

**Mises on Scope and Method
in Light of His Purposes**

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October 13, 2009

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Abstract

This essay aims to interpret the pivotal chapter 14 of Mises's treatise *Human Action* (1966). Chapter 14 is the introduction to his economics and is entitled "The Scope and Method of Catallactics." My interpretation identifies three major, albeit unstated purposes of the chapter. The first is to describe what he regarded as the incontestable procedure of economics – to elucidate market interaction under the conditions of the pure market economy and then to examine the effects of intervention in terms of whether it promotes the harmony of rightly understood interests. The second is to set the stage for the elucidation of market economy interaction by defining what he regarded as the most important concept, insofar as this is possible. The concept is the entrepreneur role and the corollary concept of consumer sovereignty. The third is to show the necessity yet danger of using imaginary constructions in economics. The essay tries to substantiate these purposes by meticulously examining the passages of the chapter in relation to the rest of the treatise.

A consequence is that I identify several messages from Mises that are important to Austrian economists today. I believe that the most important are: (1) that there is a heretofore undiscovered continuity between his praxeology and economics, (2) that he maintains this continuity by his use of the correlative concepts of consumer sovereignty and the entrepreneur role, and (3) that an understanding of these concepts is necessary if one wishes to understand his economics and, correspondingly, his elucidation of the market process.

Mises on the Scope and Method of Economics in Light of His Purposes

Ludwig von Mises's is widely regarded as the grand master of 20th century Austrian economics. His most definitive statement of his economics is his treatise *Human Action* (1966). Given this fact, one might expect that his treatise would, at least at one stage in the recent history of Austrian economics, have been the primary focus. However, while many contemporary neo-Austrian economists quote freely from the book, it has not undergone the kind of exegesis that would seem warranted following his death in 1973.¹ However, while many contemporary Austrian economists quote freely from his book, its most important ideas – indeed, the ideas that are critical to achieving an understanding of his economics – have not reached a contemporary readership.

It would not be surprising, therefore, to discover that modern neo-Austrians have misinterpreted and neglected Mises. I believe that this indeed is the current situation. There are a number of indications of this. The main one is that up to this point, no neo-Austrian economist of whom I am aware has succeeded in interpreting this the pivotal chapter in the treatise, chapter 14, which is entitled “The Scope and Method of Catallactics.” The burden of this essay is to provide the guidance necessary for a correct interpretation of the chapter.

My approach relies on identifying a purpose of the chapter that Mises neglected to state. Mises says nothing directly in the chapter about his purposes. A reader who is unaware of them from other

¹A volume of papers presented at a symposium in 1974, edited by Lawrence Moss, was published in 1976 and entitled *The Economics of Ludwig von Mises: Toward a Critical Reappraisal*. This was partly a presentation of selected ideas from Mises but there was no effort to integrate these ideas in terms of purpose. And it was very far from an exegesis.

sources is left to try to discover them on the basis of the chapter's title and what Mises actually writes in the chapter. To do this is sufficiently challenging that not a single reader of whom I am aware has succeeded. Nevertheless, I am convinced that, once the purposes are identified, both the structure of the chapter and much of its content is understandable, reasonable, and indeed a critical, though overlooked, contribution to economic methodology. As a corollary, if a reader fails to understand the purposes of this chapter, she is almost certain to be misled by the subsequent chapters of the treatise. She has little hope of comprehending Mises's contribution to economics.

The essay is organized as follows. Part one identifies Mises's purposes and presents an overview of how chapter 14 helped him accomplish them. Parts 2-5 are devoted chronologically to the first four of the seven sections in chapter 14. Part 6 discusses the last three sections. My aim is to present a summary of the ideas as Mises presents them in the relevant section and to show the relationship between those ideas and his purposes. Because this chapter has been so misunderstood, I also include commentary on a typical reader's interpretation. Part 7 presents a conclusion.

1. CHAPTER 14 AND THREE PURPOSES

The Three Purposes

The first of the three purposes that I claim Mises tried to accomplish in his chapter 14 is to introduce a praxeology-based economics that is intended to help economists make value-free evaluations of arguments for or against market intervention (subsequently called "interventionist

arguments”) made by people who subscribe to a theorem that Mises called the harmony of rightly understood interests. To do this, one builds an image of an entrepreneur role under pure market economy conditions that has the exclusive function of satisfying consumer wants in accord with the theorem

Proposed Purposes of Chapter 14:

1. To introduce a praxeology-based economics the goal of which is to enable economists to make value-free evaluations of interventionist, harmony-of-rightly-understood-interests-based arguments for and against market intervention.
2. To begin to define the entrepreneur role as a category of distinctly human action that satisfies consumer wants under pure market economy conditions.
3. To show that the imaginary constructions are necessary to help elucidate market interaction.

Box 1

of consumer sovereignty. This theorem holds that under these conditions, the entrepreneur role *always* acts in the interests of individuals in the consumer role (see below). His second purpose is to actually begin the process of defining the entrepreneur role. The third is to show that imaginary constructions are necessary to help elucidate market interaction. The purposes are listed in Box 1.

The third purpose is implied in the table of contents of the chapter which, absent the sub-headings, is shown in Box 2. He introduces the method of imaginary constructions in section 2. Then, in the next four sections, he describes different imaginary constructions, as indicated by the titles

**Chapter XIV: The Scope and Method of
Catalactics [Table of Contents]**

1. The Delimitation of the Catalactic Problems
2. The Method of Imaginary Constructions
3. The Pure Market Economy
4. The Autistic Economy
5. The State of Rest and the Evenly Rotating Economy
6. The Stationary Economy
7. The Integration of Catalactic Functions

Box 2

of sections 3-6. Section 7, which is not named after a specific imaginary construction, contains

several important imaginary constructions, including that of the *functional distribution*.² I discuss these imaginary constructions and their significance in the latter parts of this essay. This is also the section in which he begins to define the entrepreneur role.

In his chapter 14, Mises only stresses the third of the three purposes. Yet, he does not actually say that this is his purpose. Nor does he mention the other purposes. Thus it is wise to elaborate my view of his purposes before presenting my interpretation of the various sections. I begin with the first two purposes.

The First Two Purposes

Consider the first purpose. Mises points out early in the chapter that economic problems are a narrow orbit in the broader field of general praxeology (*ibid.*: 232) and states that the method of imaginary constructions is the method of both praxeology and economics (*ibid.*: 236). However, he does not say anything at all about a praxeology-based economics – i.e., about forging a bond between the two fields of study. He mentions the theorem of the harmony of rightly understood interests.³ But he does not reveal to readers the purpose he attributes to economics of evaluating interventionist arguments based on the theorem. He suggests that conclusions about the benefits of a free market are value free⁴ but he does discuss the source of the value freedom. Finally, he mentions that the

²I know of no Austrian economist who has written seriously about the method of imaginary constructions. I know of only one who has tried to use these states of rest in his work and he has been criticized (Joseph Salerno, 1993, and Israel Kirzner, 1999). Only Murray Rothbard has used the term “evenly rotating economy” extensively. Yet Rothbard’s scope and method differ from those of Mises. My impression is that these terms remain beyond the comprehension of neo-Austrians because the neo-Austrians do not understand Mises’s purpose for introducing them.

³This is in a footnote in section 3, where he refers the reader to a future chapter (!) for its explanation.

⁴See his statement on an unbiased scrutiny of interventionism at *ibid.*: 238.

actions of the businessperson are subject to the wishes of the consumer (*ibid.*: 240) but he does not call this consumer sovereignty and he says nothing else about the subject.

It is thus difficult on the basis of reading chapter 14 for the reader of this chapter to recognize the high degree of importance that Mises attaches to binding economics to praxeology, to the theorem of the harmony of rightly understood interests, to the evaluation of interventionist arguments, to the theorem of consumer sovereignty, and to value freedom. Yet knowledge of these concepts is necessary in order to appreciate the ultimate purpose (s) of the method of imaginary constructions.

To help the reader understand the importance of the first purpose and the concepts related to it, I begin with some history, as Mises viewed it. Classical economists, as Mises saw them, made a fundamental discovery, which later formed the basis of their economic theory. They discovered that exchange and specialization enable people to increase their utility because the corresponding division of labor raises the value (productivity) of labor (*ibid.*: 673).⁵ This discovery was the basis, among

⁵This fact about *Human Action* would be evident to every reader but for a combination of (1) Mises's convoluted means of presentation and (2) the training received by practically every person who has studied economics from a modern professional textbook. Mises introduces his text by referring to the "youngest of all sciences," economics (*ibid.*: 1). Prior to economics, philosophers focused on God, Nature, or the government. "They did not search for the *laws of social cooperation* because they thought that man could organize society as he pleased" (*ibid.*: 2, italics). What are these laws of social cooperation? As it turns out, the phrase never appears again in the treatise. On the other hand, an entire chapter is devoted to "Human Society," the introductory section of which is entitled "Human Cooperation." In that chapter he writes:

Society is concerted action, cooperation. Society is the outcome of conscious and purposeful behavior.

This does not mean that individuals have concluded contracts by virtue of which they have founded human society. The actions which have brought about social cooperation and daily bring it about anew do not aim at anything else than cooperation and coadjuvancy with others for the attainment of definite singular ends. The total complex of the mutual relations created by such concerted actions is called society. It substitutes collaboration for the – at least conceivable – isolated life of individuals. Society is division of labor and combination of labor. In his capacity as an acting animal man becomes a social animal (*ibid.*: 143).

The study of the laws of social cooperation means the study of the implications of the division of labor and the combination of labor, which can result from the voluntary actions of individuals. Mises's meaning is evident. However, the reader must skip around the treatise to find it. And she must be prepared to accept a use of terms that, in light of post-World War II developments in professional economics, would seem strange.

other things, for their favoring free international trade. Mises referred to the discovery as the universal law of the higher productivity of the division of labor (*ibid.*: 143-5) and of association (*ibid.*: 159-161). He transformed this into the theorem of the harmony of the rightly understood interests (*ibid.*: 674). Due to its importance, I refer to it by the acronym THRUI.

Mises proceeded to incorporate the theorem into his economics by employing the imaginary constructions of the pure market economy and entrepreneur role⁶ and to identify and elucidate what he called, following W. H. Hutt, the sovereignty of the consumers (*ibid.*: 269-73). According to consumer sovereignty, the actions associated with the *entrepreneur role* always benefit the individual in the role of a consumer.⁷ Thus through his imaginary constructions, he made the consumer sovereignty theorem of the early neoclassical economists more less equivalent to the classical economists' THRUI. Through the theorem of consumer sovereignty, he implicitly made the entrepreneur role the driving force for the expansion of the division of labor.

Mises regarded the THRUI as the foundation of economics. In his view, every judgment about an economic policy must account for the effect of the policy on the division of labor. Thus, when he transformed the classical theorem into the theorem of consumer sovereignty, he also deduced that

To modern professional economists, the idea of incorporating the assumption of higher productivity due a division of labor into the very definition of economics appears strange indeed. The training of such economists begins with the positive-normative distinction, which is based on the theoretical welfare economics of the early 20th century. This distinction seemingly prohibits confining economics to the study of states of the world in which the division of labor and corresponding higher productivity already exists. No doubt, the prominence of modern professional economics in the training of novices has inhibited understanding of the foundation of Mises's economics.

⁶Mises does not use the term "entrepreneur role." He prefers to use terms like entrepreneurs and capitalists and the entrepreneur in his entrepreneur capacity. The entrepreneur role is discussed below.

⁷See Mises's discussion of the entrepreneur in his entrepreneurial capacity (*ibid.*: 673). Entrepreneurial capacity refers the entrepreneur functions of causing consumer goods to be produced, according to the mandates of consumers, and bearing uncertainty. See my discussions later in the paper on the entrepreneur role and the integration of the catallactic functions.

every judgment about an economic policy must account for the effect on the performance of the entrepreneur role.

This deduction opened his mind to a means of achieving value freedom in his economics. Instead of evaluating policies themselves, the economist should attempt to determine whether the policies served individuals in the role of the consumer via the entrepreneur role. Thus, by using the theorem of consumer sovereignty as the criterion for evaluating interventionist arguments, Mises could legitimately claim that his economics is value free.⁸ So long as a goal of the advocate of a market intervention is to cause individuals in the role of consumers to gain through the performance of the entrepreneur role, the economics that Mises developed helps to determine, *in a value-free way*, whether a proposed intervention will achieve the advocate's goal.

The imaginary construction of the entrepreneur role also helps bind praxeology (the study of action in general) to economics (the study of action under the conditions of the market economy). To bind economics to praxeology, all economic theorems must be traced back to the wants that the entrepreneur role helps to satisfy and to the entrepreneur's employment of factors to produce the goods needed to satisfy them (*ibid.*: 68; 406).

The entrepreneur role is the embodiment of (a) the identification of and direction of factors in the production of goods and (b) the bearing of uncertainty. It complements the factor supplying and consumer-saver roles. The latter two roles represent passive behavior, as evidenced by Mises's reference to the source of the entrepreneur function's profit in the imaginary construction of the

⁸To verify this, the reader should see Mises's discussion of judgments of value (*ibid.*: 882-5) and his discussion of the common ground for dealing with social problems in his section on "World View and Ideology" (*ibid.*: 179-180). The reader might also see Mises 1978a: 114.

functional distribution (*ibid.*: 254). The imaginary construction of the factor-supplying roles (worker, capitalists, landowner) represents the passive behavior of incurring the loss and receiving the gain associated with changes in the prices of the factors they supply (wages and ordinary interest). The imaginary construction of the consumer-saver role represents the passive behavior of receiving satisfaction or utility at different times.

