Rothbard on Consumer Sovereignty and His Implicit Rejection of Mises's Economics

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Abstract

Ludwig von Mises made *consumer sovereignty* the foundation of his elucidation of market interaction. An exception to consumer sovereignty is the monopoly price, which can be wasteful. Murray Rothbard rejected consumer sovereignty in favor of the concept of *individual sovereignty*. He proceeded to build his own elucidation of market interaction on the basis of the latter concept. In this theory, monopoly prices are not wasteful. This seemingly minor difference between the two Austrian economists can be traced to a pivotal and crucial difference in fundamental assumptions about the nature and purpose of economics. Mises sought to create a value-free economics based on the assumption that readers accept the classical and early neoclassical assumption that people benefit from the division of labor and from its further extension. Rothbard sought to create a ethics-based economics, founded on the assumption that the individual is sovereign and on a welfare function of "demonstrated preference."

The difference in the goals of the two authors is reflected by a difference in their definitions of private property rights and of the pure, unhampered market economy. Mises defined such an economy as containing a complete set of private property rights. In such an economy external effects cannot exist because of the assumption. An incomplete private property system leads to external effects. He asserted that a government is needed to enforce such rights. Rothbard defined his unhampered market economy as containing what I call Rothbardian rights conditions. These are conditions in which rightful ownership is determined on the basis of whether property is acquired in ways that are consistent with the principle of individual sovereignty. He denied the necessity of government enforcement. An incomplete private property system, for Rothbard, means that someone has violated another's individual sovereignty by invading his private property. The remedy for this is simple: return the property to the rightful owner. He disregards the possibility that a rightful owner could not be identified in reality.

Mises defined the benefits and harm due to market interaction and to market intervention in terms of how these phenomena would affect the higher productivity of the division of labor. In his pure market economy, every market action benefits others, except for monopoly. Rothbard defined benefits and harm entirely in terms of whether there is a violation of individual sovereignty, which he believed could be determined on the basis of a welfare criterion that he called demonstrated preference. Since Rothbard regarded an individual as sovereign over his own property and since charging a monopoly price leads to demonstrated benefits and no demonstrated harm, monopoly is not an exception to the notion that the unhampered market economy yields benefits to all.

The importance of distinguishing between Mises's and Rothbard's economics derives from Rothbard's (sometimes implicit) claims that he meant to clarify and extend Mises's economics. Many students of Austrian economics believe that they can learn Mises's economics by studying Rothbard. This paper shows that Rothbard's claims cannot be justified and that students cannot learn about Mises's economics by studying Rothbard's theory of the unhampered market economy.

Rothbard on Consumer Sovereignty and His Implicit Rejection of Mises's Economics

Although Ludwig von Mises and Murray Rothbard were both advocates of greater economic freedom, there is a wide gulf between their economics. Evidence of this is Rothbard's rejection of the two pillars upon which Mises's economics is founded. The first is Mises's decision to address his economics to people who accept the classical economists' theorem of the harmony of rightly understood interests (THRUI), as transformed by the early neoclassical economists and himself into the theorem of consumer sovereignty. This pillar enabled Mises's theorems to pass the test of value freedom. The second pillar is the bond Mises established between economic theorems and the properties of action. An integral part of this bond was the entrepreneur role as the servant of the consumer role.

Mises incorporated the harmony theorem of the classical economists into the Austrian theory of value and cost, as amended by early neoclassical economist Herbert Davenport's work on the entrepreneur (1913) and by Frank Knight (1921) in his classic work on profit. Using this economics, Mises revised W. H. Hutt's idea of consumer sovereignty in such a way that the entrepreneur role came to represent all of the want-satisfying action under pure market economy conditions. He thereby transformed the classical harmony theorem into the theorem of consumer sovereignty while, at the same time, binding economics to the want-satisfying aspect of action in general.

In his 1960 book, Rothbard criticized Hutt's consumer sovereignty and, in early letters to his publisher, expressed his disapproval of Mises's use of the consumer sovereignty concept. His criticism was based on his ethical principle of individual sovereignty. This principle also constituted the foundation for his definition of the unhampered market economy (free market). The combined action of rejecting consumer sovereignty and employing an ethically-based definition of the unhampered market economy made Rothbard's economics very different from that of Mises. In light of this, it is ironic that his stated goal was merely to popularize and slightly tweak Mises.[1] He did not achieve this goal.

It is absolutely essential, in my opinion, for the student of Austrian economics to distinguish between Mises and Rothbard. On the basis of Rothbard's proposals prior to writing his *Man, Economy and State* (1960 [2004]) and also on the basis of a publised endorsement of the project by Mises (Mises 1962), an uninformed reader is inclined to believe that Rothbard's book is a textbook version of Mises's *Human Action*.[2] This belief is likely to be fortified by the fact that the structure of Rothbard's book and of the economics part of Mises's book are similar. Both begin with many chapters on the "pure" or "unhampered" market economy. This is followed in both books by an analysis of economies containing various forms of government intervention. However, in this case, appearances are highly deceiving. It will be shown in this chapter that Mises's pure market economy is very different from Rothbard's unhampered market economy and that this difference portends a fundamental and irreconcilable difference between the two approaches to market interaction. The

[1]See, for example, Rothbard's statement prior to completing his treatise that "[t]he aim I set myself was to fulfill the essence of Mises's structure of praxiology by spelling it out, step by step, in one coherent, integrated structure" (2004: xxxiv). See also: "The purpose of his treatise was to 'isolate the economic, fill in the interstices, and spell out the detailed implications, as I see them, of the Misesian structure'" (*ibid*.: lxxiv).

[2]Mises's review is discussed in the appendix.

reason for Rothbard's rejection of consumer sovereignty can be traced directly to the different economics that the two writers advocated.

Part 1 of the essay summarizes Mises's treatment of the subject, including the kinds of interventionist arguments that he believed the consumer sovereignty concept would help economists evaluate. The summary is customized to emphasize differences between Mises and Rothbard. Part 2 describes Rothbard's view of consumer sovereignty, along with his critique of Hutt on the subject. Part 3 compares Mises and Rothbard and makes some concluding statements.

2. MISES ON CONSUMER SOVEREIGNTY

Mises presented his economics in his treatise *Human Action* (1966). It was based on the purpose of evaluating arguments for and against economic intervention *that are made by utilitarians who understand and accept what Mises called the universal law of the higher productivity of the division of labor.*[3] That this fact has not previously been appreciated is largely the result of Mises's convoluted way of presenting the economics. Instead of presenting it directly at the outset of his studies, he waits until after he has developed his economic theorems about market interaction under the conditions of the pure market economy. Moreover, when he does discuss it, he uses definitions

[3]Mises uses the term "universal law" at *ibid*.: 159.

and theorems in the discussion that he had established elsewhere in the treatise but which the typical reader is unlikely to link to an economic theorem.

In spite of the difficulty of interpreting Mises, a student of Mises cannot afford to ignore the logic of his chapter in *Human Action* on the “Harmony and Conflict of Interests.” The logic goes something like this. Mises points out that friendly relations among human beings are only possible because of the higher productivity of the division of labor. In a market economy,

> [c]atallactic competition is substituted for biological competition. [This] makes for harmony of the interests of all members of society. The very condition from which the irreconcilable conflicts of biological competition arise – viz., the fact that all people by and large strive after the same things – is transformed into a factor making for harmony of interests (*ibid*.: 673).

Mises labels this the

> the theorem of the harmony of the rightly understood interests of all members of the market society” (*ibid*.: 674). When the classical economists made this statement, they were trying to stress two points: First, that everybody is interested in the preservation of the social division of labor, the system that multiplies the productivity of human efforts. Second, that in the market society consumers' demand ultimately directs all production activities (*ibid*.: 674).

In economic theory, the classical “theorem” was transformed by the Austrian theory of value and cost. In its most advance formulation, the *entrepreneur function* represents all of the distinctly human use of means – i.e., production of goods. The entrepreneur earns profit (*ibid*.: 252). The ultimate source of profits is always the foresight of future conditions. Those who succeeded better than others in anticipating...the future state of the market and the demand of the consumers (*ibid*.: 665). He is referring here to “the sovereignty of the consumers.”

> Capitalists, entrepreneurs, and landowners can only preserve and increase their wealth by filling best the orders of the consumers. They are not free to spend money which the consumers are not prepared to refund to them in paying more for the products. In the conduct of their business affairs they must be unfeeling and stony-hearted because the consumers, their bosses, are themselves unfeeling and stony-hearted (*ibid*.: 270-1).

Consumers' sovereignty is not perfect (*ibid*.: 681). "[I]n some instances of minor importance, even in the unhampered market economy, monopoly prices may appear" (*ibid*.: 682). "With regard to monopoly prices there is not harmony, but conflict of interests" (*ibid*.: 680). Monopoly prices are not, however, due to the entrepreneur in his entrepreneurial capacity. They are due to the owners of existing goods or factors of production trying to earn the highest revenue from the factors that they own.

After appreciating the logic of the theorem of the harmony of rightly understood interests (henceforth referred to as THRUI), the student who aims to understand Mises must relate it to the goals that he aimed to achieve in his book. The fundamental goal is to put the reader in a position to evaluate arguments favoring or opposed to intervention, or interventionist arguments.[4] I useBecause everyone agrees with the law of the higher productivity of the division of labor, it is sensible to evaluate interventionist arguments – what Mises variously calls the social or economic "problems" – using this criterion:

> The higher productivity of cooperation under division of labor makes society the foremost means of every individual for the attainment of his own ends whatever they may be. The maintenance and further intensification of social cooperation become a concern of everybody. Every world view and every ideology which is not entirely and unconditionally committed to the practice of asceticism and to a life in anchoritic reclusion must pay heed to the fact that society is the great means for the attainment of earthly ends. But then a common ground is won to clear the way for an agreement concerning minor *social problems* and the details of society's organization. However various ideologies may conflict with one another, they harmonize in one point, in the acknowledgment of life in society (*ibid*.: 179, italics added).
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> Praxeology and economics do not say that men should peacefully cooperate within the frame of societal bonds; they merely say that men must act this way if they want to make their actions attain the ends [they seek to attain] (*ibid*.: 883), Also see *ibid*.: 140.

[4]I use the term "interventionist arguments" to refer to arguments in favor of or against a particular intervention in a market economy. See Mises's discussion at *ibid*.: 10, and 884-885. Also see his discussion of how he was able to achieve value freedom in his *Notes and Recollections* (Mises 1978a: 114).

The full meaning of these statements can only be understood by recognizing what Mises means by "social cooperation" and "society." These terms have a special meaning. They refer to peoples' recognition of the gains in labor productivity that result from specialization and the division of labor.[5] If the economist directs his evaluations of interventionist policies at the people who already accept the THRUI, value freedom is achievable. Indeed, it is achievable regardless of the criterion one uses to support an interventionist argument:

> Economics...is perfectly neutral with regard to the labor-union doctrine, the credit-expansion doctrine and all such doctrines...Economics does not say labor unionism is a bad myth. It merely says it is an inappropriate means of raising wage rates for all those eager to earn wages. It leaves it to every man to decide whether the realization of the labor-union myth is more important than the avoidance of the inevitable consequences of labor-union policies.
>
> In this sense we may say that economics is apolitical or nonpolitical, although it is the foundation of politics and of every kind of political action. We may furthermore say that it is perfectly neutral with regard to all judgments of value, as it refers always to means and never to the choice of ultimate ends (*ibid*.: 884-5).

