthetic” or “analytic”? In a sense, such questions are a waste of time, because the all-important fact is that the axiom is self-evidently true, self-evident to a far greater and broader extent than the other postulates. For this Axiom is true for all human beings, everywhere, at any time, and could not even *conceivably* be violated. In short, we may conceive of a world where resources are *not* varied, but not of one where human beings exist but do not act. We have seen that the other postulates, while “empirical,” are so obvious and acceptable that they can hardly be called “falsifiable” in the usual empiricist

sense. How much more is this true of the Axiom, which is not even conceivably falsifiable!

Postivists of all shades boggle at self-evident propositions. And yet, what is the vaunted “evidence” of the empiricists but the bringing of a hitherto obscure proposition into *evident* view? But some propositions need only to be stated to become at once evident to the self, and the action axiom is just such a proposition.

Whether we consider the Action Axiom “*a priori*” or “empirical” depends on our ultimate philosophical position. Professor Mises, in the neo-Kantian tradition, considers this axiom a *law of thought* and therefore a categorical truth *a priori* to all experience. My own epistemological position rests on Aristotle and St. Thomas rather than Kant, and hence I would interpret the proposition differently. I would consider the axiom a *law of reality* rather than a law of thought, and hence “empirical” rather than “*a priori*.” But it should be obvious that this type of “empiricism” is so out of step with modern empiricism that I may just as well continue to call it *a priori* for present purposes. For (1) it is a law of reality that is not conceivably falsifiable, and yet is empirically meaningful and true; (2) it rests on universal *inner* experience, and not simply on external experience, that is, its evidence is *reflective* rather than physical; and (3) it is clearly *a priori* to complex historical events³.

Polylogism, Psychologism and Wittgenstein

Polylogism was already mentioned above in the context of the Marxist assertion that an economic theory could not claim to be logically true if its authors were members of the

‘bourgeoisie’. According to the Marxist position, there is a difference between ‘proletarian’ and ‘bourgeois’ logic.

It seems hardly necessary to demonstrate that this makes no sense, but it is noteworthy that neither Marx nor Engels ever stopped to explain how it was then possible that they, who themselves were clearly well-to-do members of the bourgeoisie, could conceive of a ‘proletarian theory’.

Moreover, they never deigned to explain the actual difference between these two types of logic. How exactly does ‘proletarian logic’ work? It remains a mystery to this day. Similar assertions were made by racist ideologies, such as German National Socialism, which claimed that the logic of the ‘master race’ was different and superior to the logic employed by all other, inferior races. They also failed to demonstrate of what the alleged differences consisted. Note here that Historicism’s claim that economic laws vary between different historical periods perforce also relies on polylogism.

A variant of empiricism is so-called psychologism, of which John Stuart Mill was a prominent proponent. As Christian Bryan Bustamante notes in **Husserl’s Criticism of Psychologism**³ – an examination of Edmund Husserl’s transformation from a supporter to a

“It is as impossible to represent in language anything that ‘contradicts logic’ as it is in geometry ... to give the coordinates of a point that does not exist”.

critic of psychologism (likely due to Gottlob Frege’s influence: *see below*) – Mill said “logic is a science and as a science it cannot be separated from, and is coordinate with, psychology”. He furthermore said:

“To the extent that it is science at all, it is a part or branch of psychology, distinguished from it on the one hand as the part is from the whole, and on the other hand as the art is from the science. It owes all its theoretical foundations to psychology, and includes as much of that science as is necessary to establish the rule of the art.”⁴

Roderick Long from the philosophical department at Auburn University has written an interesting paper entitled *Wittgenstein, Austrian Economics, and the Logic of Action*⁵ that examines in what way Wittgenstein supports the praxeological method (mainly referencing his later work, such as the ‘Philosophical Investigations’ and his books on the foundations of mathematics; the earlier **Tractatus Logico-Philosophicus** [TLP] is widely regarded as a logical-positivist work but contains some interesting passages in this context: *see below*).