Most of these propositions must be inferred by the reader of chapter 14 and the inference must often be based on what Mises writes elsewhere in the treatise. He does not use the term “entrepreneur role” in the chapter and he does not relate his elucidation of the role to the purpose of binding economics to praxeology. That this role enables the economist to trace back all actions that cause goods to be produced to the category of action must be inferred from the fact that he says this is necessary, from his use of the imaginary construction of the functional distribution and his exercise in trying to think the imaginary construction of the pure entrepreneur to its logical consequences (see below). Mises provides no guidance whatsoever on the matter.

In other words, the only way to know that Mises is trying to accomplish this first purpose is to read both back and ahead and then return to chapter 14 with an eye toward finding out whether his scope and method chapter identified and tried to accomplish the purpose. Obviously, Mises did not intend the chapter, by itself, to accomplish what I have called his first purpose. He needed help from other chapters. What I want to stress, however, is that it is not possible to appreciate his remarks about the method of imaginary constructions or why he uses the imaginary constructions as he does without realizing that he is trying to accomplish this first purpose. On this basis, I conclude that he would have been wise to articulate this purpose in the chapter in order to persuade the reader that studying

the various imaginary constructions is worthwhile. I believe that his failure to do so is part of the reason why previous students of *Human Action* have neglected this chapter.

Mises reserves his lengthy section 7 for the accomplishment of the second purpose. In his presentation, however, it appears that his discussion of the entrepreneur role is part of his effort to elucidate one of the several imaginary construction of the chapter – that of the functional distribution. Indeed, if the reader is unaware of the first purpose, she could probably not appreciate why Mises approaches the concept of the entrepreneur in the way that he does. This is another factor contributing to neglect. The typical reader is unlikely to have any idea why Mises begins to elucidate the entrepreneur role. Yet the effort to elucidate it fits neatly with Mises’s ultimate goal of evaluating interventionist arguments made on the basis of the THRUI in a praxeology-based, value-free economics. The fact that practically the entire section is devoted to the entrepreneur role leads me to conclude that the second purpose of the chapter is to introduce this role.

The Method of Imaginary Constructions as a Means

I intend to show that the method of imaginary constructions is the means that Mises uses to achieve the purposes of binding economics to praxeology and helping him attain a position in which he can evaluate interventionist arguments on the basis of the theorem of consumer sovereignty. However, Mises wrote only that the method of imaginary constructions is the method of praxeology and economics. To make my case, I must show that when he used the term “economics,” he was referring to the field of study the purpose of which is to achieve these other two purposes. Moreover, I must

show what he means by saying that the method of imaginary constructions is the method of praxeology. I discuss these two tasks in reverse order.

Praxeology is the study of all that is implied by the notion of distinctly human action.⁹ Its starting point is the identification of the necessary properties of action. When Mises wrote about the method of praxeology, he was referring to the method of identifying the properties of action and of producing praxeological theorems. The properties of action that he identified were ends and means, time, and uncertainty. As I show below, to identify them he used the method of imaginary constructions in a particular way. He contrasted the imaginary construction of a being that does not possess a property of action with one who does. I believe that the use of method in this way also enables one to identify the characteristics of imagination, creativity, and inventiveness. I also think that by exploring the characteristics of uncertainty, one can better understand the function of guaranty under market economy conditions. But these are minor additions to the fundamental core properties of distinctly human action.

I now turn to economics. In order to achieve the first purpose listed in Box 1, the economist needs images of market interaction that is suitable for evaluating interventionist arguments on the basis of the theorem of consumer sovereignty. But he also needs images of phenomena (1) that can be traced to the property of action¹⁰ and (2) that are relevant to evaluating particular interventionist arguments.

⁹I use the term “distinctly human action” to clearly distinguish human action from the behavior of animals and robots. It also distinguishes the actions of normal adults from the behavior of children and otherwise handicapped humans and from human beings that lack what Mises calls vital energy Mises 1966: 490.

¹⁰Mises used various terms to refer to these properties. They were ends and means, time, and uncertainty. Typically he called each of them a category of action. My purpose for using the term “property” is to employ a standard terminology. The separate properties and how he derived them is discussed below.

If his images do not contain the first characteristic, they will not pass the test of subjectivism.¹¹ If his images are not relevant to any particular interventionist argument, they will not help him achieve his purpose.

In my discussion of Mises's chapter 14, I argue that Mises used a number of images that satisfied these two conditions. In order to trace a theorem to the properties of action, it is necessary to contrast the image of market interaction in the theorem with an image that is similar but which contains no action. Mises showed how to do this with his elucidation of the role of the entrepreneur. To define the entrepreneur role, he contrasted factor supply, production, and consumption action under market economy conditions with an image of factor supply, production, and consumption behavior in a system that contains no action (the *evenly rotating economy*). To relate the entrepreneur role to other non-action functions, he built the image of the *functional distribution*. To build an economic theorem about how distinctly human actions cause a particular relationship between the prices of different goods and factors of production are related, he employed the image of a *stationary economy*. This is an economy in which competitors, acting in the entrepreneur role, aim to maximize profit by taking advantage of profit opportunities that arise as a result of change. In addition, I show that to build theorems about how the gains from progress (an increase in per-capita wealth) are distributed, Mises employed the imaginary construction of the *progressing economy*, which contains conditions in which potential gains are already present. As a final case, to comprehend the significance of monetary calculation and the planning based on it, Mises built an imaginary construction of an economy in which money is neutral.

¹¹This concept of subjectivism is discussed by Mises at *ibid.*: 21-2.

Why Mises Stressed the Method of Imaginary Constructions

As I pointed out, in his chapter 14, Mises only stresses the purpose of the the third of the three purposes. I am confident that the reason for this is that he believed that the bulk of errors in economic reasoning during the time he was writing his book (1930s) were made by economists who improperly employed imaginary constructs. Of special importance to Mises was the error of using imaginary constructions like the evenly rotating economy to represent real market interaction. The most common makers of this error were the mathematical economists. Thus, he aimed to show that although imaginary constructions are necessary, the potential for error in using them is high. Unfortunately, in my opinion, the economics profession changed. The post-war period was characterized by a more fundamental set of errors. These were due to a failure to bind economics to praxeology. By the 1950s, mathematical economics was still employing imaginary constructions to represent market interaction. But economists were now using them to help organize their numerical data analysis. Moreover, the purpose of economics had gradually been redefined as the testing of hypotheses regarding the relationships among variables that the imaginary constructions are deemed to represent. In effect, professional economists had shifted away from what appeared to Mises as (a) a choice-based, if not praxeology-based, economics concerned with identifying the effects of market intervention on individuals' well-being to (b) an empirical, behaviorist discipline. Panphysicalism had expanded to become the dominant methodology (*ibid.*: 23-24, 18). Mises regarded this as intolerable (*ibid.*: 7).

Those post-war readers of *Human Action* who had already studied the new economics were not prepared to take for granted that all economic theorems had to be traced to the properties of action.

Accordingly, they were not prepared to consider that imaginary constructions were useful only to the extent that they helped elucidate the properties of action or to trace back an economic theorem to these properties. In short, these already indoctrinated readers of the treatise were not prepared to recognize that Mises's emphasis on the method of imaginary constructions was intended to show that mathematical modeling is an unsuitable way to build theorems in an economics that is strictly bound to praxeology.

I am confident that the third purpose of Mises's chapter is mainly to describe the method that is intended to help achieve the first purpose. The entrepreneur role is the most important imaginary construction that he employs to help achieve that purpose. His definition of this role constitutes the start of his effort to construct the praxeology-based economic theorems that he regards as necessary to evaluate interventionist arguments. I am also confident that the reason why Mises's chapter 14 has not been understood is that typical readers have not grasped both (1) the significance of binding economics to praxeology and (2) Mises's deep concern with the misuse of imaginary constructions by mathematical economists.

My interpretation of the chapter is based on my assumptions about Mises's purposes. Unfortunately, Mises does not say anything in the chapter about these. As a result, I have the duty of justifying my beliefs before presenting my interpretation of the various sections. Now that I have presented and defended these views, it is only necessary to discuss the purpose of presenting the method of imaginary constructions. I do this in Part Three, after I describe the method.

2. DELIMITATION OF CATALLECTIC PROBLEMS

I now proceed to analyze the various sections in Mises's chapter 14 with regard to how they help achieve one or more of the purposes. In most cases, I begin with a summary of the text and then provide an interpretation.

The Text

Mises kicks off his chapter 14 in section 1 by stating a point of agreement. Everybody agrees, Mises says, that the scope of economics is market phenomena. Problems arise, however, because in order to study these phenomena, one must build images of (1) the action of the isolated actor and (2) the "socialist commonwealth" (*ibid.*: 232).

Next he seems to switch topics to the scope of economics. Economics, he says, has a limited scope. It settles, by tradition, on studying that aspect of distinctly human action that is related to "the analysis of the determination of money prices of goods and services exchanged on the market" (*ibid.*: 234). Such actions are conducted on the basis of monetary calculation (*ibid.*).

The reason why other attempts to delimit the scope have failed, he says, is that the people who have worked on the problem have not realized that economic action is embedded in action in the more general sense. Once one attains this realization, it becomes evident that economics must be conceived as a branch of praxeology – the study of distinctly human action in general (*ibid.*: 232-4). In this section Mises uses another term for economics – *catallactics*.

Since economics is only concerned with action under a particular set of circumstances, a person who wants to analyze economic action must find a way to disengage the problems of economic action “from the comprehensive body of praxeological theory” (*ibid.*). In order to do this, the economist “must study not only the market phenomena, but no less the hypothetical conduct of an isolated man and of a socialist community (*ibid.*: 234). Thus, at the end of his discussion of scope and method, he returns to the perplexing statement at the beginning of the section, namely, that the economist must build these other images.¹²

Interpretation

The principal difficulty for the reader posed by this section is the lack of clear referents. I begin with his use of the term “catallactics.” He says in chapter 14 that catallactics, which he equates with “economics in the narrower sense” differs from economics in the broader sense. A search of previous uses of this “catallactics” in the treatise indicates that, by economics in the broader sense, he means the science of exchanges that entail monetary calculation (*ibid.*: 3, 202-3). To understand what he means by this, one must return to his introduction:

Until the late nineteenth century political economy remained a science of the "economic" aspects of human action, a theory of wealth and selfishness.... The transformation of thought which the classical economists had initiated was brought to its consummation only by modern subjectivist economics, which converted the theory of market prices into a general theory of human choice...The modern theory of value widens the scientific horizon and enlarges the field of economic studies. Out of the political economy of the classical school emerges the general theory of human action, praxeology. The economic or catallactic problems are embedded in a more general science, and can no longer be severed from this connection. No treatment of economic problems proper can avoid starting from acts of choice; economics becomes a part, although the hitherto best elaborated part, of a more universal science, praxeology (*ibid.*: 3).

¹²I am disregarding a subsection in which Mises discusses the Marxian denial of economics.

On the basis of this statement, I interpret the study of “economic problems,” as stated in chapter 14, to be part of the narrower field of economics. This narrower field is a branch of the broader field of praxeology. What he means by “problems” is discussed in the Part Three of this chapter.

Mises’s use of the term “catallactics” in chapter 14 seems to be an effort to clearly distinguish in the reader’s mind between economics in the broader sense and economics in the narrower sense. I believe that it would be better to substitute the term “economics” for “catallactics” throughout the treatise. The word “catallactics” is unnecessary and potentially distracting. Modern professional economics accepts that microeconomics is theory, or logic, of choice under market economy conditions. Mises sought only to provide a praxeology foundation for this theory. There is no need to ask readers to learn a new term. Mises’s main purpose for using “economics” in the two senses, it seems, is to remind the reader of the history of the subject. However, there is no need for this either.

Once Mises’s meanings are understood, most of section 1 falls into place. In my interpretation, it consists of three main ideas. First, the actions that are relevant to economics consists of those that are based on monetary calculation for which the actors are contemplating monetary exchange and that determine prices. Second, economics must be a branch of praxeology, the study of action in general. Third, to study economic actions, one must also study the isolated actor and socialist commonwealth.

A shortcoming of this section is that Mises does not explain why the images of isolated action and of the socialist commonwealth are necessary. He also does not provide references to the use of these concepts. As a result, the reader is in no position to comprehend how the use of these constructs may

cause difficulties. In fact, isolated action is discussed in section 4 of his chapter 14 under the title "The Autistic Economy." The socialist commonwealth is discussed in section 3. So I postpone my treatment of these. It seems, in light of his later discussion, that he inserted these constructions into his first section either to create a mystery in the mind of the reader or with the idea that the reader would be willing to reread *Human Action* until she finally discovers why these concepts are necessary. If the latter is true, one would have to hypothesize that Mises meant to present the almost 900 pages of *Human Action* as a gestalt.

It is worth noting the character of Mises's presentation. Mises does not state the plan of his section outright and then proceed to develop it step-by-step with references back to his initial statement. He develops it in a prose-like fashion, making reference to what economics does and to disagreements among economists that he does not fully describe. This form of presentation does not make it less logical but it does challenge the reader.

3. THE METHOD OF IMAGINARY CONSTRUCTIONS

Text

Section 2 introduces "The Method of Imaginary Constructions." Mises writes that it is the method of praxeology (*ibid.*: 236). This implies to those readers who understand the connection between praxeology and economics that it is also the method of economics. It is the method of studying action (praxeology) and the economic problems. He does not write that it is *a* method or that it is part of

the method. He writes that it is *the* method. He goes on to say that it has been carefully elaborated in the field of economics but he gives no references. A key sentence is: “Everyone who wants to express an opinion about the *problems* commonly called economic takes recourse to this method” (*ibid.*, italics added). This implies that practically every reader should be able to understand what he means by the method.