Mises might have added here that economics refers to the means of achieving the harmony of rightly understood interests.[6] But he did not.

The Pure Market Economy

I mentioned that the THRUI was transformed into the theorem of consumer sovereignty. Mises achieved this by building the THRUI into the definition of the pure market economy.

> The imaginary construction of a pure or unhampered market economy assumes that there is division of labor and private ownership (control) of the means of production and that consequently there is market exchange of goods and services. It assumes that the operation of the market is not obstructed by institutional factors. It assumes that the government, the social apparatus of compulsion and coercion, is intent upon preserving the operation of the market

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[5] *Ibid*.: 143-5.

[6] The context in which Mises makes these statement provides the rationale. Mises is writing about the *ends* that critics of economics have in mind – those of "material well-being and a higher standard of living." One learns about the means of achieving these ends only through "the painstaking discipline of economic studies," which anti-liberalism and dogmatism "give the average intellectual a welcome excuse to shun" (*ibid*.: 883-4).

> system, abstains from hindering its functioning, and protects it against encroachments on the part of other people. The market is free; there is no interference of factors, foreign to the market, with prices, wage rates, and interest rates (Mises 1966: 237-8).

The government and coercion play an integral role in this definition. Mises later writes that:

> Government, i.e, a social apparatus of coercion and compulsion, is a necessary requisite of peaceful cooperation. The market economy cannot do without a police power safeguarding its smooth functioning by the threat or the application of violence against peace-breakers" (*ibid*.: 324).

Also see his discussion at *ibid*.: 718-9.

Another way to see Mises's view of the role of government is to consider how he deals with anarchy. He implicitly defines anarchy as a situation in which no one or group has a monopoly over coercion of compulsion. A characteristic of such situations is that "[r]evolutions and civil strife become permanent" (*ibid*.: 191).

Consumer Sovereignty and the Monopoly Exception

The key characteristic of the pure market economy is consumer sovereignty. The actions of individuals in the role of the resource suppliers and producers are aimed at maximizing money income (Mises 1966: 271-2). In a pure market economy, income-maximizing actions lead to the satisfaction of consumer wants.[7] An exception is monopoly. In this case, the owner of a resource may be able to maximize income by withholding some of the monopolized resource from being used to produce consumer goods even though the THRUI-based benefits are greater in terms of money than

[7]A person may diverge from the goal of maximizing money income in order satisfy her own wants as a consumer or resource supplier. An example is a shoemaker who enjoys his work. In doing so, she elevates her own wants as a consumer or resource supplier above those of the consumers whose wants she would otherwise cause to be satisfied. Consumer wants are still satisfied to a greater extent, but the economist must, in this circumstance, balance the consumer wants of the resource-supplier or producer against those who consume goods produced by others.

the sacrifice to the supplier. A seller who also owns many units of a particular resource may have an incentive to withhold some of it (*ibid*.: 360-1). This incentive exists if the present value of the revenue of the resource owner would be higher than if he sold the whole amount that he owns.

The withholding of a resource from the use that most benefits consumers is regarded by Mises as a waste. The waste demonstrates that pricing in a pure market economy may lead consumer sovereignty to be compromised. Consumers' wants would not be satisfied as well as otherwise, as judged in terms of rightly understood interests. Mises did not suggest government intervention to deal with monopoly. He believed that the exception was a minor issue and that most monopolies were due to government intervention. Nevertheless, he said that the monopoly price could compromise consumer sovereignty in some cases. In other words, economic reasoning could not assure that the actions of individuals would lead consumers to be served to the greatest extent, as judged by the THRUI.

Tight Relationship Between the Pure Market Economy, Consumer Sovereignty and the Entrepreneur Function

Although monopoly is an exception to the rule that individuals in a pure market economy serve the consumers' interests, the entrepreneur function *always* serves consumer interest. Mises does not actually say this. It is implicit in his use of terms. To understand what I mean by this, one must recognize that the entrepreneur function refers to, equivalently, the "entrepreneur in his entrepreneur capacity" and to "entrepreneurs and capitalists." Regarding the term "entrepreneur capacity," Mises says that the entrepreneur in this capacity "is always subject to the full supremacy of the consumers.

But it is different with the owners of vendible goods." That the entrepreneur capacity refers to the entrepreneur function can be inferred from passages earlier in the text, before he even defines the entrepreneur function (*ibid*.: 81, 240). Now consider the phrase "entrepreneurs and capitalists." In the passage at *ibid*.: 81, he refers to the capacity of entrepreneurs and capitalists. Although he does not cite pages, this is clearly a reference to the section of Chapter 14, where he attempts to define the entrepreneur function by attempting to "think the imaginary construction of a pure entrepreneur to its ultimate logical consequences" (*ibid*.: 253). The pure entrepreneur is penniless. Since a penniless entrepreneur cannot bear uncertainty, the attempt fails. A financing "capitalist is always also virtually an entrepreneur and speculator" (*ibid*.). Henceforth, whenever he wants to refer to the entrepreneur function, he uses the phrase "entrepreneurs and capitalists," or its equivalent to alert the reader to the fact that he is referring to the entrepreneur function. In short, in developing theorems relating to the pure market economy, Mises employs a "tight" definition of the entrepreneur function as a producer and uncertainty bearer, who always is the mandatory of the consumers.

The Pure Market Economy and Intervention

Mises approach to "social problems" – i.e., to the problems concerning market intervention – starts with the assumptions of the conditions of the pure market economy – private ownership of the means of production and a government that protects the "operation of the market" against "encroachments on the part of other people" [which includes fraud]:

> Starting from these assumptions economics tries to elucidate the operation of a pure market economy. Only at a later stage, having exhausted everything which can be learned from the study of this imaginary construction, does it turn to the study of the various problems raised by interference with the market on the part of governments and other agencies employing coercion and compulsion...There is, of course, no other way available for the elucidation of a measure limiting

> the free play of the factors operating on an unhampered market than to study first the state of affairs prevailing under economic freedom (*ibid*.: 238).

He goes on to discuss the issue of value judgments:

> It is true that economists have drawn from their investigations the conclusion that the goals which most people, practically even all people, are intent on attaining by toiling and working and by economic policy can best be realized where the free market system is not impeded by government decrees. But this is not a preconceived judgment stemming from an insufficient occupation with the operation of government interference with business. It is, on the contrary, the result of a careful unbiased scrutiny of all aspects of interventionism (*ibid*.).

In the first set of quotations, Mises refers to the arguments favoring or opposing intervention. In the second, he refers indirectly to the use of THRUI when he writes of "what people are intent on attaining" from their economic policy.

Writing these words in a section entitled "The Pure Market Economy," Mises is telling his readers why this imaginary construction is a necessary part of economic analysis. And he is telling them that the use of this construction yields knowledge which, when followed by the study of market intervention, enables the economist to do value-free evaluations of interventionist arguments based on the THRUI.

We only learn later that consumer sovereignty necessarily results from the operation of the entrepreneur function in the pure market economy. At the stage where he introduces the pure market economy, even a careful reader is unlikely to realize that he is incorporating the THRUI into the very definition of the pure market economy.

Mises also writes that this procedure is "the only one that is fitted to solve the problems involved" and he refers to the classical economists and their epigones (*ibid*.: 238-9). By this means, he is stating the claim that the procedure he is describing is derived from that used by his economist predecessors. He is establishing a link between the economics of the past, which used the THRUI as a criterion for evaluating arguments, and his own economics.

Why Only Arguments Based on the THRUI?

Why does Mises assert that the purpose of economics is to evaluate interventionist arguments based on the THRUI? He gives two answers. The first is that the THRUI is the criterion used by the classical economists. Economists have traditionally studied economic problems (i.e., the problems associated with arguments favoring intervention) by referring to the THRUI (*ibid*.: 673-4; 682). Thus Mises aims to keep with tradition. The second answer is that economics is only suited to evaluate ideologies that value "earthly things." So long as people recognize the gains that result from higher labor productivity due to specialization and the division of labor, people will be able to agree on a criterion that can be used to judge a proposed market intervention. In this case, a value-free analysis is possible (*ibid*.: 179-80).

Private Property Rights

I will show that a major difference between Mises and Rothbard concerns the role of government. To define this role in Mises's pure market economy, one must first understand what he means by private property rights. The rights that are important consist of *rights to control*. In the economic "notion of ownership and property," "[o]wnership means full control"(*ibid*.: 682).

A condition of Mises's pure market economy is *complete private property rights*. Unfortunately, he does not operationally define this concept until long after he has stated the pure market economy conditions. His definition comes in a section entitled "The Limits of Property Rights and the Problems of External Costs and External Economies." In that section, the reader learns that the condition of complete private property rights implies the absence of what professional economists call non-pecuniary external effects.

> Carried through consistently, the right of property would entitle the proprietor to claim all the advantages which the good's employment may generate on the one hand and would burden him with all the disadvantages resulting from its employment on the other hand (*ibid*.: 655).

Mises defines external effects as a situation in which "some of the consequences of [a person's] action are outside of the sphere of the benefits he is entitled to reap and of the drawbacks that are put to his debit" (*ibid*.).

In making these definitions of private property rights and external effects, Mises must be making some assumption that enables him to define advantages, disadvantages, benefits and drawbacks. He does not tell the reader in this section what this assumption is. I can safely assume, however, that he defines these terms in two ways which, in Mises's economics, are equivalent. The first is in conjunction with the THRUI. The pure market economy contains a market process that is "the adjustment of the individual actions of the various members of the market society to the requirements of mutual cooperation" (*ibid*.: 258). In turn, "[s]ociety is concerted action, cooperation...[I]t is division of labor and combination of labor" (*ibid*.: 143). Thus, the advantages that each person enjoys under a system of complete private property rights are those which the classical economists had in mind when they wrote of the harmony of rightly understood interests due to the expansion of the division of labor. The second way that he defined advantages is in conjunction with the theorem of consumer sovereignty. The advantages in this case are the benefits enjoyed by consumers due to entrepreneurship. Thus, Mises incorporates both the THRUI and the theorem of consumer sovereignty into his definition of the pure market economy.

Evolution of Property Rights

Mises recognizes that, in the real world, private property rights and ownership are the result of a long history of expropriation.

> The history of private property can be traced back to a point at which it originated out of acts which were certainly not legal. Virtually every owner is the direct or indirect legal successor of people who acquired ownership either by arbitrary appropriation of ownerless things or by violent spoilation of their predecessor (*ibid*.: 683).

