



JE KINDLE-NOTITIES VOOR:

## Choice: Cooperation, Enterprise, and Human Action

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## 20 Highlights

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It's true that the man chose a poor means to achieve the desired end, but that doesn't render his behavior irrational, according to Mises. No, the fact that we are interpreting the man's bodily movements as a rain dance means that we are attributing a plan to the man, and hence we think he is a rational being. To see this distinction, consider that we don't say a falling boulder acts irrationally; rather, we say that a falling boulder doesn't act, period. Thus, for Mises (and his followers), the important boundary line is between action and nonaction, not between successful action and unsuccessful action.

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The single most important and versatile producer good is labor, which is the flow of productive services the individual performs with his or her body. In terms of the logic of economic principles, it would be perfectly sensible to group labor along with other natural resources that provide a durable flow of services with adequate maintenance. However, economists have historically accorded labor special treatment because labor is the one factor of production that every individual possesses and also because labor is the one producer good that is required for every production process. When Crusoe devotes his physical efforts toward the indirect satisfaction of goals, he is engaged in labor. On the other hand, if he achieves direct satisfaction of goals through use of his body, then economists call this leisure. Crusoe will allocate his body power among labor and leisure activities according to what he sees as most important. Historically, economists have referred to the disutility of labor to underscore the fact that individuals directly enjoy leisure and will only devote some of their scarce time to labor if it allows the indirect achievement of more important ends than the leisure being sacrificed.

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We should note that leisure doesn't necessarily imply lounging around on the beach, and labor (or work) doesn't necessarily imply physical exertion. Crusoe might love swimming in the ocean, which provides a good workout and can even leave his muscles sore the next day. But before he can enjoy himself in this activity, he first engages in the extremely boring—but physically undemanding—task of gathering small twigs for the night's fire.

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Finally, capital goods are those factors of production that are created by people, as opposed to being direct gifts from nature. Every capital good is produced from the combination of labor and at least one natural resource.

Most capital goods are also produced with the help of pre-existing capital goods. For Crusoe on his island, examples of capital goods would be a fishing net that he constructs out of vines and his labor and a shelter that he creates out of rocks, branches, mud, leaves, and his labor.

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The utility of the least urgent use to which the good is being deployed is the marginal utility. Because consumers will always use the available quantity of a good to satisfy the most important goals or preferences, the importance of the goals satisfied with successive units of a good will necessarily decrease. This phenomenon is called the law of diminishing marginal utility. A

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The above quotation from Mises is instructive for two reasons. First, it demonstrates that Mises is fully aware of the power of friendship and other feelings of sympathy that humans feel for each other; indeed Mises describes them as “the most precious adornment of life.” So Mises is clearly not some heartless robot, oblivious to the motivations of everyday people.

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Yet even though he recognizes and cherishes this dimension of human existence, he asserts that it cannot provide the basis for society. The widespread reading of Charles Dickens's stories would not be enough. Instead, Mises argues that society was originally founded upon the two conditions that (a) humans are more physically productive when they act in concert with each other, and that (b) they were able to perceive and understand this crucial fact.

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Thus Mises turns the tables on those who argue that social bonds are somehow unnatural and at odds with the evolution of the species. On the contrary, it is only through the achievements made possible by social life that humans have subordinated other animals that are physically stronger and faster and have virtually eliminated the threat posed by many bacteria and viruses.

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Notice, too, the constant emphasis Mises puts on reason and the importance attached to human recognition of the higher productivity available with the division of labor. Even though an evolutionary argument might explain why feelings of sympathy come innately to humans, such a mechanism is inadequate to explain the emergence and maintenance of society. Mises argues that society is composed of countless actions on the part of its individuals, and underlying each act of social cooperation is the implicit recognition that such cooperation is more advantageous than antisocial action. Mises is claiming not that individuals consciously aim to “create society,”<sup>4</sup> but that the billions of individual actions upholding society are done consciously—that's what makes them actions.