His second paragraph defines an imaginary construction as “a conceptual image of a sequence of events logically evolved from the elements of action employed in its formation” (*ibid.*). He goes on to write about the use of the method in economics. He says that one should not be concerned with the fact that a particular construction is “inconceivable, self-contradictory, or unrealizable” (*ibid.*). He does not elaborate.

The third paragraph says that the method is “justified by its success” (*ibid.*). I believe that he means by this that it is justified by its usefulness in achieving the goals of the economist. He does not say this, however. He writes only that the function of the method is “to serve man in a scrutiny which cannot rely upon his senses” (*ibid.*: 237). He says that the economist cannot conduct experiments (*ibid.*: 236) and that it is a “serious blunder to look for analogies to the imaginary constructions used by economists in the field of the natural sciences.” Nor can the imaginary constructions ever “be appraised from the point of view of experience” (*ibid.*: 237)

Next, he describes the “main formula for designing of imaginary constructions” and gives two examples. The main formula

is to abstract from the operation of some conditions present in actual action. Then we are in a position to grasp the hypothetical consequences of the absence of these conditions and to conceive the effects of their existence. Thus we conceive the category of action by constructing the image of a state in which there is no action, either because the individual is fully contented and does not feel any uneasiness or because he does not know any procedure from which an improvement in his well-being (state of satisfaction) could be expected. Thus we conceive the notion of originary

interest from an imaginary construction in which no distinction is made between satisfactions in periods of time equal in length but unequal with regard to their distance from the instant of action (*ibid.*).

In this passage, he describes a procedure and gives two examples. However, he again gives no references. He ends the section by saying that the method is indispensable but that it can easily result in fallacious syllogisms, which he regards as dangerous. He gives no examples of a fallacy that a person who uses the method may commit or why he regards the method's misuse as dangerous.

Interpretation

This section must appear very confusing to the typical first-time reader for at least three reasons. First it refers to "economic problems" which Mises does not clearly define and to a method that must be used in dealing with them of which the reader has never heard. Second, both the "formula" he describes and the examples are obscure. Third, he does not distinguish between two very different purposes that the method helps the praxeology-based economist achieve. To interpret his meaning, I discuss each of these issues in turn.

Economic Problems and the Method of Imaginary Constructions

Up to this point in the chapter, Mises had written that the scope of economics is the analysis of actions based on monetary calculation that determine money prices (see above). To the typical reader, economic problems would presumably refer to "problems" associated with such analysis. I am convinced that Mises's meaning is more specific. Since the main purpose of Mises's economics is to evaluate interventionist arguments (see part 1), I am sure that an economic problem refers

ultimately to the evaluation of such an argument.¹³ In other words, when Mises writes that the method is used to express opinions about economic problems, he means that in order to evaluate interventionist arguments, one must build images of two economies: one that contains and another that does not contain the intervention. It may also be necessary to build other imaginary constructions, but it is evident that these two are absolutely necessary. In any case, the absence of an example of an economic problem makes it very difficult to comprehend, much less to evaluate, his claim that to deal with such a problem, it is necessary to use imaginary constructions.

I believe that Mises assumes too much of his reader. What he really has in mind here is the construction of economic theorems to help evaluate interventionist arguments. He knows that the method of imaginary constructions helps the economist assure that his theorems can be traced back to the properties of action. Thus it must be used to deal with “economic problems.” But there is no way for the typical reader to make this connection. The phrase “economic problems” is vague and, accordingly, potentially misleading.

So far as I know, no previous economist had suggested that the method of imaginary constructions is *the* method of economics.¹⁴ Many economists had discussed the “isolation method.” And

¹³One searches *Human Action* in vain for a clear definition of the “problems of economic action.” The term does not appear anywhere else. However, the term “economic problems” appears many times, although it is never defined. Interestingly however, the term “social problems” appears in precisely the context one would expect, given that one recognizes how the THRUUI can be used to produce a value-free economics. See his discussion relating to “minor social problems” at (*ibid.*: 179-80).

¹⁴Actually, the precedent seems to be in Mises’s own work. A word search of the word “imaginary” in his 1981 [1933] *Epistemological Problems of Economics* turns up a number of entries that demonstrate that he already conceived of the “autistic economy,” the “socialist economy,” the “final state of rest,” and the “stationary economy” as imaginary constructions that were of use in economics. One does not find a reference in the earlier text to the use of imaginary constructions to elucidate the category and properties of action. Nor does one find a reference to *the method* of imaginary constructions. Judging from his references in the treatise, it is possible that he invented the phrase “method of imaginary constructions” on the basis of remarks by J. B. Clark. See his reference to Clark at Mises 1981: 108 – n75. Clark wrote that the “static state,” which corresponds to Mises’s evenly rotating economy, is imaginary at Clark, 1899: 29-30.

As a point of interest for Misesian scholars, he only mentions this method once in his later book *The Ultimate*

practically all economists have recognized the imaginary nature of economic models or images.¹⁵ Given the novelty of Mises's claims about the method of imaginary constructions, I reckon that whether the reader can comprehend Mises's formula for designing imaginary constructions depends on whether she can understand and agree with Mises on the basis of the examples he gives of the use of the method. These examples are likely to seem obscure to the typical reader, as I now show.

The First Example

To say that the method of imaginary constructions is *the* method of praxeology must imply that it is *the only* method of doing praxeology.¹⁶ Indeed, it turns out that he used it in his very first set of exercises in the treatise. He used it to derive the properties of action. In giving the example of

Foundation of Economic Science. He writes:

The imaginary constructions that are the main – or, as some people would rather say, the only – mental tool of praxeology describe conditions that can never be present in the reality of action. Yet they are indispensable for conceiving what is going on in this reality. Even the most bigoted advocates of an empiricist interpretation of the methods of economics employ the imaginary construction of an evenly rotating economy (static equilibrium), although such a state of human affairs can never be realized Mises (1978b: 41).

Interestingly, he refers to *Human Action*. A chapter on “Some Popular Errors Concerning the Scope and Method of Economics” in his 1978b book makes no mention of this method.

¹⁵For example, Wieser writes that for the economist

Isolation and idealization are [the instruments of the economist]...Complex experiences cannot possibly be interpreted as wholes. They must be isolated and separated into their elements in order that their effects may be known. The elements, moreover, must ideally be protected from all disturbing influences, in order that the pure effect may be recognized...Side by side with the isolating assumptions which embrace less than the entire truth, the theoretical economist then proceeds to form numerous idealizing assumptions which embrace more than the truth...Thus the theorist assumes the existence of a model man, a man such as actually has never existed, nor can ever exist. One of the best known instances of isolating assumption is Thünen's “State in Isolation.” (Wieser 1927 [1914]: 5-6).

Wieser refers to isolation but not to imaginary constructions.

¹⁶Mises discusses the scope of praxeology at (*ibid.*: 64).

conceiving *the category of action*, he is surely referring to this derivation. However, since he provides no references, the reader who does not make the connection herself would not know what he is referring to.

To see how he uses the method of imaginary constructions to identify the properties of action, consider how he identifies what he calls the “prerequisites of action” in chapter 1. These, he says, are: (1) uneasiness, (2) the perception of a more satisfactory state, and (3) “the expectation that purposeful behavior has the power to remove or at least to alleviate the felt uneasiness.” He elucidates the first with the following reasoning:

A man perfectly content with the state of his affairs would have no incentive to change things. He would have neither wishes nor desires; he would be perfectly happy. He would not act; he would simply live free from care (Mises 1966.: 13).

In light of what he says in chapter 14, I conclude that a “man perfectly content” is an imaginary construction that Mises uses to elucidate the first prerequisite. Regarding the second and third prerequisites, he writes: “[I]n the absence of [the expectation that purposeful behavior has the power to remove or at least to alleviate the felt uneasiness], no action is feasible. Man must yield to the inevitable. He must submit to destiny” (*ibid.*: 14). Here he uses the imaginary construction of a person who does not expect an action to remove uneasiness and of a person who does not have the power to behave purposefully. I conclude that Mises uses imaginary constructions that are derived, in a sense, from the prerequisites of action, to “prove” that particular prerequisites of action are present. He uses a similar method to derive the action properties of causality, time and uncertainty (*ibid.*: 22, 99, 105).

Once the reader examines how Mises elucidates the properties of action in chapter 1, it is evident that his comments in chapter 14 about the method serving humans in a scrutiny that is beyond the senses refer to a method that he has successfully used earlier in the treatise. Moreover, he has used it to accomplish precisely what he says can be accomplished. However, in the chapters where he derives the properties, he gives no hint of the idea that a man who lacks a property of action is an imaginary construction. Nor, in chapter 14 does he give a page reference to direct the reader's attention back to the earlier chapters in which he used the method. Because of this, I conclude that while the conscientious reader can discover how Mises used the "image of a state in which there is no action" (*ibid.*: 237, as quoted above), the typical reader is likely to be befuddled by this example.

It is also important to note that the imaginary construction he cites as the first example is not employed to help construct a specifically economic theorem, in the narrower sense of the term. The prerequisites of action, causality, time and uncertainty are praxeological phenomena. Deriving these properties amounts to deriving praxeological, as opposed to economic, theorems. In different terms, it amounts to defining distinctly human action. In light of this, it seems fair to say that the ambiguity of his broad and narrow use of the term "economics" is manifest the very first time that he uses the terms.

The Second Example

The second example refers to an imaginary construction that is used to comprehend the concept of originary interest (*ibid.*: 237). It is difficult to think of a more obscure example with which to confront a skeptical reader. This is the first time in the treatise that he uses the term "originary

interest” and he does not actually define it until chapter 19, where he says that it is “the discount of future goods as against present goods” (*ibid.*: 524). Moreover, when he discusses it, he makes no immediate mention of an imaginary construction. He waits until the end of his discussion to write that “[t] was only the elaboration of the imaginary construction of the evenly rotating economy that made it possible to distinguish precisely between originary interest and entrepreneurial profit and loss” (*ibid.*: 536).

This statement, in combination with his example of how the method of imaginary constructions is used (quoted above), leads me to deduce that what Mises has in mind in chapter 14 is the following. An economist who employs the evenly rotating economy to elucidate profit may conceive a more specific imaginary construction – an evenly rotating economy that helps one to define of an annual rate of profit. Whereas the evenly rotating economy merely assumes that the same behavior is repeated again and again, this more specific imaginary construction assumes, in addition, that each evenly rotating economy repetition requires a period of one year. In such an annualized evenly rotating economy, profit over the year is absent because entrepreneurship is itself absent. What is left is the annualized originary interest, which Mises conceives as a payment to the owners of capital goods.¹⁷

Note that to reach an understanding of how the method is used to elucidate originary interest, the student of economics must already know how to use the evenly rotating economy to elucidate entrepreneurship and profit and loss (see below). To elucidate entrepreneurship, one builds an image

¹⁷I have embellished this interpretation somewhat, since it is not necessary to have an annualized rate of profit or interest to elucidate originary interest. The purpose of the embellishment is to make the concept of originary interest somewhat more palatable to a reader who might take pause at my use of the more fundamental meaning of a discount of nearer future goods as against more distant future goods (*ibid.*: 524).

of the evenly rotating economy, in which “the operation of some conditions present in actual action” is absent. “Then we are in a position to grasp the hypothetical consequences of the absence of these conditions and to conceive the effects of their existence” (*ibid.*: 237, as quoted above). Profit is absent in the evenly rotating economy that he has in mind; originary interest is present. However, the reader does not find out about the evenly rotating economy until later in chapter 14.

A typical reader is unlikely to be able to make any sense out of this example. Mises’s statement about originary interest is most likely to be disregarded.

In Mises’s defense, one might observe that it is difficult to find a better example, since the concept of originary interest plays such an important role in his later theory of the trade cycle.¹⁸ It played no explicit role in his 1912 presentation of the cycle. Thus only a reader who had already become familiar with the more refined theory that he presents in *Human Action* could appreciate it. And the only way a reader could learn about the more refined theory is to read several chapters ahead.

Two Purposes of the Method

In choosing these two examples, Mises may have had a sound rationale, since a deeper understanding of them leads one to see two different ways in which the method of imaginary constructions helps economists build a praxeology-based economics. First, it helps the praxeologist identify the properties of the category of action, for which the praxeologist cannot “rely upon his senses” (*ibid.*: 237, as quoted above). It thus helps her define action. Second, it helps the economist build economic theory in such a way that theorems relating to time preference can be traced back to

¹⁸See the introductory paragraphs of chapter 20 at (*ibid.*: 539-40).

the category of action. It does this by enabling the economist to distinguish between interest, which is a reward to the saver as a capital goods owner merely for postponing consumption, and profit, which is a reward to the entrepreneur role. It is through the entrepreneur role that one can trace theorems back to the action category.

Note that the first of these examples is consistent with the purpose of deriving the properties of action while the second is consistent with elucidating action under market economy conditions in such a way that economics is bound to praxeology. Both are part of the larger project of building an image of interaction under market economy conditions in an economics that is a branch of praxeology. To say these things does not contradict Mises. Instead, it clarifies his use of the method. Mises says only that the method of imaginary constructions is the method of praxeology and economics.

Mises could possibly have clarified his meaning by referring in this section to the specific pages where he used the method and the purpose for which he used it. It is difficult to know what would have happened if he had taken this path. But there can be little doubt that the path he took confused his readers.