This fact is not relevant to the theorem of consumer sovereignty or to the evaluation of interventionist arguments, however. The relevant fact is that whoever the current owners are and however they came to be the current owners, they are the mandatories of the consumers:

> [I]n an unhampered market society the consumers daily decide anew who should own and how much he should own. The consumers allot control of the means of production to those who know how to use them best for the satisfaction of the most urgent wants of the consumers. Only in a legal and formalistic sense can the owners be considered the successors of appropriators and expropriators. In fact, they are mandataries of the consumers, bound by the operation of the market to serve the consumers best. Under capitalism, private property is the consummation of the self-determination of the consumers (*ibid*.).[8]

The First Owner and the Contestableness of Private Property Rights

How is it determined who owns property? In most cases, this is not an issue. There are traditional owners (many of whom are the "market descendants" of those who acquired their ownership rights through expropriation). But consider the case of a resource that is newly regarded as valuable. No

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[8]Here Mises uses the phrase "unhampered market society" to refer to the pure market economy.

one previously valued the resource. Now, due to a change, such as a change in technology or population, it becomes valuable. Mises gives an example of what he calls "no-man's property."

> In the early days of human civilization, when soil of a quality not inferior to that of the utilized pieces was still abundant, people did not find any fault with...predatory methods [of appropriating private property rights]. When their effects appeared in a decrease in the net returns, the ploughman abandoned his farm and moved to another place. It was only when a country was more densely settled and unoccupied first class land was no longer available for appropriation, that people began to consider such predatory methods wasteful. At that time they consolidated the institution of private property in land (ibid.: 656).

Mises is not concerned here with how the institution of private property in land was consolidated but one must presume that he recognized that a political decision was involved. Some one or group realized that by preventing those who do not conserve the productive powers of the soil from using the land (and by deterring those who interfere with such conservation), they could reduce waste and raise the net returns. So they used their power, or the power of the government, to take away what had previously been a right by anyone to use the soil. In some cases, the property laws went too far in the name of protecting "the poor, the wage earners, and the peasants against the wealthy entrepreneurs and capitalists" (ibid.: 656).[9]

It seems to follow that in every real market economy, some rights are *contestable*. Such contestable rights would be in the process of being resolved in some way. Since Mises assumes a monopoly over force, this implies that the administrator of this monopoly has not yet defined the legal rights in a way that would compel those who cause damage to pay compensation or that would compel those who benefit from others actions to pay compensation. Perhaps the administrator is not yet aware of

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[9]It is worth noting that Mises uses the phrase "entrepreneurs and capitalists" *not* to refer to the entrepreneur role here. He is presumably referring to ideal types.

the incomplete private property rights. Or perhaps a complaint has been made but it has not yet been resolved.

There is an important implication of Mises's treatment of private property rights that he does not consider. It is that making incomplete property rights complete through administration may not be the best way to deal with this exception to the theorem of consumer sovereignty. Consider an interventionist argument to the effect that the government should impose taxes on every citizen in order to finance a flood control project. The arguer claims that the sum of the personal benefits of flood control to a builder and prospective owner would exceed the sum of the personal costs and/or that if the government permits a single individual to own the right to control flooding, the owner may use his power to charge a monopoly price, leading to an inefficiently small amount of service for some consumers. Such an argument could not be evaluated on the basis of an image of the pure market economy because the pure market economy does not represent the situation in which there is no intervention. The standard for comparison would have to be an economy in which the external effects continue to occur.

There is no need to say anything more about this case. It is sufficient to note that it is an implication of Mises's theory of private property rights and that Mises himself did not follow up by considering interventionist arguments pertaining to external effects.

The Role of Government

The government is necessary for the existence of a pure market economy.

> [The...pure or unhampered market economy...assumes that the government, the social apparatus of compulsion and coercion, is intent upon preserving the operation of the market system, abstains from hindering its functioning, and

> protects it against encroachments on the part of other people. The market is free; there is no interference of factors, foreign to the market, with prices, wage rates, and interest rates (Mises 1966: 237-8).

Mises later writes that:

> Government, i.e, a social apparatus of coercion and compulsion, is a necessary requisite of peaceful cooperation. The market economy cannot do without a police power safeguarding its smooth functioning by the threat or the application of violence against peace-breakers" (*ibid*.: 324).

Also see his discussion at *ibid*.: 718-9.

Another way to see Mises's view of the role of government is to consider how he deals with anarchy. He implicitly defines anarchy as a situation in which no one or group has a monopoly over coercion of compulsion. A characteristic of such situations is that "[r]evolutions and civil strife become permanent" (*ibid*.: 191).

Loopholes

Regarding the incompleteness of private property rights in the real world, Mises writes that the "laws concerning liability and indemnification for damages caused were and still are in some respects deficient." The reason, he says, is that legislators left "loopholes." Sometimes these were intentional but at other times they were not. He does not discuss unintentional loopholes. He simply notes that individuals are faced with the problem of external costs.

> Whether the proprietor's relief from responsibility for some of the disadvantages resulting from his conduct of affairs is the outcome of a deliberate policy on the part of governments and legislators or whether it is an unintentional effect of the traditional wording of laws, it is at any rate a datum which the actors must take into account. They are faced with the problem of external costs. Then some people choose certain modes of want-satisfaction merely on account of the fact that a part of the costs incurred are debited not to them but to other people (*ibid*.: 656).

He asserts that the situation of "external costs" left by such loopholes "could be removed by a reform of the laws concerning liability for damages inflicted and by rescinding the institutional barriers preventing the full operation of private ownership" (*ibid.*: 658). Again he gives no examples.

For students of Austrian economics seeking guidance on a theory of external effects, Mises's discussion is disappointing. It gives no hint about how to evaluate arguments favoring market intervention in the case of external effects except to suggest a reform of the laws. However, the fact that his discussion assumes that laws are contestable in a real market economy suggests at least the possibility that some kind of intervention may be desirable from the point of view of the THRUI and the theorem of consumer sovereignty.[10]

Also, Mises does not invoke the THRUI or the theorem of consumer sovereignty as a means of resolving the issue of who should be regarded as the first owner of a right to control property. He merely notes that if private property rights are incomplete, the economist must recognize the existence of external effects.[11]

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[10] For a student who is familiar with the work of Ronald Coase on this issue, it seems as if a footnote on Coase's (1960) work is missing; since Coase approached the evaluation of interventionist arguments in the case of external effects in very much the same way as Mises approached the evaluation of other interventionist arguments.

[11] For a student who is familiar with the work of Ronald Coase on this issue, it seems as if a footnote on Coase's (1960) work is missing; since Coase approached the evaluation of interventionist arguments in the case of external effects in very much the same way as Mises approached the evaluation of other interventionist arguments.

3. ROTHBARD ON CONSUMER SOVEREIGNTY

Rothbard criticized Mises's view of consumer sovereignty. His criticism was, in the final analysis, based on his ethical view about how people should interact with one another. People should interact, he asserts, in accord with the principle of individual sovereignty. This principle is pervasive in Rothbard's policy analysis. It dominates Rothbard's analysis of practically every controversial issue about market interaction. Because of this, my description of Rothbard's individual sovereignty-related concepts is occasionally accompanied by an analysis of the relevance of the principle to the conclusions that Rothbard draws from it.

Individual Sovereignty and Property

Rothbard defines individual sovereignty as follows:

> Rather than "consumers' sovereignty," it would be more accurate to state that in the free market there is sovereignty of the individual: the individual is sovereign over his own person and actions and over his own property. This may be termed individual self-sovereignty: the individual is sovereign over his own person and actions and over his own property. To earn a monetary return, the individual producer must satisfy consumer demand, but the extent to which he obeys this expected monetary return, and the extent to which he pursues other, nonmonetary factors, is entirely a matter of his own free choice (Rothbard: 2004: 29).

This statement appears to only be about an individual's freedom. Hardly anyone would object to the idea that a market economy implies sovereignty over one's person and property. In fact, however, the statement has a subtle implication both about what kind of actions are acceptable and about the function of government. It implies that Rothbard is concerned with actions under conditions that are so much more limiting than those of Mises's pure market economy that the theorems he produced are practically irrelevant to the interventionist policy evaluation goals that constituted, for Mises, the purpose of economics. The key to understanding what I mean is the concept of property. Property, as Rothbard defines it, is something a person owns in an *unhampered, or free, market*.[12] "[T]he goods owned are known as property" (*ibid.*: 92). Further elucidation comes from his discussion of how property is acquired in a "free, unhampered market:"

> (1) In the first place, *each man has ownership over his own self*, over his will and actions, and the manner in which he will exert his own labor.
> (2) He acquires scarce nature-given factors either by appropriating hitherto unused factors for his own use or by receiving them as a gift from someone else, who in the last analysis must have appropriated them as hitherto unused factors.
> (3) He acquires capital goods or consumers' goods either by mixing his own labor with nature-given factors to produce them or by receiving them as a gift from someone else. As in the previous case, gifts must eventually resolve themselves into some actor's production of the goods by the use of his own labor. Clearly, it will be nature-given factors, capital goods, and *durable* consumers' goods that are likely to be handed down through gifts, since nondurable consumers' goods will probably be quickly consumed.
> (4) He may exchange any type of factor (labor service, nature-given factor, capital good, consumers' good) for any type of factor (*ibid.*: 92-93).

Knowing that all property has a history, Rothbard means to limit property in his unhampered market economy to that which is acquired in one of these four ways. Next, he condenses the four ways to three. He writes that "gifts and exchanges as a source of property must eventually be resolved into: self-ownership, appropriation of unused nature-given factors, and production of capital and consumers' goods..." Thus, these three are "the ultimate sources of property in a free economic system" (ibid.: 93). Finally he writes that "[t]hese are the [only] methods of acquiring goods that obtain on the free market, and they include all but the method of violent or other invasive expropriation of the property of others" (*ibid.*).

[12]See his statement at *ibid.* 84-85, where he defines the unhampered "society" and writes that he is concerned in what follows with the task of "working out the laws of the unhampered market." Another term that Rothbard uses to refer to these conditions is the "free society."

An Example of How Property is Acquired

To better understand this concept of private property, consider his example of radio waves and television images. He writes:

> In a free society, ownership of these channels would accrue to individuals just like that of land or animals: the first users obtain the property. The first user, Jones, of the wave length of 1,000 kilocycles, would be the absolute owner of this length for his wave area, and it will be his right to continue using it, to abandon it, to sell it, etc. Anyone else who set up a transmitter on the owner's wave length would be as guilty of invasion of another's property right as a trespasser on someone else's land or a thief of someone else's livestock (*ibid*.: 173).

Similarly,

> In a free society, fishing rights to the appropriate areas of oceans would be owned by the first users of those areas and then usable or salable to other individuals. Ownership of areas of water that contain fish is directly analogous to private ownership of areas of land or forests that contain animals to be hunted (*ibid*.: 174).

Rothbard does not discuss the possibility that the first user could not be easily identified, to my knowledge.

The Ethical Foundation and Rothbardian Rights Conditions

This definition of property implies that individuals who own property in a free, unhampered market economy are free from the threat of violent or invasive acts. Rothbard defines an invasive action as "any action – violence, theft, or fraud – taking away another's personal freedom or property without his consent" (*ibid*.: 176).