As Long shows, Wittgenstein agrees with Mises’ dislike of the positivist-empiricist approach to the social sciences. Long made the connection to Wittgenstein due to Mises mentioning Edmund Husserl’s critique of psychologism in ‘Logical Investigations’ approvingly. Husserl in turn was influenced by the mathematician and logician Gottlob Frege, who was also one of Wittgenstein’s major influences. Frege’s influence was what led Husserl away from psychologism. It is worth quoting Frege’s

assessment of Mill's statement regarding whether the proposition '2+2 = 4' can be considered true. As Long writes⁶:

‘Mises’ insistence on the universal validity of logic was shared by Frege. The primary target of Frege’s criticism, however, was not polylogism, but rather, psychologism – the view that the laws of logic and mathematics are simply empirical generalisations about the way the human mind works. John Stuart Mill, for example, had maintained that our knowledge that $2 + 2 = 4$ is an inductive generalization from our experience that when we take two groupings, each with the characteristic look of a twosome, and we put them next to one another, we see a grouping with the characteristic look of a foursome – a view Frege dismissed as “gingerbread and pebble arithmetic”, remarking that it was lucky for Mill that not everything is nailed down. And Mises likewise speaks disapprovingly of “Mill’s psychologistic epistemology, which ascribed an empirical character even to the laws of thought”, and maintains that “Under the influence of Mill’s empiricism and psychologism, logic was not prepared for the treatment of the problems that economics presents to it.”⁷

Although Long stresses that his paper is not primarily concerned with historical influences, it appears that Husserl, Wittgenstein and Mises were

all influenced by Frege, whether directly or indirectly. One of the problems with psychologism is precisely that it ‘opens the door to polylogism’ as Long *inter alia* notes. Frege and Husserl rejected both, just as Mises did. As Long remarks, Mises’ epistemological work tries to do for economics what Frege’s does for logics and mathematics: “*de-psychologize and de-empiricise*” it.

As regards Wittgenstein, although at one point in **Tractatus Logico-Philosophicus**⁷ he explicitly rejects apriorism (it is in fact considered a logical-positivist work) he affirms it with regards to logic: his standpoint is that there can simply not be an ‘illogical thought’ because the structure of language itself is logical and makes this impossible.

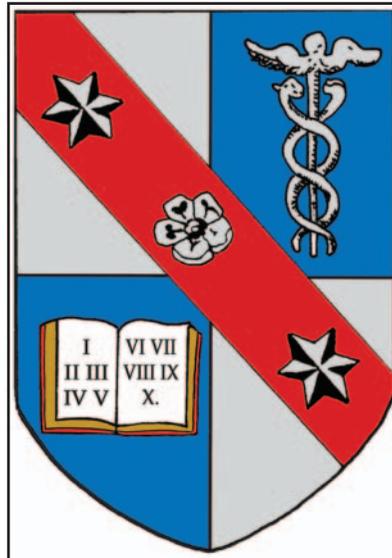
“[L]anguage itself prevents every logical mistake. – What makes logic *a priori* is the impossibility of illogical thought.” [TLP: 5.473-5.4731].

And *ibid*:

“The truth is that we could not *say* what an ‘illogical’ world would look like ... It is as impossible to represent in language anything that ‘contradicts logic’ as it is in geometry to represent by its coordinates a figure that contradicts the laws of space or to give the coordinates of a point that does not exist.” [TLP: 3.03-3.032.]

Although Long doesn’t specifically mention this

Photo: Ludvig von Mises Institute



Crest of the Ludwig von Mises Institute.

in his paper, the *Tractatus* in fact offers a bridging between the logical structure of the human mind and the real world that does not necessarily depend on the senses either. Wittgenstein describes human language as a ‘mirroring’, or drawing a picture of the real world:

“If the world had no substance, then whether a proposition had sense would depend on whether another proposition was true. It would then be impossible to form a picture of the world (true or false).” [TLP: 2.0211 - 2.0212]

The picture is a model of reality. To the objects correspond in the picture the elements of the picture.

The picture consists in the fact that its elements are combined with one another in a definite way. That the elements of the picture are combined with one another in a definite way, represents that the things are so combined with one another.

This connexion of the elements of the picture is called its structure, and the possibility of this structure is called the form of representation of the picture.