The Method of Imaginary Construction and Complexity

It is possible to conceive of these two purposes in terms of complexity. To do this, I associate complexity exclusively with action. I first associate complexity with the action of a single individual. The economist as praxeologist deals with this by using the method of imaginary constructions to isolate the distinctly human action from non-action phenomena – i.e., by defining action in terms of

the properties of action. Second I associate complexity with interaction among many actors under market economy conditions. The economist deals with this by building constructs containing roles that perform functions. To enable her constructs to help her produce relevant theorems, she makes a variety of subsidiary assumptions. So long as the roles she employs represent the properties of action, she will be able to trace the behavior of all of the complex economic phenomena she describes back to a combination of the properties of action that they entail – i.e., to the presumed ends and means, uncertainty and time. And if her subsidiary assumptions are chosen wisely, her theorems will help her evaluate the interventionist arguments with which she is concerned.

Two Other Examples

Mises could have communicated the method of imaginary constructions much easier, it seems to me, if he had used two other examples. I discuss each in turn.

The Imaginary Construction of Barter

Mises does not acknowledge earlier than chapter 14 that the method of imaginary constructions is the method of economics. Nevertheless, a word search reveals that there is one section prior to chapter 14 in which he uses the term “imaginary construction” repeatedly. In chapter 11, he introduces the concept of *monetary calculation*. His apparent goal is to prepare the reader for his chapter 14 definition of economics as the study of action on the basis of this concept. In his discussion he introduces the notion of the “barter-fiction of the elementary theory of value and prices.” He points out that a “market in which all transactions are performed in direct exchange” (as

opposed to money exchange) is an imaginary construction (*ibid.*: 201-2). This would have been a good example of the method's use in economics. A reader who paged back to chapter 11 would have a perfect referent for the method. Moreover, a footnote in the chapter 11 discussion refers to *other* imaginary constructions that are discussed in chapter 14. Yet, in chapter 14, Mises does not note his earlier use of the phrase "imaginary construction."

Another good reason to refer back to the discussion in chapter 11 is the fact that the earlier discussion exemplifies the position occupied by imaginary constructions in the economist's mental process of binding economics to praxeology. Accordingly, it is a direct reference to what I have called the binding of economics to praxeology. He writes in the earlier discussion that "[i]n order to trace back the phenomena of the market to the universal category of preferring a to b, the elementary theory of value and prices is bound to use some imaginary constructions" (*ibid.*: 201). The significance of this statement is due to the fact that he had even earlier in the book discussed "The Procedure of Economics." In that discussion, he had written:

Man is not infallible. He searches for truth – that is, for the most adequate comprehension of reality as far as the structure of his mind and reason makes it accessible to him. Man can never become omniscient. He can never be absolutely certain that his inquiries were not misled and that what he considers as certain truth is not error. All that man can do is to submit all his theories again and again to the most critical reexamination. This means for the economist to trace back all theorems to their unquestionable and certain ultimate basis, the category of human action, and to test by the most careful scrutiny all assumptions and inferences leading from this basis to the theorem under examination. It cannot be contended that this procedure is a guarantee against error. But it is undoubtedly the most effective method of avoiding error (*ibid.*: 68).

In light of these statements, a picture emerges of what the method of imaginary constructions is and of a crucial reason why it is important. It is this. *Because economics is a branch of praxeology, every theorem of economics must be capable of being traced back to a property of human action (i.e., to ends and means, time and uncertainty).* Because economics is bound to use imaginary constructions

in building economic theorems – i.e., because it uses the method of imaginary constructions – the only way to trace theorems back to the properties of action is to know how the particular imaginary constructions in question have been employed to transform these properties. As I show below, economists employ imaginary constructions such as the evenly rotating economy, the pure market economy, the functional distribution, the entrepreneur function, the passive consumer role, the passive capital goods owner role, and others. These constructs enable economists to make economic theorems in which all distinctly human action under pure market economy conditions is channeled into the role of the entrepreneur. The economist can cause this channeling to occur by building imaginary constructions based on the properties of action and subsidiary assumptions about the functions performed by the various imaginary, non-entrepreneur roles. If one considers the goal of producing economic theorems that comprise economic theory, she can see that when Mises says that the method of economics is the method of imaginary constructions, he means that it is the method of building economic theory on a praxeological foundation.

The Entrepreneur Role

Later in his chapter 14, Mises develops the concept of an entrepreneur role (*ibid.*: 253). In doing so, he introduces the imaginary construction of the pure entrepreneur. He implicitly defines this as a penniless employer of factors of production and producer of consumer goods for sale. Since a penniless entrepreneur cannot bear uncertainty, it is not representative of the entrepreneur role in economic theory (*ibid.*: 253). That role must also include uncertainty-bearing. The example of the entrepreneur role would seem to be a perfect example of how an imaginary construction is used to

help elucidate a concept the scrutiny of which requires one to go beyond the senses. Whereas the solitary actor imagines a situation in which her uneasiness will have been removed, a person acting in the role of the entrepreneur imagines a situation in which he will have caused a good to be produced, borne uncertainty and earned a profit or loss. This role is the embodiment of (1) the decision (and pre-decision activities) that causes goods to be produced to satisfy consumer wants and (2) the bearing of uncertainty. The economist employs the imaginary construction of the pure entrepreneur because he cannot use his senses alone to comprehend the decision-making and uncertainty-bearing under market economy conditions.

For Mises to use the entrepreneur role as an example at this point in his chapter, he would have to refer to a concept that he had not yet discussed. However, the fact that he presents this concept in the same chapter suggests that it would have been a useful one to give.

Mises asserts that all good economists should use the method of imaginary constructions. However, on the basis of the examples he gives, it seems that the only way for the reader to understand the nature of the method, why it must be used, and how to use it is to build a gestalt based on an encyclopedic knowledge of *Human Action*. This is the only way she could know which connections to make and when.

An Imaginary Construction as a Sequence of Events

I cannot attach much importance to Mises's statement that an imaginary construction is a conceptual image of a sequence of events. In fact, what he seems to have in mind is not an imaginary

construction but a theorem that employs imaginary constructions. I discuss this issue in greater depth in Part Six.

4. THE PURE MARKET ECONOMY

At this stage in Mises's chapter and in the text, the reader who treats the treatise as a gestalt is assumed to know that the main purpose of economics is to make THRU-based, value free evaluations of interventionist arguments. Such a reader would also know Mises's purpose of binding economics to praxeology. In addition to this, the reader would know from section 1 of chapter 14 that economic phenomena consists of decisions made on the basis of monetary calculation and of the prices that are determined by those decisions. By implication, such decisions also determine quantities of goods and the types of actions that cause the goods to be produced. Finally, the reader who had integrated the discussions of imaginary constructions in chapters 11 and 14 would know that the method of imaginary constructions enables the economist to trace all economic phenomena back to the category of action. What remains in a chapter on the scope and method of catallactics is for Mises to provide some direction on how he plans to use the method to achieve the first purpose and, perhaps, to begin using it. Section 3 on the pure market economy describes his plan, or procedure, and introduces the imaginary construction of the pure market economy, which is a necessary part in that procedure.

Text

The section contains several related ideas. First it defines the conditions of the pure market economy. These are a division of labor, private property rights and the free exchange of goods and services on markets. “The government...abstains from hindering the market’s functioning, and protects it against encroachments on the part of other people” (*ibid.*: 237). Free means that “there is no interference of factors, foreign to the market, with prices, wage rates, and interest rates” (*ibid.*: 238). He does not tell what he means by “foreign” in this statement.

He also has not, up to this point in the treatise, defined “the market.” He defines it in the next chapter, chapter 15, in the following way:

The market is not a place, a thing, or a collective entity. The market is a process, actuated by the interplay of the actions of the various individuals cooperating under the division of labor. The forces determining the – continually changing – state of the market are the value judgments of these individuals and their actions as directed by these value judgments. The state of the market at any instant is the price structure, i.e., the totality of the exchange ratios as established by the interaction of those eager to buy and those eager to sell (*ibid.*: 257-8).

Thus, he means in chapter 14 that the government does not hinder “the actions of the various individuals cooperating under the division of labor.”

The second idea contained in the section is the “incontestable procedure” that economists use to achieve the ultimate goal of evaluating interventionist arguments. It is to first exhaust all that can be learned from studying interaction under pure market economy conditions and then to consider the effects of intervention on that interaction (*ibid.*). In conjunction with his presentation of the procedure, Mises briefly mentions the task of evaluating interventionist arguments and alludes briefly to value freedom (*ibid.*).

Third, the section describes some history of economics, partly in order to make the point that the classical economists discovered how “the operation of an unhampered market, on which the consumer – i.e., every citizen – is sovereign, brings about more satisfactory results than the decrees of anointed rulers” (*ibid.*: 239). They made this discovery, Mises writes, by employing the imaginary construction of the socialist commonwealth (although they did not give it this name). They recognized that the socialist commonwealth is not necessary for a tailor to be “supplied with bread and shoes” (*ibid.*). In other words, he writes that the classical economists discovered the basis for the theorem of consumer sovereignty by comparing the imaginary constructions of the socialist commonwealth with interaction under market economy conditions.

A subsection is entitled “The Maximization of Profit.” In this subsection Mises points out that the concept of profit maximization is simply an application of the praxeological idea of “removing uneasiness” to the circumstances assumed in economics (i.e., to interaction based on monetary calculation), thus confirming the analogy that I described above between isolated action and entrepreneurial action. He refers again to the concept of consumer sovereignty (*ibid.*: 240-1), although he still does not give it this name, perhaps because he has not yet defined the entrepreneur.

Finally, he points out that the economic concept of maximizing profit and its praxeological equivalent, acting, do not imply that satisfaction is in some sense measurable. It follows that “the task of [establishing] how in the whole of society the greatest possible satisfaction of all people or of the greatest number could be attained” cannot be achieved (*ibid.*: 242-3).

Interpretation

Of the various ideas Mises presents in this section, two are crucial to understanding his economics: (1) the procedure to be followed in evaluating interventionist arguments and (2) the definition of the pure market economy, which is the starting point of the procedure. The other ideas are related to the procedure. The references, respectively, to the evaluation of intervention, consumer sovereignty, and value freedom are indications that his purpose of enabling economists to make interventionist arguments. Much in the back of his mind in the section. Thus, although the section is named after an imaginary construction, the presentation of that construct is only one of several purposes that Mises implicitly aims to accomplish in the section. It is precisely this fact that leads me to see three main deficiencies in his presentation. The first is the misdirection due to his statements to the effect that the pure market economy construct is an *object*, as opposed to a set of conditions under which action occurs. The second is his failure to make what he calls the “incontestable procedure” of economics stand out by systematically connecting it to the first purpose described in Part One. The third is the failure to adequately explore the conditions assumed in the imaginary construction of the pure market economy. I discuss each in turn.

The Pure Market Economy as an Example of Object-Centered Grammar

Mises’s presentation of economic phenomena under the conditions of the pure market economy is marred by his grammar. He begins his discussion by writing about what the pure market economy assumes. For example, he writes that it “assumes that the operation of the market is not obstructed by institutional factors” (*ibid.*: 237). What he really means is that when economists contemplate

action under the pure market economy conditions, they assume the absence of certain obstructions to “the interplay of the actions of the various individuals cooperating under the division of labor” (*ibid.*: 257, as quoted above). Mises’s focus ought to be action and not some hypothetical object – the pure market economy. To represent the conditions under which economists assume people act by saying or implying that economists study the pure market economy is potentially misleading. There is no point to it. To a reader who had not carefully studied the meaning of “the market,” it sends the message that Mises’s economics is engaged in model building, not unlike the mathematical economist who operates on the premise that the task of economics is to simulate an economy or segments of it by building a model.

This inauspicious beginning degenerates, in my opinion, when he refers a short time later to the market as free and when he writes that the pure market economy is an imaginary construction. The truly knowledgeable reader knows that Mises’s goal is to produce a set of theorems in a praxeology-based economics. The Misesian economist as opposed to the praxeologist, she knows, is concerned with action and its outcomes under special conditions. She knows that Mises’s statement about first studying “the operation of a pure market economy” and then turning “to the study of the various problems raised by interference with the market” (*ibid.*: 238) means that the economist must first study the “interplay of actions” under one set of conditions before turning to the study of the “interplay of actions” under a different set of conditions. The typical reader, however, is unlikely to know this.

In my view, it was a grave error for Mises to expect a typical reader to be able to interpret passages that use such grammar in the way that he intended. The error stems, I think, from a failure to

distinguish the two purposes of the method of imaginary constructions. It is misleading to say, as Mises does, that in carrying out the procedure of economics, the economist studies an imaginary construction. What the economist does is this. On the one hand, he contrasts the behavior in an imaginary construction in which action is absent with an image of action under similar conditions. One might safely use an object-centered grammar here, deciding to call the image of non-action an imaginary construction. Thus, it is not ambiguous to write of factor supply, saving, wages and interest in the evenly rotating economy (see below for further elaboration). But his purposes is not to comprehend the construct – i.e., the assumptions represented by the construct. The purpose is to comprehend the action that is necessarily absent in the construct. On the other hand, he studies action under imaginary *conditions*. To represent those conditions by referring to an imaginary construction like the pure market economy invites misunderstanding because it omits the fact that it is necessary to assume such conditions due to complexity. The only way to assure that the study of action under such conditions does not lead to logical error is to assure that the action represented can be traced back to the properties of action. It is necessary to study action under pure market economy conditions. But, in my view, it is misleading to say that the economist studies the pure market economy.

Unfortunately, such misleading representations pervade Mises's treatise. They reflect an object-centered grammar.¹⁹ To understand Mises's contribution to economics, the knowledgeable reader must convert every object-centered statement that Mises makes about an imaginary construction like

¹⁹This grammar is also manifest in most of Mises's chapter titles such as "The Market," "Prices," and "Interest." There are exceptions, however such as "Monetary Calculation as a Tool of Action," "Indirect Exchange," and "Action in the Passing of Time."

the pure market economy into a subject-centered statement about action under certain conditions. In part 6 of this essay, I show how to do this with the aid of Mises's definition of the entrepreneur.