Thus Rothbard's economics is about interaction under what I choose to call "Rothbardian rights conditions." This seems an appropriate name since these conditions could not exist unless people acted in a way that is consistent with Rothbard's ethical principle of individual sovereignty. In this environment, individuals either *do* acquire property exclusively in one or more of the three ways he specifies or they are compelled by authorities to do so. However, if they are compelled, the compulsion cannot impede others' rights to the property they have acquired in the specified ways. It will be convenient to refer to the individuals who have acquired property under Rothbardian rights conditions as the *rightful owners*. Then I can say that under the conditions of Rothbard's unhampered market economy, all property is owned by rightful owners.

Unlike Mises, Rothbard does not associate "Rothbardian rights conditions" with the kind of market economy that was traditionally assumed in economics. The division of labor is not a necessary condition, although it can certainly be expected, if individuals are free to exchange (*ibid*.: 95-102).

The Unhampered Market Economy and the Role of the Government

Rothbard defines the "unhampered market economy" as an economy in which Rothbardian rights conditions prevail. These conditions prevail because an ethical principle associated with the concept of invasion can always be applied to determine who owns a legal right to property and because the government, if one is present, always enforces individual sovereignty.

The free, unhampered market exists so long as no invasions occur. The government has only one role: to stop what he defines as invasions (*ibid*.: 183). It is possible that invasions could be stopped without government (*ibid*.: 176). It does not matter for Rothbard whether government is needed or not needed for this. It is important only that the government does nothing else. Indeed, because the government is an instrument of coercion, any government action other than blocking the invasions of others violates the principle of individual sovereignty.

Value Freedom

Rothbard's definition of the free, unhampered market and his deduction, or theorem, about the role of government in relation to the free market are, in the final analysis, also derived from the ethical principle of individual sovereignty. Rothbard employs this principle to develop his own concept of value freedom. He writes:

> Praxeology, through its *Wertfrei* laws, informs us that the workings of the voluntary principle and of the free market lead inexorably to freedom, prosperity, harmony, efficiency, and order; while coercion and government intervention lead inexorably to hegemony, conflict, exploitation of man by man, inefficiency, poverty, and chaos. At this point, praxeology retires from the scene; and it is up to the citizen – the ethicist – to choose his political course according to the values that he holds dear (*ibid*.: 1025).

By "voluntary principle," he means the principle of individual sovereignty. His reasoning goes like this. He begins with an ethical principle – individual sovereignty: the principle that freely chosen action is beneficial and that coercive action harms the person being coerced. Next he observes that all government action is coercive. Then he deduces, on the basis of the individual sovereignty principle, that government action is harmful to the person being coerced. Finally, he claims that such a deduction is value free. Whatever one might think of such reasoning, it is very different from the source of value freedom in Mises's economics.

Property Rights and External Effects

Rothbard's assumption that all property is owned by rightful owners leads him away from any discussion (1) of an incomplete private property system that is due to the existence of contestable property or (2) of "no-man's property" (see above). I discuss each in turn.

No Contestable Property

Rothbard also entertains the notion that private property rights might be incomplete. But if this were to happen, he says, the government should enforce private property rights in a way that is in accord with Rothbardian rights conditions. Thus he assumes either that disputes over property do not occur or that the problem of resolving them is a simple matter. Existing property rights in the free market are incontestable. It follows that external effects cannot result from disputes over ownership. In what Rothbard calls the unhampered market economy, external effects are not present because people either voluntarily choose not to invade others' persons or property or they are blocked by the government from doing so. External effects cannot exist so long as the government performs its function in *enforcing* property rights. Consider the following:

> One difficulty often raised against a free society of individual property rights is that it ignores the problem of "external diseconomies" or "external costs." But cases of "external diseconomy" all turn out to be instances of failure of government – the enforcing agency – adequately to enforce individual property rights. The "blame," therefore, rests not on the institution of private property, but on the failure of the government to enforce this property right against various subtle forms of invasion – the failure, e.g., to maintain a free society (*ibid*.: 181-2).

No-Man's Property

How did Rothbard deal with what Mises called no-man's property. The reader no doubt already has some idea on the basis of the examples of radio waves and ocean fish. But consider an additional example – that of smoke or, more generally, air pollution:

> In so far as the outpouring of smoke by factories pollutes the air and damages the persons and property of others, it is an invasive act. It is equivalent to an act of vandalism and in a truly free society would have been punished after court action brought by the victims. Air pollution, then, is not an example of a defect in a system of absolute property rights, but of failure on the part of the government to preserve property rights. Note that the remedy, in a free society, is not the creation of an administrative State bureau to prescribe regulations for smoke control. The remedy is judicial action to punish and proscribe pollution damage to the person and property of others (*ibid*.: 182).[13]

[13] I did not see a discussion in Rothbard's work about "coming to the nuisance." People would come to the nuisance if the factory pollution of the air occurred first and then they moved near the factory. I must assume that in this case, he would regard any act of violence against the factory owner as an invasion of his property rights. See Cordato (1992) for an extension of Rothbardian rights conditions to the case of coming to the nuisance.

Thus, he deals with no-man's property by assuming that what Mises would call an external effect is an invasion. There can be no external effects because Rothbardian rights conditions prevail. This assumption, in turn, implies that a first owner can always be identified.

Monopoly

Monopoly, to Rothbard, is a situation that can occur only if the government employs its coercion to prevent competition." In his preface, he writes that

> monopoly can be meaningfully defined only as a grant of privilege by the State, and that a monopoly price can be attained only from such a grant. In short, there can be no monopoly or monopoly price on the free market (*ibid*.: xcv).

Of course, the owner of a good or factor of production can refuse to sell at a lower price. However, in doing this, she is exercising the individual sovereignty which, in an unhampered market economy, is simply a manifestation of rightful ownership. This conception of monopoly is discussed further below when I turn to Rothbard's criticisms of Hutt and Mises.

Market Intervention and Utility

Rothbard's ethic of individual sovereignty precludes the possibility that anyone can be harmed by a voluntary action. Since his definition of the unhampered market economy precludes the presence of involuntary action, action under unhampered market economy conditions cannot result in harm to anyone. This implies that there can be none of what professional economists call pecuniary externalities. Professional economists use the term "externality" to refer to a beneficial or harmful effect of a decision by one set of parties in a market economy on others whose interests were not taken into account in the decision. A pecuniary externality is an externality that occurs by means of a change in prices. Consider two examples of a pecuniary externality. In the first, there are two prospective buyers of a limited amount of fruit: A and B. A bids up the price, thereby harming B. In the second, there are two sellers of nuts, C and D, to a small number of prospective buyers. C bids down the price, thereby harming D. Since there can be no harm in Rothbard's unhampered market economy, he cannot logically deal with the question of whether the benefits of competition in these cases are greater than the costs. In light of this, it is surprising to find the term "social utility" in his work. Consider the following proposition:

> In sum, the free market always benefits every participant, and it maximizes social utility *ex ante*; it also tends to do so *ex post*, for it contains an efficient mechanism for speedily converting anticipations into realizations (Rothbard 1994: 891).

The crucial part of this statement relates to *ex post* social utility. Consider the example of a buggy manufacturer whose business suffers due to the increasing use of automobiles. He writes about the losing competitor:

> The fact that, in retrospect, he prefers [a situation in which competition had not occurred] may be interesting data for the historian, but is irrelevant for the economic theorist. For the manufacturer is not living in [that situation] any more. He lives always under present conditions (*ibid*.: 883).

So far so good. But he proceeds to complicate matters by claiming that this sort of conclusion is based on a legitimate welfare criterion. He called this criterion "demonstrated preference" (882) and refers to one of a collection of essays by different authors written to honor of Mises. According to this criterion, only what people choose to do can be counted as yielding utility. As a corollary, if a person is forced to do something, her action is harmful to her since she would not otherwise have chosen to do it. Under this criterion, since the buggy manufacturer was not forced to be harmed by the auto manufacturer's competition, he could not have been harmed by it. His harm could not be demonstrated by his choice.

The problem with this reasoning is that it precludes any comparison of winners and losers. If we were to apply the same standard to a football match, both teams would win! Although this approach may help Rothbard promote the ethical principle of individual sovereignty, it is hardly relevant to "social utility," at least as most people understand this term. Indeed, it smacks of verbal chicanery.

Why is it necessary to compare winners and losers? Because this is what the mind, untrained in economic theory, naturally does. A person who wants to judge whether actions beyond his control have good effects or bad effects does not look only at the effects on him. He also looks at his compatriots. If he has access to information about the compatriots of his past, he considers them also. He cannot know about all of his neighbors or about the people who would have been his neighbors if they could have been. He is compelled to select. What criterion should he use? It is precisely in attempting to answer this question that the economic theory must be brought to bear.

Consider the classic case of pecuniary externalities that is used by critics to disparage capitalism: the factory system. The critic laments the harsh conditions faced by the lowly factory worker and points to the extravagance of the profit-earning capitalist who hires him. The critic may even write of a conspiracy among capitalists to hold wages down to the point where some workers' families cannot survive without members of their family becoming criminals. Rothbard could claim that their losses due to the conspiracy is not evidence of harm because the critic defines harm in terms of conditions that no longer prevail. As a result, one must conclude that ex post social utility is maximized. The only way in which a Rothbardian might recognize the plight of worker whose wages are reduced by a capitalist conspiracy is if the property used as capital had been appropriated from the workers. I conclude that Rothbard's treatment of the problem is irrelevant to the concerns of most people who criticize capitalism.

Whatever one may think of Rothbard's "demonstrated preference" criterion, it is evident that he does not actually address the issue that most people associate with the question of whether others gain or lose as a result of competition. His proof of the claim that action in the free market tends to maximize *ex post* social utility is irrelevant to the issue that most people have in mind when they refer to pecuniary externalities. By similar reasoning, he has no way to address the concerns of individuals about the losses they claim are due to market intervention.

Rothbard could have avoided this problem by employing the THRUI. He certainly recognized this theorem and, in fact, spent several pages elucidating it (*ibid*.: 95-102). However, if he had admitted it here, he would also have had to recognize that it could potentially conflict with his individual sovereignty principle. Monopoly restricts the expansion of the division of labor; yet the principle of individual sovereignty requires that monopoly not be curtailed.

Critique of Consumer Sovereignty and Mises

Rothbard criticized consumer sovereignty. His target was not Mises; it was Hutt. His argument is basically against the claim that consumer sovereignty can be used as a criterion to judge whether the action of an individual in a real market economy is good or bad. He says that proper analysis of the free market economy (or free society) shows that to legitimately make this claim, a person must inject his own value judgment concerning what is good. He takes two approaches both of which are based on the ethical premise of individual sovereignty. The first maintains that individuals have a natural right to dispose of any property that they rightfully own. The second is to employ his specious welfare criterion of demonstrated preference. I discuss each in turn.

A Person Has a Natural Right to Waste Her Property

The first approach is to apply the assumption of individual sovereignty over personal property directly. In the market society or "unhampered market economy," the rightful owner of property is permitted to dispose of it in any way he wants. It follows that in Rothbard's market society, one cannot legitimately judge a person's waste of her own property to be against the interests of others. In that society, the rightful owner's sovereignty trumps the interests of others. Correspondingly, when Hutt maintains that monopoly may be wasteful, he must be injecting his own values (ethical ideals) into his analysis (*ibid*.: 632). Thus Rothbard writes:

> [C]ontrary to Hutt, each individual has self-sovereignty over his person and property on the free market. The producer, and the producer alone, decides whether or not he will keep his property (including his own person) idle or sell it on the market for money, the results of his production then going to the consumers in exchange for their money (*ibid*.: 632).