In order to be a picture a fact must have something in common with what it pictures.

What the picture must have in common with reality in order to be able to represent it after is manner – rightly or falsely – is its form of representation.

What every picture, of whatever form, must

have in common with reality in order to be able to represent it at all — rightly or falsely — is the logical form, that is, the form of reality.

The logical picture can depict the world.’ [TLP: 2.3 - 2.19]

He even makes a point about ‘imaginary worlds’ (which in economics find their correspondence in artificial mental constructs such as Mises’ **Epistemological Problems of Economics**):

“It is clear that however different from the real one an imagined world may be, it must have something — a form — in common with the real world.” [TLP: 2.022]

It should be noted here that language, (similar to law, economic and social institutions) tends to evolve from social cooperation over many generations. If the logical structure of our mind - which is reflected in our language - were not to correspond to reality, there would be nothing intelligible we could say to one another.

FOOTNOTES: ¹See Geoffrey Allan Plauché, **On Praxeology and the Question of Aristotelian Apriorism**, 2006 – download link: ([Plauché, pqaa-pdf](#)).

²Murray N. Rothbard, **In Defense of Extreme Apriorism**. Download link: ([roth, dea-pdf](#)).

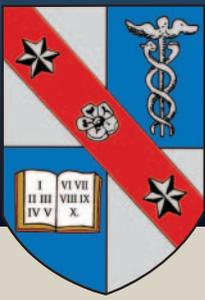
³Christian Bryan S. Bustamante, **Husserl’s Criticism of Psychologism**.

⁴Edmund Husserl, **Logical Investigations**, trans. J.N. Findlay, London: Routledge and KeganPaul, [1982], p 91.

⁵See Roderick Long, *Wittgenstein, Austrian Economics, and the Logic of Action*[*Lwitt*], 2002. Download link: ([long, wittgenstein – pdf](#)).

⁶R. Long, *Lwitt* p. 20.

⁷Ludwig von Wittgenstein, **Tractatus Logico-Philosophicus** [TLP], 1918. The link leads to a web site dedicated to the work, that offers different ways of reading it. Another tabular version is available here: [TLP, tabular](#).



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Lectures by: Dr Thomas J. DiLorenzo – a senior fellow at the Ludwig von Mises Institute and a professor of economics at Loyola University, Maryland. He holds a PhD in Economics from Virginia Tech. Dr DiLorenzo, among other works, is the author of *The Real Lincoln*, *Lincoln Unmasked*; *Hamilton's Curse*; *How Capitalism Saved America*, and *The Food and Drink Police: America's Nannies, Busybodies and Petty Tyrants*.

Time: Thursdays, 7:30 - 9:00 pm Eastern Time.



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Lectures by: David Gordon – a senior fellow at the Ludwig von Mises Institute and the editor of *The Mises Review*. He holds a PhD in Intellectual History from UCLA. Dr Gordon is the author of *Resurrecting Marx: The Analytical Marxists on Exploitation, Freedom, and Justice*; *The Philosophical Origins of Austrian Economics*, *An Introduction to Economic Reasoning*; *Critics of Marx*, and *The Essential Rothbard*.

Time: Wednesdays, 8:16 - 9:45 pm Eastern Time.

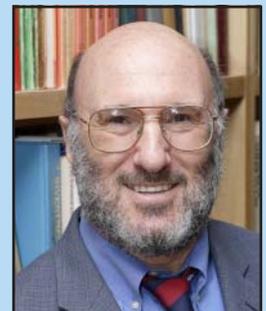


March 26: [Defending the Undefendable](#)

Category: Political philosophy

Lectures by: Walter Block – a senior fellow at the Ludwig von Mises Institute and currently a professor and chair of economics, college of business administration, at Loyola University. He holds a PhD in Economics from Columbia University. Dr Block is the author of many books which include: *Defending the Undefendable*; *The Case for Discrimination*, and *Labor Economics from a Free Market Perspective: Employing the Unemployable*.

Time: Mondays (excluding 9 April), 6:30 - 8:00 pm Eastern Time.



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