The Procedure of Economics

By far the most important idea in this chapter is what Mises calls the “logically incontestable procedure” of economics – to fully study action under the imaginary conditions of the pure market economy, learning as much about it as possible, and then to use the theorems derived from such a study to help evaluate market interventions (*ibid.*: 238).²⁰ By a procedure of economics, he means a procedure that will enable economists to attain a position from which they can evaluate interventionist arguments on the basis of the THRUI. He at least implies in the section that economists' evaluations of arguments can be value free although he does not tell the reader why. He also introduces consumer sovereignty without giving it that name. And he connects economics to praxeology via his discussion of the meaning of profit. Nevertheless the section is troubling because he does not discuss the criteria he plans to use to evaluate interventionist arguments. As a result, his claims that economics is value free and that interaction in the market economy serves consumer interests almost certainly fall either on deaf or skeptical ears or on ears that are already disposed to

²⁰One who doubts the importance of this idea can page ahead in the treatise to Mises's discussion of intervention where he writes:

In dealing with the catallactics of interventionism we...are exclusively concerned with those acts of interference which aim at forcing the entrepreneurs and capitalists to employ the factors of production in a way different from what they would have done if they merely obeyed the dictates of the market (*ibid.*: 734).

Thus, the economics of intervention, Mises says, is concerned with how the intervention changes the performance of the entrepreneur role.

favor “freer markets” for whatever reason. Only a reader who already knows Mises’s purposes and how he tries to achieve them is prepared to digest these statements.

To highlight the procedure of economics, Mises should begin with his goal – to make value-free evaluations of interventionist arguments on the basis of the THRUI. Then he should describe the procedure he plans to use to achieve this goal. To begin the section with a description of the conditions of the pure market economy is to put the cart before the horse. And to neglect to tell the ultimate goal he expects his incontestable procedure to help accomplish invites misinterpretation. I recognize that Mises's choice to label the section "The Pure Market Economy" is consistent with his third purpose of describing the method of imaginary constructions; but it conceals the more important first purpose. By doing this, Mises risked leading his reader away from what he regarded as the main purpose of economics and of his unique discovery of how to accomplish the purpose.

Why the Pure Market Economy?

As Mises puts it, the pure market economy image assumes complete private property rights. Since this condition does not exist in any real economy, a reader is likely to ask why he does not begin with a different imaginary construction – a more realistic one in which private property rights are incomplete. In other words, Mises does not address what would seem to be the most obvious and important challenge to the intermediate step of studying action under the conditions of the pure market economy. This is that an image of action under the conditions of incomplete private property rights is more realistic and, therefore, more relevant to the goal of evaluating interventionist arguments.

Consider how Mises handles private property rights. He waits nine chapters before discussing the implications of incomplete property rights (e.g., external effects) in chapter 23. Why not say something about this assumption in a section that aims to justify the use of the imaginary construction of the pure market economy for the ultimate purpose of evaluating interventionist arguments? To a reader who does not already regard Mises as an authority on value-free economics, his decision to postpone the treatment of this assumption is likely to be an indicator that the treatise will turn out to be a biased polemic. It would have been much wiser to emphasize the pure market economy as a neutral starting image from which all subsequent images that he plans to use to evaluate interventionist arguments are derived. Moreover, had he approached the subject in this way, he would have been in a position to write a paragraph or so about why he assumes that a pure market economy, as a neutral starting point, contains the division of labor. The answer, of course, is that he aims to incorporate the THRUI into his definition of the pure market economy. As he points this out, he could also mention the fact that when theoretical welfare economics assumes a division of labor, it must also be incorporating the THRUI into its image of an economy.

One last point. There is an inconsistency between his definition of the pure market economy in his chapter 14 and his definition elsewhere. In chapter 14, he neglects to mention that the pure market economy conditions include an absence of deception and fraud. He writes only that the government protects the market “against encroachments on the part of other people,” as quoted above. His later definitions of the pure market economy add the modifier “fraudulent” to the word “encroachments” (*ibid.*: 256, 281, 718). This omission is another reason for the reader to consider dismissing Mises’s statements about the pure market economy as being part of a polemic.

5. THE AUTISTIC ECONOMY

Text

Mises begins this short section by defending the use of the image of the autistic economy against presumed critics. He writes that there are two types of autistic economies: (1) the solitary actor and (2) the isolated socialist commonwealth (*ibid.*: 243). He does not describe either of these in detail at this juncture. Instead, he makes two points. The first is that “[i]n order to study interpersonal exchange it must compare it with conditions under which it is absent” (*ibid.*: 243). The second is that the socialist commonwealth has been inappropriately used as a basis for judging whether some action in the market economy is “productive.” “Every phenomenon of the market economy is judged with regard to whether or not it could be justified from the viewpoint of a socialist system” (*ibid.*: 244). Such logic is not part of economics (*ibid.*). Nevertheless, the image of the socialist commonwealth helps the economist understand how difficult it would be for “the general manager of a perfectly isolated socialist commonwealth...to plan and to act as people can only when taking recourse to economic calculation” (*ibid.*: 243).

Interpretation

The points that Mises makes in this section relate to the usefulness and hazards of using imaginary constructions. He thus uses the section to elaborate on his earlier, more general statement that these constructs are indispensable but hazardous to use (*ibid.*: 237-8). In my view, however, he overlooks

two opportunities to elaborate on the more important issues which the autistic economy is ideally suited to help elucidate. I assume that he includes this section in order to show how this imaginary construction is useful. If this is so, he could both show this and reinforce other points related to his purposes that are crucial in his effort to communicate with readers. First, he misses the opportunity to remind the reader of his purpose of binding economics to praxeology by relating the study of action, by analogy, to the study of economic interaction. Second, he neglects to show the reader that he had used the construct to elucidate the “universal law” of the higher productivity of the division of labor (*ibid.*: 145). I discuss each in turn.

The Bond Between Economics and Praxeology

Mises missed an opportunity to illustrate the bond between economics and praxeology. Consider the knowledge gained by the praxeologist when she uses the method of imaginary constructions to help her comprehend and identify the properties of the category of action. It is obvious that such knowledge provides the foundation for the grammar that a praxeology-based economist would want to use to help describe action in the pure market economy. More specifically, the praxeologist’s knowledge of the conditions faced by the isolated actor in general helps the economist, by analogy, to meaningfully state theorems about interaction under the conditions of the pure market economy.

Mises conceives of an isolated actor as a relationship between perceived uneasiness and the identification and employment of means to remove that uneasiness. By analogy, he conceives of market interaction as interaction between (1) individuals who possess wants through time and who own factors of production and (2) individuals who identify and employ means to satisfy those wants.

Maximizing profit is merely action that employs means under the particular conditions of the pure market economy. And just as the actor is compelled to act in his own interest, so is the actor “[i]n his capacity as a businessman a servant of the consumers, bound to comply with their wishes” (*ibid.*: 240).

The analogy can be pressed further. Mises writes that

The only method of dealing with the problem of action is to conceive that action ultimately aims at bringing about a state of affairs in which there is no longer any action, whether because all uneasiness has been removed or because any further removal of felt uneasiness is out of the question. Action thus tends toward a state of rest, absence of action (*ibid.*: 244).

For the isolated actor, the meaning of this statement is evident. The praxeologist conceives of the action of, say, picking berries by assuming that the action is intended to bring about a state in which the berries are picked and eaten. No further action occurs. The endpoint is an imaginary construction because the actor is always performing many actions simultaneously and because events may occur in the interim to change his decision. For the market economy, the economist has a similar conception. He also conceives of an endpoint at which no further action occurs. He may, following Mises, call this endpoint the “final state of rest.” It is an imaginary construction because, in reality, interaction is always changing so that no such point is ever reached.

The final state of rest is an imaginary construction that helps the economist comprehend the action that aims to satisfy consumer wants. It follows that it is an imaginary construction that helps the economist comprehend the entrepreneur role, which is exclusively devoted to that end. Just as the isolated actor’s identification and employment of means is guided by his perceived ends and means, so is the entrepreneur role’s identification and appraisal of factors of production guided by

entrepreneur-perceived consumer wants and knowledge of the capabilities of the factors of production.²¹ I discuss the final state of rest in greater detail in Part 6.

Making the analogy is a means of building a praxeology-based image of market interaction – i.e., of binding the phenomena of economics to the phenomena of action in general. How can one trace the complex phenomena of interaction under market economy conditions back to the actions of individuals? Mises's answer, which he gives obliquely later in the chapter, is to divide those actions into roles and functions, assigning to the entrepreneur the task of causing all wants to be satisfied. This is achieved with the help of imaginary constructions like the evenly rotating economy, the final state of rest, and the functional distribution, which I discuss in the next part.

Elucidating the Higher Productivity of Labor Achieved Through Exchange

Mises's second missed opportunity is his failure to note the role of the autistic economy in helping to establish the guiding principle for evaluating interventionist arguments. That guiding principle is the higher productivity that is achievable by means of the division of labor. It manifests itself in the use of the THRUI. Mises could have noted that he used the image of the isolated actor to derive his concept of *society*, which contains the division of labor. He had already written the following:

Use of the autistic economy image solves a problem that neither history nor ethnology can solve: the demonstration of those factors which can and must result in association and its progressive intensification [and, therefore, in society]...The factor that brought about primitive society and daily works toward its progressive intensification is human action that is animated by the insight into the higher productivity of labor achieved under the division of labor (*ibid.*: 160).

²¹See also a statement regarding “the delimitation of the ‘economic’” in Mises's book on epistemological problems (1981: 146). There he makes an analogy between the conduct of the isolated farmer and the conduct of an actor in interpersonal exchange. The earlier book contains no discussion of consumer sovereignty. His introduction of this term appears to have been a later development. Also, I should mention that there are no favorable uses of the term “analogy” in *Human Action*. So it must remain an open question whether Mises would characterize his procedure for elucidating economic action as one based on an analogy. Regardless of terminology, however, the two types of conduct are, for Mises, inextricably linked by the fact that both represent a relationship between felt uneasiness and the action that removes it.

The insight of the higher productivity of the division of labor is, in turn, the concept from which “the harmony of rightly understood interests” is derived (*ibid.*: 673). This concept is critical for establishing the single purpose of evaluating interventionist arguments, which enables the field of economics to remain value free. In my view, it is extremely unfortunate that Mises did not note the use of the autistic economy to illustrate the higher productivity of the division of labor.

6. TEXT AND INTERPRETATIONS OF THE REST OF THE CHAPTER

The remaining three sections of Mises’s chapter on scope and method have caused great confusion. This seems mostly due to omissions already mentioned. As I pointed out, Mises failed to emphasize that the structure of the economics parts of his book was based on the “incontestable procedure” that he discussed earlier in his chapter 14. Essentially, Mises asserted that if one followed the procedure, she could produce theorems that enabled her to make value-free evaluations of THRU-based interventionist arguments. Unfortunately, the typical reader has little guidance.

The Purpose of the Last Three Sections

It seems reasonable to assume that Mises would not have realized that the reader’s lack of guidance would affect her ability to understand the text in the treatise. I presume that he would have proceeded

as if the reader either fully understood and accepted the procedure or as if she would ultimately come to understand it, perhaps by repeatedly reading the text. If this assumption is correct, his obvious next step would be to carefully elucidate the roles of the consumer and entrepreneur so that they match the analogy with the isolated actor. The starting point for taking this step is to build an image of action under the conditions for which the analogy holds strictly – the pure market economy conditions. Section 3 of chapter 14 had introduced the conditions that are assumed in that imaginary construction. What would remain is to define the entrepreneur role in relation to those of the consumer and factor supplier roles. Rather than start a new chapter to do this, Mises proceeded to devote most of the rest of chapter 14 to that subject. *Thus, I maintain that the most important purposes of the last three sections – 5, 6, and 7 – are to define the entrepreneur role and to introduce the imaginary constructions that he planned to use for its elucidation.*

There is no reason to believe that the typical reader of *Human Action* would be able to identify these purposes or, beyond that, where sections 3, 5, 6 and 7 fit into Mises's plan to accomplish them. Mises did not state his purpose or plan and I have already noted the need for a reader to treat the treatise as a gestalt in order to understand it. It is true that he had described the "incontestable procedure." However, he did not sufficiently elaborate and he did not describe his plan to spend most of part 4 of his treatise completing the first part of this procedure. Also, as I mentioned, the only purpose of the chapter that he made obvious was to teach about the method of imaginary constructions. Finally, his grammar was misleading in that it often focused on outcomes rather than human causes. Thus, I can find no reason to expect the typical reader to connect Mises's last three sections to the purpose of elucidating the entrepreneur role.

Whatever disposition the reader may have, the aim of the last part of my essay is to demonstrate how the various concepts covered in sections 5-7 of Mises's chapter 14 contribute to the accomplishment of this purpose. Before proceeding, though, I believe it is helpful to do two things. First, I want to review the history of praxeology-based economics. A reader who knows this history is in a much better position to comprehend the relationship between the method of imaginary constructions and the achievement of this purpose. Second, I want to note Mises's failure to use the term "entrepreneur role." Mises avoidance of this term combined with my reliance on it may give the false impression to the reader that the concept of the entrepreneur role was not as important to Mises as I make it out to be.

Brief History of a Praxeology-Based Economics

In order to follow Mises's incontestable procedure directly and to use the criterion of the THRUUI to evaluate arguments, one would have to produce theorems about how distinctly human action under market economy conditions causes an ever increasing division of labor. The basic theorem might be expressed in the following way.