> [S]uppose producer A withholds his labor or land or capital service from the market. For whatever reason, he is exercising his sovereignty over his person and property (*ibid*.: 631).

Rothbard considers the case of a coffee cartel, the members of which decide to reduce the resources they employ to produce coffee in order to increase their total revenue. Their decision causes resources to be shifted to other endeavors. He writes:

> Suppose...that before the coffee cartel went into operation, X amount of labor and Y amount of land co-operated to produce 100 million pounds of coffee a year. The coffee cartel determined, however, that the most remunerative production was 60 million pounds and therefore reduced annual output to this level. It would have been absurd, of course, to continue wasteful production of 100 million pounds and then to burn 40 millions. But what of the now surplus labor and land? These shift to the production, say, of 10 million pounds of rubber, 50,000 hours of service as jungle guides, etc. Who is to say that the second structure of production, the second allocation of factors, is less "just" than the first?

> In fact, we may say it is more just, since the new allocation of factors will be more profitable, and hence more value-productive, to consumers (*ibid*.: 638).[14]

This discussion of alternative uses of the resources is actually irrelevant to the principle on which Rothbard's criterion is based. The principle he espouses is that the rightful owners of a resource have an individual sovereignty right to dispose of it as they wish. This principle can be applied even if the cartel wastes resources. Once that principle is accepted, the fact that others may not benefit as much from the resource owners' decisions to form a cartel as otherwise is irrelevant.

It is not easy to know what he has in mind when he says that the new allocation is more value-productive to consumers. He may be referring to his strange argument about social utility, which I described earlier.

No Prices in the "Unhampered Market Economy" Can Be Unjust

His second approach is to apply his demonstrated preference welfare criterion to the "unhampered market economy," as he defined it. Consider the following assertion:

> If the free-market route – the route of mutual benefit – is adopted, then there can be no other criterion of justice than the free-market price, and this includes alleged "competitive" and "monopoly" prices, as well as the actions of cartels. In the free market, consumers and producers adjust their actions in voluntary cooperation (Rothbard 2004: 636).

When Rothbard writes that the free-market price is his criterion of justice, he is referring ultimately to the "demonstrated preference" welfare criterion.[15] I have shown that, for the case of pecuniary

[14]In this example, the cartel does not actually destroy coffee. Thus individuals in the role of the consumers would still get some benefit.

[15]That this is so is evident from the context of the statement. He writes that in "the free market...prices are set voluntarily by each of the participating individuals. In this situation, exchanges are made on terms benefiting all the exchangers (*ibid*.: 636-7).

externalities, this welfare criterion fails to address the concerns that most people have. The same is true for the case of the monopoly price. Thus, his argument is irrelevant to the situation with which both Hutt and Mises were concerned.

Rejection of the Distinction Between Consumer and Producer

Rothbard's conception of the "unhampered market economy" leads him to reject Hutt's distinction between the individual as consumer and individual as producer as a means of helping one to understand market interaction (*ibid*.: 631-2). Rothbard argues that the categories "producer" and "consumer" are insufficient to be useful in judging whether a real businessperson is or is not harming others through his monopolistic actions. He views a monopolist not only as a producer and supplier but also as an individual who has the (ethical) right to do what she wants with her (rightfully acquired) property, regardless of the role assigned by the economist. I have pointed out that Mises expanded on Hutt by defining a praxeologically-based entrepreneur role which is *always* the mandatory of consumers under pure market economy conditions. By rejecting Hutt's distinction between consumer and producer, Rothbard implicitly rejects Mises's notion of the entrepreneur role as an aid to evaluating interventionist arguments (Mises 1966: 734).[16]

[16]Mises did not use to phrase " entrepreneur role." He preferred the term "entrepreneurs and capitalists" and other similar terms.

Mises's Presumed Ethics Are Questionable

A counterpart of Rothbard's rejection of consumer sovereignty is his claim that Mises's values tainted his analysis of the monopoly price. Rothbard asserted that Mises's treatment of monopoly was based on his ethical predispositions. In a 1954 letter he wrote:

> Mises states definitely that whenever a monopoly price is instituted, the concept of "consumer sovereignty" receives a great setback. Mises's ethics do not permit an outright value-judgment, but the inference is pretty clear that a monopoly price situation is a highly unfortunate one (*ibid*: xliii).

Here he objects to what he interprets as Mises's excess concern with the propensity of a real-world monopolist to withhold some of his output from consumers. The producer-monopolist has a right, asserts Rothbard, to do with the property as she pleases.

In the excerpt of the letter that I quoted, Rothbard does not say what he means by Mises's ethics. Moreover, in *Man, Economy and State*, his attack on consumer sovereignty is not aimed at Mises but at Hutt. One must presume, however, that he had in mind the notion that Mises is a utilitarian, which he expressed in a later paper (Rothbard 1976: 104). I discuss this paper in the appendix to this chapter.

I pointed out earlier that Mises built his economics around the purpose of being prepared to evaluate interventionist arguments made on the basis the THRUI. This theorem is related to Bentham's felicific calculus. However, it is substantively different in that it presumes that one possesses the insight that individuals gain from specialization and the division of labor. In addition, Mises also pointed out that so long as economics addresses itself to the criteria used by those who make interventionist arguments, it can remain value free. Rothbard apparently did not recognize that Mises could achieve value freedom by addressing his arguments solely to those who accept the

THRUI. For Mises, a person who objects to using the THRUI – and, therefore, to the theorem of consumer sovereignty – as a criterion for evaluating interventionist arguments – must also object to this insight. Yet a person cannot reject the insight and still be called an economist, as defined by Mises.

4. COMPARISON AND CONCLUSION

Both Mises and Rothbard advocated greater economic freedom. In their academic work, they built images of market economies based on individual choice and then sought to evaluate government restrictions. In these senses, their two treatises were similar. Beyond this, however, their purposes were quite different and their evaluations of restrictions incomparable. Mises built his image of the pure market economy in a way that was specifically designed to evaluate interventionist arguments that are made by individuals who accept the classical theorem of the harmony of rightly understood interests. This economics contains an entrepreneur role, which he defined in such a way that it represents all action under pure market economy conditions that results in the satisfaction of the wants of individuals in the consumer role. Individuals acting in the entrepreneur role always act in accord with the theorem of consumer sovereignty under pure market economy conditions. In other words, the entrepreneur is the mandatory of the consumer. He defined the pure market economy, the entrepreneur role and consumer sovereignty in such a way that all sorts of interventionist arguments could be evaluated according to how the intervention would affect the performance of the entrepreneur role The types of arguments that he could evaluate include those associated with external effects due to incomplete private property rights. He regarded government in its capacity of enforcing private property rights and preventing a descent into anarchy and chaos, as absolutely essential. In addition, he intended this combination of constructs to help the economist avoid errors by helping her trace all market interaction back to the category of action.

Mises could legitimately claim value freedom for his economics because he addressed his arguments only to those who accepted the classical universal law – that specialization and the division of labor increase productivity. So long as the maker of an interventionist argument accepted this law – i.e., so long as she was an economist in the traditional sense – the incorporation of this theorem into the various images Mises uses to help evaluate arguments would not constitute a violation of the precept of value freedom.

Mises did not invent consumer sovereignty. Nor did he invent the entrepreneur role. This was done by the early neoclassical economists who preceded him. He also did not invent the classical theorem. However, he provided the praxeological basis for the use of these in economics with his analogy between the isolated actor satisfying his own wants and the entrepreneur role satisfying the wants of individuals in the consumer role. By following the tradition of the classical economists and the early neoclassicals, Mises was assured that his economics would be relevant to the concerns of almost everyone who makes qnas.

Rothbard built his image of the unhampered market economy on the basis of the assumption that individual sovereignty prevails – that there are no invasions of person or of rightfully owned property. By defining the "unhampered market economy" in this way, he molded his own creation – a new "economics" that rejects the traditional criterion for evaluating interventionist arguments in favor of an individual sovereignty criterion. Similarly, by introducing an individual sovereignty-based definition of private property and market interaction, he gave up any hope of being part of the economics tradition to which Mises attached himself. He rejected consumer sovereignty for the same reason that he rejected the tradition of economics. It did not accord with his individual sovereignty ethic.

Rothbard asserted that Mises's support for consumer sovereignty was based on his ethics. He did not realize that what he called Mises's ethics was a manifestation of the link Mises provided between his economics and the classical and early neoclassical economics tradition. Rothbard broke the link.

In rejecting Mises's and traditional economics, Rothbard closed the door to the evaluation of arguments about a market economy on any other grounds than his ethic of individual sovereignty or his welfare criterion of demonstrated preference. Many people use benefit-cost arguments to support interventionist policies. Such policies include the restriction of monopoly, the compensation of losers due to pecuniary externalities, and the regulation of externally harmful effects. Rothbard's individual sovereignty analysis of such arguments is irrelevant to such arguments. Followers of Rothbard are ill-equipped to engage modern advocates of market intervention. At the same time, Rothbard opened the door for his followers to claim that there is economic justification for asserting that all government intervention is invasive and, therefore, bad. It is not surprising that some of these followers have become anarchists.

Like Mises, Rothbard wanted to be able to say that market interaction is beneficial. Instead of using the universal law, the THRUI, consumer sovereignty, and the entrepreneur role, however; he produced the ethic of individual sovereignty. He reasoned that individual sovereignty trumps whatever harm one may attribute to monopoly. But he apparently became confused. For he concluded that "[p]raxeology, through its *wertfrei* laws, informs us that the workings of the voluntary principle and of the free market lead inexorably to freedom, prosperity, harmony, efficiency, and order..." By "voluntary principle," he is presumably referring to the ethic of individual sovereignty. Even if one substitutes "economics" for "praxeology," there is no *wertfrei* law that informs the attentive reader of this.

It is difficult for me to reconstruct Rothbard's reasoning. But perhaps it went like this. Perhaps he regarded his economics and that of Mises as similar in that both employ reasoning that is based on the individual choice paradigm and because each incorporates principles into their definitions of their respective basic images of the market economy. Rothbard may have believed that if one accepts his ethical principle, then all subsequent theorems about the market economy and market intervention follow. He may have reasoned that the same is true for Mises if one accepts utilitarianism. From this point of view the logical derivation of the theorems is value free – i.e., independent of the fact that principles are incorporated into the definitions.

The problem with such a comparison is twofold. First Mises's economics was not build on a utilitarian ethic but on the universal law of the higher productivity of the division of labor. Second, such value-free theorems are irrelevant to the evaluation of interventionist arguments unless the person making an argument accepts the founding principle. While the PHRUI is an undeniable conclusion reached on the basis of astute observation and while it is consistent with the tradition in economics, the individual sovereignty principle is a mere assertion of values that cannot be linked to traditional economics.

Mises's economics would fail if those whose interventionist arguments Mises aimed to evaluate disagreed with the universal law of the higher productivity of the division of labor, the THRUI and consumer sovereignty. These fundamental theorems anchor Mises's economics to classical and early neoclassical economics. Rothbard's economics completely disregards the ethics of the person who makes an interventionist argument. As a consequence, his individual sovereignty principle provides no anchor.

Rothbard said that at least one goal of his *Man, Economy and State* was "to isolate the economic, fill in the interstices, and spell out the detailed implications, as I see them, of the Misesian structure" (Rothbard 2004: xciv, as quoted above). Unfortunately for those who hope to find the essence of Misesian economics in the writings of Rothbard, this rejection marked an inexorable split with Mises. Rather than fill in interstices, Rothbard distorted Mises's economics and proceeded to produce a system of thought that can hardly be called economics at all.

APPENDIX

MISES AND ROTHBARD, ACCORDING TO JOSEPH SALERNO

Prior to this book, no one has completed the kind of exegesis that is needed to comprehend Mises's economics. This includes Joseph Salerno, who has probably written more pages about Mises than all but Mises's direct students and myself. In his position as editor of one of the two main Austrian journals and his close association with the Mises Institute, he has exercised substantial influence over students. If his interpretation of Mises is wrong, it is more likely that the interpretations of his students will also turn out be wrong. Sadly, Salerno's work, including his interpretation of Mises, has been guided by Rothbard. He has followed Rothbard both in misinterpreting Mises and in Rothbard's own errors.

Salerno bestows lavish praise on Rothbard's treatise, *Man, Economy and State* (1962) and suggests that it should be the new source book for those interested in Austrian economics. He writes that "Rothbard's treatise in was a milestone in the development of sound economic theory and an event that rescued the science from self-destruction" (Salerno 2009).[17] And he makes the following statements about Rothbard in relation to Mises.

> While many elements of the theory had been developed previously by various Austrian economists, they had never been fully integrated and several elements were still missing. Rothbard's methodical treatment of production repaired one of the few serious gaps remaining in Austrian economics after Mises (Salerno 2002: 117).

> The revival of Austrian economics as a living scientific movement can be dated from the publication of Rothbard's *Man, Economy, and State* in 1962, a contribution to Austrian economics and to pure economics in general that ranks as one of the most brilliant performances in the history of economic thought (*ibid*.: 116).

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[17] I possess only the online version. Thus there are no page references.

> Thus paraphrasing Mises's...characterization of Menger, we may say: "Until the early 1970s, there was no modern Austrian School. There was only Murray Rothbard" (*ibid*.: 118).

One can conclude that Salerno sees Rothbard's treatise as having improved on Mises's economics and having salvaged all of Austrian economics.

I have shown in this chapter how different Rothbard's economics is from that of Mises. As proof, I have compared the economics in Rothbard's treatise with that in Mises's treatise. Of special significance has been their difference in the fundamental purpose of economics and in their meaning of the pure market economy. I have organized my discussion around the concept of consumer sovereignty because I believe that Mises's and Rothbard's treatment of that concept is a fine way to differentiate the two. Salerno does not mention consumer sovereignty and only briefly refers to Rothbard's theory of monopoly. Instead, he focuses on other aspects of Rothbard's work. In this appendix, I wish to deal with three of these. First, I want to discuss Salerno's views on how Mises and Rothbard treated values and praxeology. This first concept naturally leads to a second – their respective views on the nature of a praxeology-based economics. Third, I will deal with Salerno's claim that Rothbard improved on Mises's production theory. At the end, I will discuss Mises's favorable review of Rothbard's treatise because Salerno has employed it as support for his claim that neo-Austrians have much to learn from Rothbard.

Ethics, Value Judgments and Praxeology

In this chapter, I indicated how both Mises and Rothbard dealt with value judgments. Mises incorporated the traditional universal law of the higher productivity of the division of labor into his definition of the pure market economy. Next, he transformed that law, via the Austrian theory of value and cost, into the theorem of consumer sovereignty. Then he evaluated interventionist arguments either on the basis of the announced goal of the proponent of intervention (or non-intervention) or on the basis of the economist's implicit goal of achieving the harmony of rightly understood interests or consumer sovereignty. On the other hand, Rothbard began with the principle of individual sovereignty and built an image of an unhampered market economy on the basis of an assumption that all private property rights were acquired according to that principle. He also assumed that there was no unowned property and, therefore, no external effects. The existence of external effects is evidence of an invasion of property. The effects can be eliminated by identifying the true owner of the property, which could be easily done.

Rothbard's "Demonstrated Preference" Welfare Function

Salerno refers to none of this in his praise of Rothbard. Instead, in extolling the virtues of Rothbard's approach to values. Instead, he focuses on Rothbard's 1956 essay on "demonstrated preference." In describing the development of Austrian economics during the second half of the 20th century, Salerno writes that

> The second outstanding essay published during [the 1950s] was "Toward a Reconstruction of Utility and Welfare Economics" by Murray Rothbard (1956, pp. 224–62). In this essay, Rothbard finally brought to light and formalized the purely ordinalist, "demonstrated preference" approach to utility analysis inherent in Austrian economics since the early twentieth century (Salerno 2002: 116).

Surprisingly, he does not refers to this essay in his 2009 introduction.

In proposing a welfare function, Rothbard accept the framework established in the field of theoretical welfare economics. As I have pointed out, this discipline assumes that goods can be produced without the presence of a market economy in which individuals gain from the higher productivity of the division of labor. It also establishes an untenable distinction between positive and normative economics. In referring to Rothbard's welfare economics, Salerno is certainly correct to say that Rothbard introduced something totally new. But the idea that this new thing was inherent in early twentieth century Austrian economics is, in my view, wrong. That it was a contribution to Austrian economics is equally wrong.

I have already suggested how Mises would have dealt with theoretical welfare economics. Here I will show that Rothbard uses demonstrated preference as a kind of smokescreen for his ethic of individual sovereignty and his assumption that the unhampered market economy has property rights that are defined in accord with this ethic. These two ideas are the basis for his theory of market interaction under anarchy, although his article does not present this.

Rothbard defines demonstrated preference as follows: "actual choice reveals, or demonstrates, a man's preferences; that is, that his preferences are deducible from what he has chosen in action" (Rothbard 1956: 225). Although this seems like a clear statement, he immediately muddies the presentation with two examples that have different implications. The first is of a man who *chooses* to spend time at a concert. The second is of a man who spends five dollars on clothing. In the first case, the actor *chooses* and actually spends time. In the second, he spends money but does not necessarily choose. Rothbard presumably clears up any confusion with the statement that follows these examples: "This concept of preference, rooted in real choices, forms the keystone of the logical structure of economic analysis, and particularly of utility and welfare analysis" (*ibid*.). The phrase "rooted in real choices" suggests that there must be both a choice *and* some observable behavior. Since one cannot observe a choice, he is presumably assuming that all observed behavior is chosen.

Rothbard's article is lengthy and treats many ancillary issues. Its main points that are relevant here, however, are easily stated. They are that the welfare criterion of demonstrated preference can be invoked to support all market activity because all exchanges are voluntary. On the other hand, it cannot be used to support activity by the government because all government activity entails coercion.

First Misinterpretation of Mises

In subsequent discussion, Rothbard associates these main points with Mises. "The clearest and most thorough formulation of the concept, he writes, has been the works of Professor Mises (*ibid*.: 226). He refers to the reader to three pages in *Human Action* and to Alan Sweezy's representation of Mises's ideas.

It is important to recognize Mises's meaning, which is different from what Rothbard represents. The section of *Human Action* to which Rothbard refers is entitled "The Scale of Values." Mises writes:

> Acting man chooses between various opportunities offered for choice. He prefers one alternative to others.
>
> It is customary to say that acting man has a scale of wants or values in his mind when he arranges his actions. On the basis of such a scale he satisfies what is of higher value, i.e., his more urgent wants, and leaves unsatisfied what is of lower value, i.e., what is a less urgent want. There is no objection to such a presentation of the state of affairs. However, one must not forget that the scale of values or wants manifests itself only in the reality of action. These scales have no independent existence apart from the actual behavior of individuals. The only source from which our knowledge concerning these scales is derived is the observation of a man's actions. Every action is always in perfect agreement with the scale of values or wants because these scales are nothing but an instrument for the interpretation of a man's acting (Mises 1966: 94-5).

I want to focus specifically on the last two sentences. I will paraphrase it in relation to the other sentences. It says that in order to interpret man's action, the praxeologist presumes that he chooses.

The presumption of action implies the presumption of choice between various opportunities. It is customary to say that the arrangement of opportunities implies that acting man has a scale of values. The praxeologist can only define scales of value in terms of the assumed choice and perceived opportunities.

He goes on to write of the "attitude of praxeology and economics" toward whether the scale of value of a particular individual is right or proper. Praxeology and economics take the attitude that ultimate ends are "not open to examination from any absolute standard;" "they are purely subjective." Praxeology and economics do not deal with these ends. They "deal with the means for the attainment of the ends chosen by the acting individuals...They apply to the means only one yardstick, viz., whether or not they are suitable to attain the ends at which the acting individuals aim." (*ibid*.: 95). Since the economist must assume these ends, Mises could have written: "They apply to the means only one yardstick, viz., whether or not they are suitable to attain *what the economist assumes are* the ends at which the acting individuals aim."

The point I want to make is that there is not the slightest hint in this discussion of what Rothbard calls "demonstrated preference." On the contrary, I have shown that to the extent that "demonstrated preference" is regarded as a basis for opposing market intervention, Mises explicitly denies that economics is directly interested in this.[18] It is sufficient to say that Mises does not assume that observed behavior implies choice. Instead, he writes that when the economist interprets behavior – i.e., when she is engaged in the understanding which is necessary to do economic history – she

[18]The economist could be indirectly interested in the sense that she could investigate whether some proposed intervention or some proposal to remove an intervention could achieve the ends that are implicit in a demonstrated preference welfare criterion. Such an investigator would want to examine carefully the Rothbardian assumption about private property rights and Rothbard's definition of the unhampered market economy.

assumes that behavior is chosen. My conclusion is that Rothbard's reference to Mises is inaccurate and misleading.[19]

It is worth mentioning one fact about the passage section to which Rothbard refers. It is one of two places in Mises's treatise where he uses the term "normative." The significance of this is that, as I have noted, the distinction between normative and positive is part of the stock in trade of the theoretical welfare economists and is a source of Rothbard's misinterpretation. Mises did not make this distinction because he defined positivism in a completely different way than the welfare economists did.

Rothbard's error in interpreting Mises is evident when he uses his demonstrated preference criterion as a means of making judgments about market interaction and state intervention. In the process, he conflates praxeology with economics and the method of interpreting historical behavior with a method for making judgments about the cause of behavior. His discussion begins with the question of whether praxeology can say something about "social utility." It can, he says. He writes that:

> praxeology maintains that when a person acts, his utility, or at least his ex ante utility, increases; he expects to enjoy a psychic benefit from the act, otherwise he would not have done it. When, in a voluntary free-market exchange, for example, I buy a newspaper from a newsdealer for 15 cents, I demonstrate by my action that I prefer (at least ex ante) the newspaper to the 15 cents, while the newsdealer demonstrates by his action the reverse order of preference. Since each of us is better off by the exchange, both the newsdealer and I have demonstrably gained in utility, while nothing has demonstrably happened to anyone else. Elsewhere I have called this praxeological concept "demonstrated preference",,,(*ibid*.: 98).