Thanks to the higher productivity of labor performed under the division of tasks, the supply of goods multiplies. A pre-eminent common interest, the preservation and further intensification of social cooperation, becomes paramount and obliterates all essential collisions. Catallactic competition is substituted for biological competition...Because many people or even all people want bread, clothes, shoes, and cars, large-scale production of these goods becomes feasible and reduces the costs of production to such an extent that they are accessible at low prices...This is the meaning of the theorem of the harmony of the rightly understood interests of all members of the market society [or, as Mises suggests in a footnote the theorem of interests "in the long run"] (*ibid.*: 673-4).

The subjective value theorists like Carl Menger, Eugen Bohm Bawerk, Clark (who seems to have developed subjective value theory independently of Menger), Herbert Davenport, Philip Wicksteed, J. A. Schumpeter and Frank Knight, transformed this criterion. In different degrees and in different

styles, all acknowledged two aspects of the new economics. The first was that the quantities and relative prices of all factors of production and, therefore, the incomes of the factor owners are ultimately determined by the prospective valuations of the people who consume the goods that the factors help to produce (*ibid.*: 333). Subjective value means value as determined by individuals in the role of the consumer. The second aspect recognized by the early neoclassicals is a sharp distinction between (1) an *image* of interaction among distinctly human beings divided into function-performing roles, and (2) a *model* of interactive behavior in which the outcomes (prices, quantities, etc.) are determined by maximizing behavior alone. The image of interaction pigeonholed all of the “active” and progressive elements of distinctly human action. These elements were typically represented by a reference to the entrepreneur and to profit and loss. The model – which was called a static equilibrium, a circular flow of wealth, or some other name that corresponds to what Mises called the evenly rotating economy – captured the essential functions of consuming goods, saving, supplying factors, and producing.

The most advanced transformation of neoclassical economics came in the form of Mises’s praxeology-based economics. Mises implicitly recognized the purpose behind the distinction between the image and the model. It is to pigeonhole distinctly human action. I do not know whether this recognition led him to conceive of economics as a branch of praxeology or whether his insight that economics is a branch of praxeology led him to comprehend the necessity of pigeonholing action. In any case, he was led to the further recognition that economists could learn much and avoid logical error by acting as praxeologists. Thus, he advocated an economics comprised of economic theorems depicting sequences of actions that can always be traced to action in general. The first step

in such an economics is to study the fundamental properties of action. The next step is to build economic theorems that can always be traced back to the properties of the category of action. This is accomplished by identifying the imaginary construction and distinctly human action used in each theorem's production. I conclude that Mises was able to invent a praxeology-based economic science.

The most critical concepts in the new science were the theorem of consumer sovereignty, entrepreneurship, and the conditions of the pure market economy. The consumer sovereignty theorem is based on the analogy between the action of an individual (the use of means to achieve ends) and interaction under market economy conditions (the entrepreneur's driving force in the satisfaction of consumer wants). The entrepreneur role refers to all distinctly human action under the conditions of the pure market economy. I have already defined the pure market economy conditions.

The arguments made for intervention most typically refer to the consequences of actions – for example, the prices of goods or factors, the distribution of the goods or factors, and the nature of goods produced. Faced with an argument that is stated in terms of consequences, the economist's task is to determine the effects of the intervention first on the mental phenomena and later on their consequences. Thus, an economic evaluation of an argument typically consists of comparing at least two proposed situations (e.g., the pure market economy and a particular hampered market economy) with respect to two types of phenomena (1) the combination of prices, quantities, and other theoretically observable outcomes of action and (2) the mental phenomena of wants and perceived means of satisfying them that lie behind the decisions to identify and employ factors for the

production of goods. The comparison entails the use of theorems that are produced with the aid of imaginary constructions.

The Entrepreneur Role

In his descriptions of market interaction, Mises did not refer to the entrepreneur role. Instead, he wrote of the capitalists and entrepreneurs, the businessman, the entrepreneur in his entrepreneurial capacity, and others. Moreover, he often described market interaction in terms of its outcomes instead in terms of the entrepreneur role that causes the outcomes. The entrepreneur role was implicit in such descriptions. But the fact that he did not mention it or, in some cases, any other distinctly human cause of the outcomes detracted from his revolutionary procedure for binding economics to praxeology.

For example, at the start of the chapter 14, Mises says that economics has always been concerned with “the analysis of the determination of money prices of goods and services exchanged on the market” (*ibid.*: 234). As a student of early neoclassical economics, he knows that in showing how these are determined, a praxeology-based economists must ultimately refer to ends and perceived means that are in the minds of individuals. The money prices on the market are the outcomes of the choices that are driven by these essentially mental phenomena. He also knows that he will assert that the entrepreneurial actions are taken accord with the theorem of consumer sovereignty (*ibid.*: 269-70). Finally, he knows that he will show in chapter 16 that the entrepreneur determines the prices of consumer goods (*ibid.*: 329) and the factors of production (*ibid.*: 333-6). In short, he knows that

while economics has always been concerned with money prices of goods and services, a praxeology-based economics must be concerned ultimately with how these are caused by the entrepreneur role.

If the reader also knew these things, then she would surely realize that in every case where Mises writes about markets, prices, goods and services; he is referring also to the entrepreneur role that causes them. Moreover, she would anticipate that in referring to an imaginary construction that is useful in representing a price in a real market economy, Mises has the entrepreneur role in the back of his mind. Unfortunately, it is highly unlikely that a reader would realize these things. The typical reader may see little relationship between Mises's discussion of imaginary constructions relating to prices and the entrepreneur role.

Indeed, Mises seems in some cases to want to avoid the kinds of language that would directly link economics to praxeology. In his chapter 15 on the pure market economy, he distinguishes between the *state* of the pure market economy and *forces* that determine this state. The state "is the price structure, i.e., the totality of the exchange ratios." The forces determining it are "the value judgments of these individuals and their actions as directed by these value judgments" (*ibid.*: 257-8). In this conception, the forces are the wants of individual in the consumer role and the decisions of individuals acting in the entrepreneur role. These forces are behind the scenes, so to speak. They are data that cannot be comprehended by referring to the senses alone.²² The economist assumes that they are in the minds of the actors. She also assumes that other actors may attempt to predict both consumer wants and the entrepreneurial decisions of prospective rivals. The outward manifestation

²²Mises writes that "[f]or praxeology data are the bodily and psychological features of the acting men, their desires and value judgments, and the theories, doctrines, and ideologies they develop in order to adjust themselves purposively to the conditions of their environment and thus to attain the ends they are aiming at" (Mises 1966: 646).

of these essentially mental phenomena are markets and prices. However, it seems to me that the least misleading way to represent these facts is not to write of forces but to employ the entrepreneur role which, as I will show, he clearly identifies and defines in section 7 of chapter 14.

Mises's initial discussion in his chapter 14 is almost totally about theoretically observable outcomes. He writes nothing about the entrepreneur until later in the chapter. Nor does he tell his readers why he initially presents his ideas on scope and method mainly in terms of outcomes. For the most part, he employs a grammar that emphasizes outcomes rather than causes. If the reader is not aware of the fact that he deals with the subject matter in this way and that Mises has mental phenomena in the back of his mind, she will fail to comprehend Mises's meaning. One wishes in retrospect that Mises had made it easier for prospective followers to comprehend his revolutionary economics.

With these ideas in mind, I now proceed to discuss the last three sections. Interpretation is interspersed with statements about what Mises writes.

Section 5: "The State of Rest and the Evenly Rotating Economy"

Mises organizes his theory of markets and prices under the conditions of the pure market economy by systematically introducing a set of imaginary constructions. Each construct performs one of the two purposes that I described above in part 3 of this essay. The introductory constructs are the "plain state of rest" (not an imaginary construction) and the "final state of rest" (an imaginary construction).

To a reader who now knows and accepts that the method of praxeology and economics is the method of imaginary constructions, Mises's statements about the states of rest introduce the idea that the imaginary construction of a state of rest is the chief imaginary construction used in both fields. Even if or even though action never stops, the only way to represent it is to refer to an imaginary construction that assumes that it stops. And, of course, action that is assumed to stop must also be assumed to begin. Thus, the imaginary construction of a beginning point is also implied. The important point is that the statement implies that *to comprehend economic action, one must employ the imaginary constructions of a beginning point and an ending point*. Mises calls this hypothetical ending point the final state of rest.²³ He does not mention a beginning point

Mises goes on to say that to build an image of the "final state of rest," the economist must take account of "factors which are bound to bring about a tendency toward price changes. We try to find out to what goal this tendency must lead before all its driving force is exhausted and a new state of rest emerges" (*ibid.*: 245). These "factors," of course, are the valuations or appraisals of the item exchanged by parties who are *not* making the exchange that Mises calls the plain state of rest. Thus, the final state of rest appears to refer to a kind of final general equilibrium of market prices, albeit one that takes account of the fact that "a span of time must elapse before all their effects are exhausted" (*ibid.*: 246). That this is the correct interpretation is evidenced by his distinction between the final state of rest and the evenly rotating economy, which is also a system of interrelated prices. Whereas one who uses the former construct pays "full regard to change in the temporal succession

²³I skip Mises's confusing distinction between the "plain state of rest" and the final state of rest. I discuss this distinction in the Appendix One.

of events,” “the latter is characterized by the elimination of change in the data and of the time element” (*ibid.*: 246-7). I discuss this distinction in the next subsection.

Final State of Rest is a Tool for Building Economic Theorems

Mises promotes the idea that the final state of rest is a necessary part of “doing economics.” He calls the method that uses this construct the “static method:”

There is no means of studying the complex phenomena of action other than first to abstract from change altogether, then to introduce an isolated factor provoking change, and ultimately to analyze its effects under the assumption that other things remain equal...The static method, the employment of the imaginary construction of an evenly rotating economy, is the only adequate method of analyzing the changes concerned without regard to whether they are great or small, sudden or slow. (*ibid.*: 248).

This statement is deficient for four reasons. First, it is about the final state of rest yet it refers to the evenly rotating economy. Second, it neglects the purpose of economics. Third, the focus of its grammar is outcomes, instead of human causes. Fourth, the label “static method” is confusing and unexplained.

Mises’s distinction between the evenly rotating economy and the final state of rest is unclear. This is due to an omission. To say that the evenly rotating economy is characterized by the elimination of change and the time element does not preclude the use of this construct as a final state of rest. In fact, Mises does use it for this purpose. The term “final state or rest” appears only twice again in the treatise. He substitutes the term “evenly rotating economy.” In almost every context where one might expect to see a reference to the final state of rest, Mises uses the evenly rotating economy.²⁴ Yet in

²⁴The doubtful reader can conduct a search of the phrase “tendency toward the evenly rotating economy.”

this section, his emphasis on the difference between the two suggests otherwise. Mises should have devoted more energy to the issue of how he planned to use the constructs.

What Mises really means is that when the economist uses the phrase “final state of rest,” he implies an analysis that specifies the assumed actions that temporally precede an evenly rotating economy. As I pointed out above, the imaginary constructions used by economists have one of two possible purposes: to help the economist identify the properties of action and to help the economist make theorems that can be traced to the properties of action. The evenly rotating economy can be employed for both purposes. Thus it can be used as a final state of rest, as he uses it here. Mises says as much when he warns readers about misusing this construct. He writes about the two purposes that the imaginary construction of the evenly rotating economy “is designed to serve:”

We want first of all to analyze the tendency, prevailing in every action, toward the establishment of an evenly rotating economy; in doing so, we must always take into account that this tendency can never attain its goal in a universe not perfectly rigid and immutable, that is, in a universe which is living and not dead. Secondly, we need to comprehend in what respects the conditions of a living world in which there is action differ from those of a rigid world. This we can discover only by the *argumentum a contrario* provided by the image of a rigid economy (*ibid.*: 250).

In serving the first purpose, the evenly rotating economy functions as the final state of rest in helping the economist make theorems. In serving the second purpose, it functions as a model of maximizers in helping the economists identify the properties of economic action, namely, the entrepreneur role. A reader who realizes that the evenly rotating economy can be used for these purpose would substitute the term “final state of rest” for the term “evenly rotating economy” in the above quotation

on page 248.²⁵ The “static method” of which Mises is writing employs the evenly rotating economy as a final state of rest. And its purpose is to help the economist produce economic theorems.

The second deficiency of his statement on page 248 is his neglect of the purpose of economics. When Mises writes about “studying the complex phenomena,” what he really means is “producing theorems for use in evaluating interventionist arguments.” To produce such theorems it is necessary to study complex phenomena. However, Mises’s failure to tell on the purpose leads the typical reader not to think of the ultimate goal of economics. This is likely to be counterproductive for readers trained in modern professional economics because such training often neglects this purpose also.

The third deficiency relates to the object-centered grammar. An economic theorem is a description of a scenario, or sequence of action-caused events, which

Economic theorem: a description of a scenario, or sequence of action-caused events, which the economist proposes will occur under certain assumed conditions.

the economist proposes will occur under certain assumed conditions. It contains references to the hypothetically observable prices, quantities, etc. along with the mental phenomena that lie behind them. The economist who aims to produce an economic theorem would begin with some existing state of an economy that is not a final state of rest. Then he would proceed to describe, in a general way, the choice or choices that would lead to a final state of rest. In essence, he would describe a beginning point and an ending point at which there is no longer a reason for action. Prices and quantities are elements of his description. However, they should not be the primary focus. The action

²⁵Mises implies his intent to make this substitution at *ibid.*: 355. Perhaps the best evidence of his actually making it is his introduction to the trade cycle, which he begins with a description of the rate of originary interest in the evenly rotating economy (*ibid.*: 538) and then, later, refers to the final state of originary interest (*ibid.*: 547). He writes that the tendency toward this final state is a “mental tool for the interpretation of the facts concerning the history of interest rates (*ibid.*: 546). Regrettably, he does not connect its use to the production of economic theorems.

that drives the prices and quantities toward the final state of rest is entrepreneurial.²⁶ Accordingly, the primary focus should be entrepreneurship. The prices that the economist employs to represent the final state of rest help her show the effects by describing one aspect of entrepreneurship – the entrepreneur as an agent whose actions lead to the final state of rest. Because, profit and loss represent the motivating element for the entrepreneur, these concepts should also be part of every economic theorem.