[19]In another reference to Mises, Rothbard concludes that "no valid theory can be built on a constancy assumption" (*ibid*.: 229). While this is correct, Rothbard's application implies that "theory" may refer to a welfare criterion. Mises would not countenance that.

What Mises pointed out was a means of interpreting history – to assume that the historical event was caused by a choice – becomes for Rothbard a deduction that all observed behavior is evidence of a choice.

Application of the Demonstrated Preference Criterion

Rothbard's application of his demonstrated preference welfare criterion is best illustrated by his case of "external economies," as illustrated by his examples of military protection, dams, and highways (*ibid*.: 257). This refers to what is today known as a public good in mainstream economics. Rothbard argues that because a person must be coerced to pay the tax needed to cause these goods to be supplied, an increase in "social utility" cannot be demonstrated and, therefore, state action cannot be justified (*ibid*.).

The only sensible conclusion that one can reach about Rothbard's demonstrated preference criterion is the same as the conclusion I reached about Rothbard's treatment of external effects in his treatise, which I discussed in the body of this Chapter. It is that his deduction is irrelevant to the arguments made by people who advocate intervention. Although some economists try to justify government intervention by means of abstract arguments relating to hypothetical conditions, practically everyone else who argues in favor of market intervention agrees that it entails coercion that is harmful. But they go on to say that the benefit of the intervention outweighs the harm. Many such arguments are incomplete in that they do not take account of the inefficiency of government action and the effect of coercion on incentives. But a competent maker of an interventionist argument does not make the error of ignoring coercion. Thus, the welfare criterion of demonstrate preference is irrelevant to the task of helping to evaluate the typical intervention argument. It does provide a basis for Rothbard to reject all government intervention. But for Rothbard to claim that this welfare criterion is derived from Mises is misleading.

I presume that Salerno was not able to see this because, like practically all economists of his generation, he was indoctrinated by teachers of economics who accepted – hook, line and sinker – the idea that a scientific economics must correspond to the positive study implied in the theoretical welfare economics distinction between positive and normative.

Praxeology-Based Economics of Mises and Rothbard

Salerno writes that although "Mises's great treatise was almost completely ignored by the postwar economics profession, it "did lay the foundations for [the later revival of Austrian economics]. This revival was to be ignited by the publication of *Man, Economy, and State* in 1962 " (Salerno 2009).[20] Salerno proceeds to present an uncritical report of what Rothbard claimed was missing and wrong in Mises's treatise. He writes:

> Rothbard's proposed book was thus transformed, in the very process of its writing, from a straightforward exposition of the principles of received doctrine of the Austrian School narrowly conceived to a treatise elaborating a complete system of economic theory and featuring many original, and even radically new, deductions and theorems (*ibid*.).

He also writes that Mises and Rothbard's praxeology-based economics differentiates them from the economics of others who are labeled Austrian (*ibid*.). I can agree with this last statement. However, rather than a revival of Austrian economics, I would argue that Rothbard's treatise attempts to take

[20]Salerno cites his own papers, published through the Mises Institute, as evidence of this.

Austrian economics in a new and strange direction and that it largely disregards the teachings of the Mises and other predecessors. Rothbard's use of praxeology and, correspondingly, the development of his economic theorems differs radically from that of Mises.

Mises used the method of imaginary constructions to identify the properties of action which he later incorporated into producing economic theorems. To produce economic theorems, he added assumptions designed to ultimately evaluate interventionist arguments for which the goal or goals of the interventionist are specified. As distinct from this, Rothbard used the method to build a set of theorems based on the assumption that his ethical principle of individual sovereignty prevails in the society. Whereas Mises's economics is relevant to traditional concerns of economics, Rothbard's is relevant to only a small group of idealistic libertarian anarchists, whose principle activity seems to be to complain about all government action.

Although Rothbard's imaginary constructions are not relevant to the goals of practically everyone who makes an interventionist argument, they do have some value for economists. In Chapter 1 of his Power and Market (Rothbard 2004), for example, Rothbard builds an imaginary construction of an unhampered market economy in which (1) interacting individuals respect individual sovereignty and (2) private property rights are fully assigned on the basis of the assumption that they were established in accord with the principle of individual sovereignty. This enables him to build an image of market interaction in which individuals benefit from exchange. In this image, collective defense services and property rights enforcement services are provided without a government.

By contrasting this image with one based on more realistic assumptions about actions under these conditions, the economist can better understand why a government would be needed (and, also, why anarchy is untenable). Similarly by constructing an image of a system in which private property rights are defined in accord with the principle of individual sovereignty, one can better understand the origin, in conflict resolution, of private property rights.

Praxeology, Value Judgments, and Public Policy

One of the articles by Rothbard that Salerno cites is his 1976 paper entitled “Praxeology, Value Judgments, and Public Policy. The reader of this book is now well aware of Mises views on these issues. By comparing them with Rothbard’s views, one can identify with greater clarity the difference between the two writers. In this paper, Rothbard reveals his ignorance of Mises’s economics in his first definitive statement. One “thing is certain,” he writes:

> praxeology, economic theory, cannot itself establish ethical judgments. How could it when it deals with the formal fact that men act rather than with the content of such actions? Furthermore, praxeology is not grounded on any value judgments of the praxeologist, since what he is doing is analyzing the fact that people in general have values rather than inserting any value judgments of his own (Rothbard 1976: 89.)

Here he conflates praxeology and economics. What he writes is true about praxeology. However, as I have shown, Mises incorporates the universal law of the higher productivity of the division of labor into his economics at the most fundamental level. This enables him to build an economics based on the THRUI.

On the basis of his statement above, he concludes:

> In brief, the citizen, or the "ethicist," may have framed, in ways which we cannot deal with here, general ethical rules or goals. But in order to decide how to arrive at such goals, he must employ all the relevant conclusions of the various sciences, all of which are in themselves value-free (*ibid*.: 89-90).

Although this statement is consistent with scientism and the theoretical welfare economics based on it, its treatment of values is quite different from that of Mises in his economics.

One problem with Rothbard's presentation is that he does not distinguish between praxeology and economics. Thus when he writes that "[p]raxeology, like the other sciences, is the value-free handmaiden of values and ethics" (*ibid*.: 91), this is true of praxeology but not of Mises's economics. However, Rothbard's belief that he has correctly represented Mises's economics emboldens him to employ praxeology as a means of building an image of an unhampered market economy under the assumption that individuals adhere to the ethical rule of individual sovereignty. In this case, his theory of economic action, which does not incorporate the "universal law" is merely a theory of market exchange which functions as the handmaiden of his ethic of individual sovereignty. Thus, Rothbard's statement about the handmaiden accurately represents his own economics, which I have shown is irrelevant to the evaluation of the kinds of interventionist arguments that are typically made. But his statements do not apply to the economics of Mises, which I have shown *is* relevant to the kinds of interventionist argument that individuals typically make.

Misinterpretation of Mises's Rationale for Supporting Laissez Faire

No doubt, if Rothbard believed that Mises would have supported this conflation, he must have been unhappy with the fact that Mises himself did not invent or at least recognize demonstrated preference. In any case, it was reasonable for Rothbard to ask how Mises could be a supporter of laissez faire yet, at the same time, claim to not base his support on an ethical judgment. Consider how he dealt with Mises.

Rothbard's dilemma was that Mises asserted that individuals benefit from laissez faire while at the same time maintaining that utility is not measurable and that economics is value free. His explanation of Mises answer consisted of presenting two cases. In the first, Rothbard says that Mises assumed that every supporter would agree with Mises that a laissez faire government policy would be beneficial. In the second, he said that although Mises agreed that the economist qua economist could not make a judgment about laissez faire, Mises maintained that the economist, qua citizen, could.

Regarding the first case, Rothbard quotes Mises twice (*ibid*.: 101). However, in neither quotation does Mises say anything about "every supporter" of an argument. He simply says that if a supporter wanted to achieve a particular goal, economics could help determine whether that goal could be achieved in the way suggested. Unless one adds a goal associated with the harmony of rightly understood interests, this is not even related to Mises's support for a laissez faire policy. However, if it is assumed that the supporter aims to achieve the goals associated with the harmony theorem, laissez faire can be deduced as the best way to achieve them, given the conditions of the pure market economy. This is not to say that Mises supported laissez faire under all circumstances. He recognized the need for taxation to pay for the enforcement of private property rights and he also pointed out that interaction in the presence of incomplete property rights and external effects would not lead to results that are in accord with the harmony theorem. He did not explore the possibility of government intervention in this case, however.

Regarding Rothbard's second explanation of Mises's support for a laissez faire policy, Rothbard quotes Mises's statement about the ideology of liberalism not about his economics. The classical liberal may hold the ideology that laissez faire is desirable, Mises says. Consider a passage from the paragraph that Rothbard quotes.

> While praxeology, and therefore economics too, uses the terms happiness and removal of uneasiness in a purely formal sense, liberalism attaches to them a concrete meaning. It presupposes that people prefer life to death, health to sickness. . . abundance to poverty. It teaches men how to act in accordance with these valuations (*ibid*.: 95; Mises 1966: 154).

The praxeologist and the economist do not make independent judgments. The liberal, however, does. Mises may have held a liberal ideology. I cannot be certain of this. However, I have no doubt that in writing about the economist's support for laissez faire, he was referring to the refutation of arguments regarding proposals by interventionists on the common ground of the principle of the harmony of rightly understood interests.

Finally, in reporting about Mises, Rothbard makes a curious statement about the harmony of rightly understood interests. He writes that

> one of Mises's basic arguments for the free market is that, on the market, there is a "harmony of the rightly understood interests of all members of the market society." It is clear from his discussion that he could not merely mean "interests" after learning the praxeological consequences of market activity or of government intervention. He also, and in particular, meant people's long-run interests. As he stated, "For 'rightly understood' interests we may as well say interests 'in the long run."' But what about the high-time-preference folk, who prefer to consult their short- run interests? How can the long run be called "better" than the short run? Why is "right understanding" necessarily the long run?(Rothbard 1976: 104).

It is obvious from what I have shown about how Mises employed the theorem of the harmony of rightly understood interests that this is a misinterpretation. Mises's statement about the long run was probably a sublime endorsement of Henry Hazlitt's *Economics in One Lesson* (1946), which used this phrase repeatedly.

Improvements on Mises's Production Theory

Salerno believes that Rothbard made improvements in Austrian production theory.

> One of Rothbard's greatest accomplishments in production theory was the development of a capital-and-interest theory that integrated the temporal production-structure analysis of Knut Wicksell and Hayek with the pure-time-preference theory expounded by Frank A. Fetter and Ludwig von Mises. Although the roots of both of these

> strands of thought can be traced back to Böhm-Bawerk's work, his exposition was confused and raised seemingly insoluble contradictions between the two. They were subsequently developed separately until Rothbard revealed their inherent logical connection (Salerno 2009).