The fourth deficiency is Mises's reference to the "static method." He uses the term twice in one paragraph but he never uses the term again. Nor does he provide a reference. He presumably takes it for granted that the reader understand what he means by this. His goal in using this term is to contrast this method with a "study of dynamics," which he denies is capable of being accomplished except by means of the method he is describing. To understand more completely what he has in mind, consider his reference to the "often raised request to enlarge the scope of economic science by the construction of a dynamic theory instead of the mere occupation with static problems" (*ibid.*: 356). He points out that for economics as he presents it, this request makes no sense. The reason is that economics uses the only method of producing praxeology-based theorems for economics that is available. If one wishes to study action under market economy conditions, he has no choice but to produce economic theorems that contain a beginning and an ending point, such as that described in the discussion of the static method.

If Mises wants to nullify the notion of a dynamic theory in economics, why does he call the method of economics the "static method." Why not say there is no static-dynamic dichotomy in economics

²⁶In chapter 15, Mises refers to the entrepreneurial acts as the "forces of the market" and the final state of rest prices as the "state of the market" (*ibid.*: 257).

and that those economists who use the phrases static and dynamic obfuscate the problem of identifying the method of economics.

Interpreted properly, the true message of the section is that to build an economic theorem, an economist must abstract from the actual, potentially observable prices, etc. of a market economy and try to conceive of the prices, etc. that would result if the plans and expectations of the entrepreneurs who are assumed to be present could be realized. The final state of rest prices are these hypothetical prices. They differ from the actual prices that one can observe in a real market economy.²⁷

The Missing Entrepreneur

Except some phrases telling the reason for the evenly rotating economy, Mises writes the entire section 5 without a single reference to the entrepreneur. What he does write with respect to the evenly rotating economy is that this imaginary construction provides only two services in the treatment of economic “problems.” These are:

the problem of the relation between the prices of products and those of the factors required for their production, and the implied problems of entrepreneurship and of profit and loss. In order to grasp the function of entrepreneurship and the meaning of profit and loss, we construct a system from which they are absent (*ibid.*: 248).

²⁷Mises’s confusion on this issue is indicated by how he deals with the sequence of events that I have said characterizes an economic theorem. On the one hand he writes:

Action is change, and change is in the temporal sequence. But in the evenly rotating economy change and succession of events are eliminated. Action is to make choices and to cope with an uncertain future. But in the evenly rotating economy there is no choosing and the future is not uncertain as it does not differ from the present known state. Such a rigid system is not peopled with living men making choices and liable to error; it is a world of soulless unthinking automatons; it is not a human society, it is an ant hill (*ibid.*: 248).

So far, so good. However, he also describes an imaginary constructions with similar language. He writes that “[a]n imaginary construction is a conceptual image of a sequence of events logically evolved from the elements of action employed in its formation” (*ibid.*: 236). What he is really referring to in this statement is an imaginary construction that is made by employing an economic theorem.

Later in the treatise, he writes that “[t]he concept of final prices is merely a mental tool for the grasp of a particular problem, the emergence of entrepreneurial profit and loss” (*ibid.*: 332). If the main purpose of these two constructs is to help comprehend the concept of the entrepreneur, why not use this term to help describe the market economy situations to which the final state of rest refers? Instead of elucidating the final state of rest, he writes about “factors” that “bring about a tendency toward price changes” (*ibid.*: 245), “latent forces operating...in the market situation...(*ibid.*: 246),” and the “perfect adjustment of the market” (*ibid.*). A reader could be excused for not realizing that the entire section is a preparation for the introduction of the entrepreneur role, which occurs in his section 7. Yet it most certainly is.

Section 6: “The Stationary Economy”

The next section, section 6, is devoted to “The stationary Economy.” Mises notes that this imaginary construction and its companions, the progressing and retrogressing economies, are precarious because they assume that total wealth and total income have measurable counterparts in the real world. But he does not tell the reader how he plans to use them. His use is related to the concept of the promoting entrepreneur, which he introduces in section 7. I discuss the promoting entrepreneur in Appendix Two.

Section 7: “The Integration of Catallactic Functions”

Mises begins this section by informing readers that in building economic theorems, the economist identifies functions and roles. However, he does not actually say this; and what he does say is not so easy to follow. It requires some interpolation and interpretation. He writes:

Economics, exploring the structure of acting in the market society without any regard to the ends people aim at and the means they employ, is intent upon discerning categories and functions...When economics employs the [terms] entrepreneurs, capitalists, landowners, workers, and consumers...it speaks of catallactic categories...[These categories]...are not living men as one meets them in the reality of life and history. They are the embodiment of distinct functions in the market operations...The economic categories we are concerned with refer to purely integrated functions...Living and acting man by necessity combines various functions (*ibid.*: 251-2).

Here, he seems to be writing about the “explorations” that economists (we) make about acting in the market society. He does not say anything about building economic theorems for the purpose of evaluating interventionist arguments. Yet there can be no question that this is what he means, since this is the primary purpose of economics, as he conceives it. To explore the structure of acting in the market society can mean nothing other than to provide a grammar to be used in building economic theorems and possibly to actually begin building the theorems. If Mises had not already identified the purpose and procedure of economics, one might argue differently. However, there can be no doubt about what he claims is the ultimate purpose of economics.²⁸

This set of quotations also contains nothing about roles. He associates economic categories with the terms “entrepreneur,” “capitalist,” “landowner,” “worker,” and “consumer.” These categories, he seems to say, refer to the performance of distinct, perhaps conceptually separate, functions. Why not call these roles? Why not introduce the term “entrepreneur role” at this point?

²⁸I do not mean to imply, of course, that the typical reader would know this purpose.

There can be no doubt that the most important of the categories, or roles, is the entrepreneur. He makes this clear in subsequent discussion. Although section 7 refers to a number of categories and functions, the entrepreneur stands out. Indeed, it becomes evident from his discussion that his ultimate aim in using this category and function is to channel all distinctly human action into it. As I stated above, the entrepreneur role (1) helps him bind economics to praxeology and (2) enables him to employ the consumer sovereignty theorem as a foundation for producing other theorems. The other theorems are necessary to accomplish the first purpose described in Part One. In addition to evidence I have already provided, consider the following remarks from his chapter “The Government and the Market.”

In dealing with the [economics] of interventionism we...are exclusively concerned with those acts of interference which aim at forcing the *entrepreneurs and capitalists* to employ the factors of production in a way different from what they would have done if they merely obeyed the dictates of the market. In doing this, we do not raise the question of whether such interference is good or bad from any preconceived point of view. We merely ask whether or not it can attain those ends which those advocating and resorting to it are trying to attain (*ibid.*: 734, italics added).

Note Mises’s use of the phrase “entrepreneurs and capitalists” in this quotation. This phrase is one of many that he uses to refer to what I have labeled “the entrepreneur role.” Its source is his discussion of the penniless entrepreneur in the section, as follows.

The Penniless Entrepreneur and Uncertainty

Mises’s first statement about the entrepreneur function in section 7 emphasizes uncertainty:

Economics, in speaking of entrepreneurs, has in view not men, but a definite function. This function is not the particular feature of a special group or class of men; it is inherent in every action and burdens every actor. In embodying this function in an imaginary figure, we resort to a methodological makeshift. The term entrepreneur as used by catallactic theory means: acting man exclusively seen from the aspect of the uncertainty inherent in every action (*ibid.*: 252-3).

This appears to be a definition of the term “entrepreneur.” However, if Mises means it as such, it is woefully incomplete. It is easy to show that this quotation does not capture all of what Mises designates the term “entrepreneur” to signify. The phrase “exclusively seen” is too strong. This is evident from his treatment of the concept of the *pure entrepreneur*. He carries out an exercise in which he tries to “to think the imaginary construction of a *pure entrepreneur* to its ultimate logical consequences” (*ibid.*: 253). In the exercise, he assumes that the pure entrepreneur is penniless. If an entrepreneur is penniless, he writes, she would be an employee of the capitalist who supplies the “capital required for his entrepreneurial activities.” Since any loss incurred by such a penniless entrepreneur’s activities would fall on the capitalist, the “capitalist is always also virtually an entrepreneur” (*ibid.*). Obviously, he means for the entrepreneur function to include more than merely uncertainty-bearing. Otherwise, why would the penniless entrepreneur need a loan? In assuming that the pure entrepreneur needs capital and that she may earn profit, Mises must be implying that the entrepreneur category employs factors of production and undertakes production. Moreover, since the decision-making of the pure entrepreneur requires an estimate of revenues and costs, he must mean for the entrepreneur function to include the identification of factors and an estimation of the costs. More simply, he must mean for the entrepreneur category to include the appraisalment of factors. That he does not state these implications has the potential of misleading readers.

The Imaginary Construction of the Functional Distribution

I have said in earlier parts of this chapter that Mises’s entrepreneur role excludes the passive performance of the functions of expressing consumer wants through time and supplying factors of

production. This performance of these functions is captured by the roles of the consumer and factor suppliers. The evidence for this comes in this section where he writes about the “nicely integrated” functions:

In the context of economic theory the meaning of the terms concerned is this: entrepreneur means acting man in regard to the changes occurring in the data of the market. Capitalist and landowner mean acting man in regard to the changes in value and price which, even with all the market data remaining equal, are brought about by the mere passing of time as a consequence of the different valuation of present goods and of future goods. Worker means man in regard to the employment of the factor of production human labor. Thus every function is nicely integrated: the entrepreneur earns profit or suffers loss; the owners of means of production (capital goods or land) earn ordinary interest; the workers earn wages. In this sense we elaborate the imaginary construction of *functional distribution* as different from the actual historical distribution” (*ibid.*).

Note first how the construct of the functional distribution helps the economist separate the active, price determining actions by the entrepreneur role from the passive, income-maximizing behavior of suppliers of the factors of production. The entrepreneur bids for the factors. The factor suppliers respond by supplying their factors to the highest bidders. Next note how the roles represent different aspects of the category of action. The factor supplier roles represent the behavioral aspect of the means that are used to achieve ends. Factors must be supplied in order for the production of consumer goods to occur. In addition, the specific factor supplier roles of the capitalists and landowner represent consumer time preference. Their election to rent out their factors instead of selling them off in order to enable the consumer to make higher bids for consumer goods in the near future enables them to earn ordinary interest. Mises defines ordinary interest as “discount of future goods as against present goods” (*ibid.*: 524). The entrepreneur role represents appraisal, undertaking production, and uncertainty-bearing.

Unfortunately, one aspect of action is missing, or implicit. There is no consumer of goods in the functional distribution. This is omitted, I believe, because Mises did not keep in mind his purposes.

The functional distribution, as he describes it, is designed to conceive the price of a consumer good from the point of view of the entrepreneur who is the first recipient of the money that is exchanged for the good. The entrepreneur receives revenue and then distributes part or all of it to the owners of the factors who transferred control over their factors to her. She then takes the remainder, if any. Mises's goal seems to be to focus on the distribution of the revenue. In doing this, however, he loses sight, of what seems to be the principal goal of section 7: to identify the most fundamental functions and roles under the conditions of a market economy in order to provide a foundation for building economic theorems. This is probably another example of his convoluted presentation. Instead of stating his purposes outright and then identifying the functions and roles that are appropriate for achieving these purposes, he writes first about the theory, or set of theorems. Only in a much later chapter does he write about the purposes that the theory can help one achieve in a praxeology-based economics.

In fact, these functions and roles can be derived from an understanding of Mises's purpose of binding economics to praxeology. Such binding occurs by first recognizing the performance of functions in the imaginary construction of an isolated actor's use of means to achieve his ends. The isolated actor undertakes production of goods by supplying his factors of production to himself. In conjunction with his undertaking, he compares the costs of producing each possible good and he bears uncertainty. His action is thus analogous to that of the entrepreneur under pure market economy conditions. To compare costs he takes account of his wants as a consumer. In deciding whether to produce capital goods, he takes account of his time preference. Of course, all of his costs are in the form utility foregone. There is no money accounting.

Due to the complexity of market interaction, Mises employs the analogy between the actions of the isolated actor and actions and behavior of roles under market economy conditions. The economist produces categories and functions that represent the properties of action. Under market economy conditions, these categories correspond to the roles Mises has listed: entrepreneurs, capitalists, landowners, workers, and consumers (*ibid.*: 252). The entrepreneur role represents the active appraisal, undertaking and uncertainty-bearing category. The other roles represent the passive preference expressing and the factor supplying, price-taking aspects.

What is important for my purpose is that the reader recognize that a full understanding of the functional distribution shows that Mises employed this construct as a means of signifying to the reader of the treatise that the basic economic functions and roles can be derived from, and therefore be traced back directly to, the category of action. That Mises does not tell the reader this in his presentation of this imaginary construction is a flaw. But the stress he places on the imaginary construction of the functional distribution as a part of the method of economics is sound.

The principal contribution of Mises's section on the integration of the catallactic functions and of his imaginary construction of the functional distribution is to isolate the properties of distinctly human action in a single personage – the entrepreneur. This is necessary in order to bind economics to praxeology. Unfortunately, the reader is in no position to interpret Mises's discussion of the functional distribution in the way I have described. On the contrary, she is likely to be confused. The typical reader has referents in her experience for the concepts of profit and loss, market interest, wages, and rent. However, Mises does not mention rent in this passage and he has not yet defined "originary interest." Moreover, he has not yet mentioned the entrepreneur as a borrower of funds,

an employer of factors of production, and a producer of goods. Because he does not write explicitly about the producing entrepreneur, it is possible that the reader will think that uncertainty-bearing is the only property of the entrepreneur. At the very least, the reader may be somewhat confused. Surely, Mises means for the entrepreneur role to include both the producing entrepreneur role and uncertainty-bearing.²⁹ Nevertheless, at this stage, the reader has no alternative but to merely accept what Mises says. She has no way to judge whether it makes sense.³⁰

Rest of the Section

The rest of the section concerns two ideas. The first is the promoting entrepreneur. Mises distinguishes the entrepreneur-as-promoter from the entrepreneur function. The promoting entrepreneur concept is necessary, he maintains, in order to incorporate the fact that the entrepreneur role is performed by individuals with different characters and abilities. His discussion of this concept is mainly an extension of his entrepreneur role. It is capable of generating some confusion among readers.

²⁹That he wants to include the producing entrepreneur function can be documented by referring to his discussions at *ibid.*: 290-1; 306)

³⁰A major problem here, as it is in many of Mises's discussions prior to his discussion of interest, is that a correct interpretation depends on the reader's understanding of originary interest. Unfortunately, the Austrian economists who followed Mises were not able to comprehend this concept until just recently. See Gunning 2005 and Block et. al. (2006).

The inability to conceive of originary interest is a complement to the failure of many Austrians to recognize that, in terms of the performance of economic functions, no one in the functional distribution earns rent. The owner of a non-labor factor, in Mises's scheme, earns originary interest. How then can one describe the income of a person who saves? The answer must be that such a person is, in fact, a factor owner or a surrogate for one. She saves either by owning and purchasing factors or by possessing a command over factors by virtue of her control over her saved purchasing power. She earns originary interest by either or both renting out factors that she owns or by lending out her purchasing power.

What is commonly regarded as rent is either interest or profit due to the entrepreneurial discovery of the higher value productivity of a factor in a given class or a new type of factor.

A second idea may also confuse readers – that of an economy in which capitalist-entrepreneurs direct all activity in the market economy by means of their bids for shares of stock. This idea is represented by an imaginary construction of futures markets in every factor and good (*ibid.*: 256). This imaginary construction seems to be a useful way of representing the entrepreneur role and consumer sovereignty in the simplest case – i.e., where entrepreneurs did not have to be concerned with satisfying wants that exist at different times. Indeed, Murray Rothbard has used it for precisely this purpose (Rothbard 2004: 509-12). Mises does not regard such constructs as worthwhile, however, perhaps because he places special emphasis on loan markets, which are absent in this construct.

7. CONCLUSION

Mises provides little preparation for the twists and turns he takes in chapter 14. I have shown that he has distinguishable and important purposes and that there is a sound logic behind his effort to achieve them. To understand the chapter requires the reader to recognize these purposes and logic. I have argued that his ultimate purpose is to build an economics on the basis of which one can make praxeology-based, value-free evaluations of interventionist arguments, given that the arguer accepts the “universal law” of the higher productivity achievable with the division of labor. A crucial step is to develop a strong and tight praxeology-based concept of the entrepreneur – one that he can co-

relate to consumer sovereignty in the pure market economy. He begins to develop such a concept in the last section of the chapter.

It is evident that he aims to relate the entrepreneur role to the pure market economy in the chapter, even if he does not state this purpose or use the entrepreneur role terminology. However, he also uses the chapter to teach readers about the method of imaginary constructions – the only method that is suitable for both praxeology and economics. This purpose is also important since it is the only method available to the praxeologist and economist to make definitions and to produce theorems and since so many economists tend to misuse imaginary constructions. Beyond this, he introduces the concept of the promoter entrepreneur, which I shall argue is confusing (see Chapter Five).

Mises could have better transmitted his ideas if he had tried to achieve these purposes separately and independently. At the very least, he could have provided a roadmap. Since he did not and since the neo-Austrian economists have shown practically no understanding of his purposes and how he achieved them. I must conclude that Austrian economists today are in great need of a restatement of the ideas in this important chapter.

APPENDIX ONE

THE PLAIN AND FINAL STATES OF REST

A regrettable fact about Mises's presentation is his apparent stress on what he calls "the plain state of rest." I am persuaded that this means nothing more than a price that can be observed under market economy conditions. His purpose for introducing this concept is to distinguish between a plain state of rest price and what he calls a "final price," by which he means a price that exists in the final state of rest. He says that the first price is real; the second is an imaginary construction. It is possible that his purpose is to warn against error. However, there are many ways to get confused by his presentation.

A major source of confusion is the failure to distinguish between a final price and a final state of rest. Mises writes that to identify the final price, we

pay attention to factors which are bound to bring about a tendency toward price changes. We try to find out to what goal this tendency must lead before all its driving force is exhausted and a new state of rest emerges. The price corresponding to this future state of rest was called the *natural price* by older economists; nowadays the term *static price* is often used. In order to avoid misleading associations it is more expedient to call it the *final price* and accordingly to speak of the *final state of rest* (*ibid.*: 245).

One must assume that he means that the final price of a specific good cannot be conceived without, at the same time, conceiving of a final price of all goods. In other words, the economist must have in mind a set of equilibrium prices and quantities for the entire system. One cannot expect to communicate with an audience trained in modern professional economists without acknowledging this fact. Whether Mises's words actually make this distinction is a matter of conjecture. The reader should not have to make such a conjecture.

The import of this potential ambiguity arises from the fact that in describing the plain state of rest, Mises refers only to the price of a good in a single market. That this is so is evident from his example of the price of a share of stock at the time when the stock market closes. When he proceeds to compare this price with the final price, the reader may be led to think that the final price of a single good can be conceptually separated from the final prices of all other goods.

Another source of confusion is the idea of theorems connected with the plain state of rest. He writes that the "theorems implied in the notion of the plain state of rest are valid with regard to all transactions without exception" (*ibid.*: 245). To what theorems can he be referring? He does not give the reader a good example until he writes much later about market intervention in a different part of the book. He writes:

The characteristic feature of the market price is that it tends to equalize supply and demand. The size of the demand coincides with the size of supply not only in the imaginary construction of the evenly rotating economy. The notion of the plain state of rest as developed by the elementary theory of prices is a faithful description of what come to pass in

the market at every instant. Any deviation of a market price from the height at which supply and demand are equal is – in the unhampered market – self-liquidating.

But if the government fixes prices at a height different from what the market would have fixed if left alone, this equilibrium of demand and supply is disturbed. Then there are – with maximum prices – potential buyers who cannot buy although they are ready to pay the price fixed by the authority, or even a higher price...If the authority does not want chance or violence to determine the allocation of the supply available and conditions to become chaotic, it must itself regulate the amount which each individual is permitted to buy. It must resort to rationing (*ibid.*: 762-3).

It is easy for readers who are familiar with modern textbook teaching to interpret the prices in the “elementary theory of prices” as long run equilibrium prices. However, the long run equilibrium correspond most closely with prices in Mises’s final state of rest or evenly rotating economy. Such an interpretation would be a mistake.

Mises says that the elementary theory of prices is “a faithful description of what comes to pass...at every instant,” as quoted above. Such a theory is obviously not a theory of such long-run equilibrium prices. I am persuaded that when Mises refers to real prices, he is referring to observable, plain-state-of-rest prices and that demand and supply in this context refer not to hypothetical final-state-of-rest demand and supply curves but to the fact that the buyers and sellers who exchange a particular good at a real price take account of the announced price bids and potential price bids at the moment a trade is consummated. For example, a woman buys rice at the farmer’s market. The trade is consummated. The theory of prices that is used to explain, or describe, this trade takes account of the other rice sellers who are known to the woman and who are expected to be available to sell within the time horizon of her buying plans. It also takes account of the rice seller’s expectations about future sales of rice. In this sense, the explanation takes account of the momentary demand and supply conditions. However, at the very time that the exchange occurs there are other buyers and sellers who are not known to the trading parties.

Mises is not wrong in his analysis of maximum prices. But I believe that his analysis is incomplete. When the economist proceeds to develop theorems that are needed to evaluate interventionist argument, he takes account not only of the momentary, or trade-specific, demands and supplies but also of the demands and supplies that are assumed in his analysis but that are not known to the trading parties. In other words, the bids that are taken account in “plain state of rest analysis,” if you will, do not (and, of course, cannot) include the potential bids of those who are not parties to the trade. If they were taken into account, then the price of the exchange would not be a plain state of rest price; it would be a final price that corresponds to a final state of rest.

In conceiving of Mises’s treatment of the plain state of rest in this analysis of price fixing, one must ask about the purpose for using the plain state of rest price of a particular good instead of using the final state of rest price. Both modern professional economics and a praxeology-based economics deals with final prices, since it is only by conceiving of the final state of rest that one can properly incorporate the entrepreneur role. Mises recognizes this when he writes of evaluating a proposed market interaction (*ibid.*: 734, as quoted above). Yet he seems to imply in his treatment of the plain state of rest that this is not necessary.

So far as I can tell, Mises’s main reason for making the distinction between the plain state of rest and the final state of rest is to use the reference of (1) a price that actually occurs to help him define (2) what he calls the “final price.” It is an effort to elucidate how prices are determined by making a comparison between an observable event and an event that is not observable. When the economist

conceptualizes the “plain state of rest” in terms of economic theory, she has in mind the idea that the trading parties have reached the best agreement that they perceive at the moment. The conceptualization is confined to the trading parties themselves. They agree on a price. It is possible that, at the moment the trade occurs, a person who is not a party to it would make a decision that would, if the trade was not made, cause all parties to regard a different trade as best. The economist disregards this possibility when she defines the plain state of rest.

The plain state of rest is not ordinarily used in economics, although it can be used as a reference in describing the real world or even in evaluating policies toward the real world.³¹ The reason it is not used is that the economist directs her attention toward the full, or long run, tendencies and to the long run effects of the policy. Consider, for example, a law that sets a maximum price of some good below the price that would otherwise be charged. The economist could describe the effects by saying that the plain state of rest price charged by sellers would not be allowed to rise to the level that it would otherwise rise and that, as a result, all those exchanges that would have occurred at the higher price will not occur. This may be sufficient if the goal desired by a person proposing an intervention is to cause a lower price without affecting the quantity sold. However, since more complex arguments can be made to support the contention that good results will follow an intervention, it would be wise to either carry out, or at least to be prepared to carry out, a full blown analysis in which the long run effects are described by referring to the endpoint, or final state of rest, that would result from the active appraisal, undertaking, and uncertainty-bearing of the entrepreneur role.

³¹To the reader who is not fully aware of Mises’s method of evaluating interventionist argument, it may appear that he uses it in the analysis to which I referred in the quotation above (*ibid.*: 760-67). Although he certainly begins the discussion by writing about a plain state of rest price and never refers to the final state of rest, a close reading indicates that the analysis is much deeper. The deeper analysis suggest that Mises did not consider a reference to plain state of rest prices as sufficient to deal completely with the argument that maximum prices are beneficial.

APPENDIX TWO

THE ENTREPRENEUR AS PROMOTER AND THE IMAGE OF A
FUTURES MARKET IN ALL GOODS AND FACTORS**The Entrepreneur as Promoter**

In addition to the entrepreneur role, Mises introduces a different meaning of the entrepreneur. He says that economics uses the term “entrepreneur” to refer to *promoters*. Promoters refer to:

those who are especially eager to profit from adjusting production to the expected changes in conditions, those who have more initiative, more venturesomeness, and a quicker eye than the crowd, the pushing and promoting pioneers of economic improvement (Mises 1966: 254-5).

He says that this idea is necessary because it is a “datum that is a general characteristic of human nature” (*ibid.*: 255). It captures the notion that individuals differ in their eagerness “to profit from adjusting production to the expected changes in conditions” (*ibid.*: 254). It refers to “the fact that various individuals do not react to a change in conditions with the same quickness and in the same way...There are in the market pacemakers and others who only imitate the procedures of their more agile fellow citizens” (*ibid.*: 255). He does not tell his reader how he plans to use the promoter concept. Moreover, in a chapter that is replete with imaginary constructions, he does not tell us whether it is an imaginary construction or how, except in very general terms, it relates to the imaginary construction of the entrepreneur role.

For those readers who either understand what he means by a datum or who have read ahead to his chapter 23, his statement that the promoter entrepreneur “refers to a datum” is significant. He apparently means by this that it refers to a characteristic of human action that individuals learn about from experience. He seems to say that it is not sufficient for economists, in dealing with interventionist arguments, to refer merely to the entrepreneur function as it exists in the imaginary construction of the functional distribution. (This function is presumably not a datum.) Economists must also recognize that among those who cause the production of goods and who bear uncertainty are leaders who are the “driving force of the market, the element tending toward unceasing innovation and improvement” (*ibid.*). Thus, it appears that Mises means for his readers to conceive of the promoting entrepreneurs as a set of individuals with different abilities (or at least with different characteristics) who, acting separately yet with the similar goal of earning a profit, represent a tendency toward innovation and improvement.

As I interpret it, the distinction between the entrepreneur role and the entrepreneur-as-promoter is a distinction between (1) a term that represents the part of distinctly human action that, facing uncertainty, employs means to cause consumer goods to be produced under the conditions of the market economy and (2) a term that represents our experience with separate individuals of different qualities who compete in trying to satisfy consumer wants. Although this appears to be what Mises has in mind when he distinguishes the “promoting entrepreneur” as a second meaning, he does not tell his readers this – at least not directly.

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