He goes on to claim that Rothbard "not only skillfully used the various imaginary constructs whose nature and specific use Mises had explicitly formulated in Human Action, but also devised new ones as needed to assist in the deduction of new theorems to elucidate unexplained features of economic reality."

Salerno is merely repeating Rothbard's own claim, which the latter makes in his preface. Rothbard says the following about the chapters that Salerno uses for his example:

> Chapters 5-9 analyze production on the free market. One of the features of this consumption and production theory is the resurrection of Professor Frank A. Fetter's brilliant and completely neglected theory of rent – i.e., the concept of rent as the hire price of a unit service. Capitalization then becomes the process of determining the present values of the expected future rents of a good.
>
> The Fetter-Mises pure time-preference theory of interest is synthesized with the Fetter rent theory, with the Austrian theory of the structure of production, and with separation of original from produced factors of production (Rothbard 2004: xciv).

If Rothbard meant to make an advance in Austrian economic theory beyond Mises, it would have been his duty to comment on Mises's statements that contradict his own. One searches in vain in the chapters he mentions for such a comment. In fact, the search turns up an unsubstantiated statement that

> As Mises has shown, however, we can revise Böhm-Bawerk's theory and still retain the vital distinction between land and capital goods. We do not have to throw out, as do the Knightians, the land baby with the average-period-of-production bathwater. We can, instead, reformulate the concept of "land" (2004:483.

Rothbard provides no page references and, in light of the theorem of price determination that Mises held, one must surmise that such references do not exist.

What is remarkable about both Rothbard and Salerno is that neither one provides any evidence that Mises's theory of production is faulty or not fully integrated. Yet both claim that Rothbard's theory of production is an advance. Both also make the claim that a superior theory of production distinguishes land as a factor of production deserving special attention.

The only way I know to counter such a remarkable and undocumented claim is to reiterate, for the particular case of land, Mises's theorem of how the prices of factors of production are determined. I shall do so for the particular example from Rothbard's treatise that Salerno cites in his 2009 essay. The example refers to a particular imaginary construction that Rothbard uses – a construction of an economy that only contains absolutely specific factors of production. These factors are assumed to be owned by particular individuals. Salerno claims that "[w]ith the assistance of this construct, Rothbard deduces a number of important theorems and principles of production (Salerno 2009).

In light of the importance of the entrepreneur role in Mises's economics, it is essential before proceeding to recast Rothbard's assumption in terms of that role. I begin with appraisement, which includes the identification of factors and the assignment of opportunity costs. Beginning with a final state of rest, suppose that a new parcel of land that was previously not regarded as a factor of production is identified as such and that it is in the same class as a number of other existing parcels of land. An example might be a parcel that it is especially suited to growing oranges. At first, a single entrepreneur would appraise it high enough to be regarded as valuable in production. If the land was unowned, she would either appropriate the factor or file a claim with the government. In either case, she would become the first owner and, as a consequence, be both an entrepreneur and a landowner. Her entrepreneur function with respect to the land would cease when the land was actually employed in producing oranges. If she priced the land below the appraised value attached by an orange farmer (a producing entrepreneur), the the farmer would bid control of it away from her.

Now consider the economist's task of producing a theorem about how the newly identified land resource ultimately gets integrated into a pure market economy. The economist would imagine a market process that is initiated by the discovery of the new land and that ends when the competition of the entrepreneurs had bid the price of the land up to the point where it equals the marginal revenue product of the land – the final state of rest. The ownership of the land would ultimately revert to a person who performs the function of the landowner. The ultimate beneficiaries of the newly integrated farmland would be the consumers and the owners of the factors that complement the new land. The losers would be the owners of existing land of the same type.[21]

New income would be generated during the market process. Part of this is reflected in the change in prices of the factors of production. The owners of factors that complement the new land would receive higher incomes. The owners of substitutes for the new land would receive lower incomes. The entrepreneur who discovered the new land and others who may be responsible for causing the new land to be put to use will earn profit. Some competitors may earn losses. The income consists of income to the owners of capital goods (interest), to the workers (wages), and to the entrepreneur (profit). The income to the owners of the capital goods is interest. If one assumes that capital goods are infinitely durable, the interest would be in the form of what in ordinary speech is called rent. The proper term is interest, however, because the individuals who own the capital goods could have sold off their factors prior to their use in a production process and bought consumer goods. Each one's

[21]There may be other gainers and losers due to the various complementarities and substitutabilities as among the different factors and goods. There is no need here to think in such a detailed way about the issue.

decision not to sell off his capital goods indicates his desire to save. In return for the decision to renting out their capital goods, they receive interest.

It is possible that a capital will need maintenance or that it will gradually be depleted. In these case, the reward to the supplier of the capital goods will have to be higher than the rent on a comparably priced infinitely durable capital good. In the extreme case of raw materials that must be produced, the buyer will have to pay the full replacement cost plus the interest.

In Mises's economics, the newly discovered land, as well as existing land, is identical in a functional sense to an infinitely durable capital good. Its income is interest. Similarly, the discovery of new land is no different from the discover of a new method of production.

Suppose that the otherwise worthless land was already owned before an entrepreneur came to assign a positive appraisal to it. The reasoning involved in producing a theorem about how such farmland becomes integrated into a pure market economy would differ only in the initial action by the entrepreneur to secure temporary control over the factor. Instead of appropriating the land or filing a claim for previously unowned land, the entrepreneur would buy it from the initial owner. She may be able to buy it at a very low price; or, if the landowner finds out about the higher appraised value, he may hold out for a higher price.

Mises did not go into such detail in his analysis of land as a factor of production. However, he provided sufficient analysis for the reasonably astute reader to recognize how to produce such a theorem. In his chapter Twenty-Two on "The Nonhuman Original Factors of Production," he points out that modern economics deals with land "in the same way as other factors of production and their services" (Mises 1966: 635). He writes:

> The modern theory of value and prices is not based on the classification of the factors of production as land, capital, and labor. Its fundamental distinction is between goods of higher and of lower orders, between producers' goods and consumers' goods. When it distinguishes within the class of factors of production the original (nature-given) factors from the produced factors of production (the intermediary products) and furthermore within the class of original factors the nonhuman (external) factors from the human factors (labor), it does not break up the uniformity of its reasoning concerning the determination of the prices of the factors of production. The law controlling the determination of the prices of the factors of production is the same with all classes and specimens of these factors. The fact that different services rendered by such factors are valued, appraised, and dealt with in a different way can only amaze people who fail to notice these differences in serviceableness (*ibid*.: 636).

Here Mises is referring to what I called in Chapter 5 the theorem of the prices and quantities of the factors of production. He is saying that the prices and quantities of the factors of production produced and sold under pure market economy conditions are determined by the entrepreneur role in accord with the theorem of consumer sovereignty. He is also saying that this theorem is completely integrated, implying that there is no need to add "the temporal production-structure analysis of Knut Wicksell and Hayek" (Salerno 2009, as quoted above).

Regarding rent capitalization, Mises writes that "this terminology is rather inexpedient as it misrepresents the nature of the process" (Mises 1966: 643-4). The process to which he is referring is how the prices of land are determined.

There is a portion of Mises's chapter Twenty-Two in which he treats land as a permanent factor. He writes that

> in order to integrate into [the imaginary construction of the evenly rotating economy] mining and oil drilling we must ascribe to the mines and oil wells a permanent character and must disregard the possibility that any of the operated mines and wells could be exhausted or even undergo a change in the quantity of output or of current input required (*ibid*.: 643).

However, this formal requirement for this imaginary construction has nothing to do with price determination in a changing economy.

In my view, nothing remains to be said about the new theorems that Salerno claims Rothbard derived. Whatever they are, they are based on a faulty understanding of how prices are determined under the conditions of a pure market economy and a faulty interpretation of Mises.

Mises's Review of *Man, Economy and State*

Salerno has referred in a number of his essays on Rothbard to Mises's 1962 review of Rothbard's treatise. For example, he writes:

> Mises himself immediately recognized the profound originality and significance of Rothbard's contribution. In his review of Man, Economy, and State, Mises wrote that Rothbard joins the ranks of eminent economists by publishing a voluminous work, a systematic treatise on economics … . In every chapter of his treatise, Rothbard … adopt[s] the best teachings of his predecessors … and add[s] to them highly important observations …(Salerno 2009).

Most of Mises's review is about what he conceives to be general problems in economics and in its study. However, several passages regarding Rothbard's treatise stand out as potential testimony that Rothbard was very much in tune with Mises and even that he went beyond Mises. Consider the following:

> In every chapter of his treatise, Dr. Rothbard, adopting the best of the teachings of his predecessors, and adding to them highly important observations, not only develops the correct theory but is no less anxious to refute all objections ever raised against these doctrines.
>
> [S]uch a book as *Man, Economy, and State* offers to every intelligent man an opportunity to obtain reliable information concerning the great controversies and conflicts of our age.
>
> Less successful than his investigations in the fields of general praxeology and economics are the author's occasional observations concerning the philosophy of law and some problems of the penal code. But disagreement with his opinions concerning these matters cannot prevent me from qualifying Rothbard's work as an epochal contribution to the general science of human action, praxeology, and its practically most important and up-to-now best elaborated part, economics. Henceforth all essential studies in these branches of knowledge will have to take full account of the theories and criticisms expounded by Dr. Rothbard. (Mises 1962).

In the first statement, Mises says that Rothbard "develops the correct theory." This certainly suggests that Mises approves of Rothbard's economic theory. Less praiseworthy is his statement that

Rothbard provides opportunities to learn about the great controversies and conflicts. Somewhat critical is his implications of disapproval concerning investigations into "philosophy of law" and "problems of the penal code." However, this is counter-balanced by what seems to be an implicit approval of his investigations in praxeology and economics. And the statement "epocal contribution" seems to remove all doubt that Mises approves.

I must admit that I do not know what to make of Mises's review. I do not know whether he had a general policy toward requests that he review the works of students and colleagues and, if he did, what that policy might be. There are two possible explanations of his favorable review. At one extreme, he may not have read the book closely. At the other extreme, the aging Mises may have hoped that if he facilitated the acceptance of his student's work, others would eventually more fully appreciate his own work. Surely, he did not expect that 50 years later, his review might lead to a situation in which an economics that provides a misleading picture of his own writings on praxeology and economics would threaten to undermine those writings. If he had conceived of this possibility, he would certainly have read Rothbard's treatise more closely and either refused to review it or noted the vast difference between his own and Rothbard's treatment of the concepts of values, praxeology, and economics. He would also have presumably corrected Rothbard's treatment of production. Indeed, on the basis of his argument that everyone interested in worldly goods must pay heed to the division of labor that occurs in a market economy (Mises 1966: 179-180 – see Chapter 2), one would not be surprised if an attentive Mises were to label Rothbard a non-economist.

I do not like having to speculate like this, but I feel obligated to do so by Salerno's reliance on the review as evidence of Rothbard's contribution to Austrian economics. Had Salerno or Rothbard correctly interpreted Mises's economics, this would not be necessary. However, in most cases, neither one bothered to even present their interpretations. And in many cases where the they did present interpretations, documentation is lacking.

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