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So we see, Mises literally thought that world peace rested on the capacity of people to use their reason in order to grasp the advantages of social cooperation. This aspect of his thought helps to shed light on the passion with which Mises describes the workings of a market economy based on private property and monetary calculation. For Mises, sharing the logical deductions of economic science with the masses was a moral duty because the fate of civilization itself rested on teaching enough people the truth. Some

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Precisely because of this popular Marxist rhetorical move, Mises devoted several sections in his Chapter III of Human Action to refuting polylogism, the doctrine of multiple logics. One of Mises's strongest arguments here was to point out that the Marxists never showed exactly how the doctrines of the classical economists were valid in bourgeois logic but invalid in proletariat logic; they never made the attempt because doing so would show that in fact the Marxists couldn't respond to the demonstrations of the economists.

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To sum up: When commercial banks engage in credit expansion, they issue new fiduciary media in the form of loans to their customers. Other things being equal, credit expansion decreases the purchasing power of money, raises prices in general, and reduces the rate of interest. The opposite results hold as well: If banks engage in a credit contraction, they do not re-lend the fiduciary media that they receive as customers pay back their loans. This effectively destroys money in the broader sense, such that—other things being equal—the purchasing power of money increases, prices tend to fall, and the rate of interest increases. In Chapter 14, we will see how credit expansion and credit contraction interact with the physical structure of capital goods to yield the familiar boom-bust cycle. This explanation is Mises's famous circulation credit theory of the trade cycle, or what is nowadays more popularly known as Austrian business cycle theory.

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By this procedure, Böhm-Bawerk had transformed his original question. Rather than asking, “Why do capitalists earn an effortless flow of interest income?” he could instead wonder, “Why is it that the initial purchase prices of capital goods systematically fall short of the future income their use is expected to yield?” Against this metric, Böhm-Bawerk measured all of the explanations of interest that economic theorists had offered before his own writing. One of those earlier explanations relied on the productivity of capital to explain the ability of capitalists to earn interest income. Surviving to this day, the orthodox treatment explains interest as the return to the marginal product of capital. Coming from this perspective, an economist would look at our example and claim that the capitalist earns a net return on his wealth for the simple reason that the tractor is productive: After all, a farmer can harvest more crops, year after year, with a tractor than without one, and so naturally someone who buys a tractor can earn an income over time.

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we are trying to explain the apparent undervaluation of the tractor: Why is it that a capitalist can spend less than \$10,000 today to buy a tractor that will—over the course of ten years—yield a cumulative sum of \$10,000 in net

income? Böhm-Bawerk observed that it makes little sense to say, “The tractor is physically productive and allows the farmer to harvest more crops than he could without it,” as a way of explaining this fact about the market. The productivity of the tractor explains why it throws off an annual net income—why the farmer can generate \$1,000 more in crops with the tractor than without it—but Böhm-Bawerk's question didn't concern the figure of \$1,000 per year. Rather, Böhm-Bawerk's question concerned the relationship of the initial purchase price to the subsequent flow of \$1,000 annual payments over the course of a decade.

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Yet, as first Böhm-Bawerk and then Mises pointed out, the brute fact that resources are productive does not explain interest. The phenomenon of interest has to do with an apparent undervaluation in the original purchase price of various inputs, so that the capitalist can buy them for less money upfront than they are expected to yield in the form of net income over their lifespans. In a sense, interest is about the relationship between two prices rather than one particular price. The fact that interest is expressed as a percentage—rather than as a dollar figure—should have been a clue in this respect. Explaining

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Rather, Böhm-Bawerk was arguing that people value present money more than future money because present money allows us to buy present goods while money delivered in the future only allows us to buy goods available in the future.

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In other words, economic calculation—as epitomized in modern accounting techniques—shows entrepreneurs whether their actions have maintained, accumulated, or consumed capital. Yet, capital in this respect is not capital goods, which are by their very nature fleeting. Mises explains the subtle way in which capital is embodied in particular capital goods, which themselves constantly turn over:

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First, some writers argued that calculation under socialism could be performed in kind, rather than in money. Yet this entirely ignores the original critique: Without resort to a single commodity against which all others can trade, no common denominator is possible, and hence calculations would be made in terms of disparate units. The planner has no way of knowing how to compare, say, seven automobiles with fourteen tons of steel, five gallons of paint, and seven panes of glass. Physicists, chemists, and engineers can tell the planner the technological recipes for converting inputs into outputs in various ratios, but these raw facts do not in any way indicate the economic efficiency of such projects. Second, some writers relied upon the labor theory of value to solve the calculation problem. Yet this is not right because the economic significance of natural resources has nothing to do with labor power. In addition, even looking at labor, there are different qualities among workers; an hour of a surgeon's labor is more valuable than an hour of a busboy's labor. Third, some writers recommended that the socialist planner calculate in terms of units of utility. Yet this also is a nonsensical proposal because utility, in the sense associated with human action, is an ordinal concept and is not comparable across individuals. To say that the planner should distribute resources so as to maximize utility is akin to saying

that a teacher should assign seats in her class so as to maximize total friendship units. Fourth, some writers, such as Dickinson and Lange, suggested that the socialist planner resort to quasi-markets; this solution has been dubbed market socialism. In this approach, the socialist planner would announce a vector of prices for the various factors of production, would appoint certain individuals to be the managers of the various firms, and then would instruct the managers to act as if they were profit-maximizing entrepreneurs in a capitalist society, who faced the market prices that were announced by the socialist planner. Mises remarks that the proposal of market socialism is “nothing short of a full acknowledgement of the correctness and irrefutability of the economists’ analysis and devastating critique” of socialism.<sup>7</sup> Historically, the appeal of socialism was the entire abolition of the crass marketplace with its haggling and commodification of workers; yet now, Mises points out, the leading socialist intellectuals acknowledge that under socialism, too, it will be necessary to have prices and competition. Yet even these concessions do not save the socialist project. Such proposals “look at the economic problem from the perspective of the subaltern clerk.”<sup>8</sup> It is not enough to ask a socialist factory manager to take the announced vector of prices and produce the amount of output that will maximize profit according to these numbers. The much more fundamental questions are: Should this factory remain in operation at all? Should new factories be built—and if so, where, and what size? To answer such questions, the socialist planner cannot resort to a simulated market. She cannot, as some theorists suggested, act as a bank and administer funds to various competing promoters because some of the potential borrowers will exaggerate the viability of their projects. Ultimately, the planner must make the final decision on how to allocate all of society’s funds. “Then we are back again where we started: the director...is not aided by the division of intellectual labor which under capitalism provides a practicable method for economic calculation.”<sup>9</sup>

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Fifth, some writers suggested that the socialist planner could resort to differential equations to determine the efficient allocation of resources. (This proposal was related to the suggestion of quasi-markets.) Here Mises heaps particular scorn, as he believed the approach of mathematical economics had bolstered the untenable idea of socialist calculation in the first place. Typically, the mathematical economist studies the conditions of equilibrium in a static setting. There is no role for the entrepreneur or what Mises dubbed the market process in such sterile models. Sixth and finally, some writers suggested that the socialist planner could resort to trial and error. In other words, these writers could have agreed with Mises that the planner would have no surefire way beforehand of knowing the proper allocation of resources among different industries and projects, but after the fact the planner could evaluate the results and tweak the plan, improving it incrementally as time passed. Here, too, the response entirely misses the problem. Trial and error works only when there is a definitive way to evaluate the outcome. A woman can search for her car keys through trial and error in the sense of looking under various pieces of furniture in her house. This method can work because if she happens to stumble upon the keys, she will recognize success. Yet when it comes to the allocation of resources, there is no such mark of success for the socialist planner. Even after the fact, she will have no way of ascertaining whether a particular project represented an efficient use of society’s resources. Under capitalism, trial and error does work, because “the correct solution is easily recognizable as such; it is the emergence of a surplus of proceeds over costs.”<sup>10</sup> But, in a socialist system lacking genuine market prices, accountants cannot tell their boss—even after the fact—whether a given project turned a profit or a loss. Such a calculation requires money prices for the inputs and outputs, but these are lacking under socialism.

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The above quotation crystallizes Mises's main themes concerning interventionism. First, limited interventions are a failure, not according to the outside economist's personal value judgment, but according to the very criterion by which the intervention was originally justified. Second, the government can attempt to remedy the initial failing with further rounds of intervention, but these too will lead to unintended consequences that frustrate the supporters of the scheme. In the end, the government will either resort to full-blown socialism, or it must return to laissez-faire capitalism. Before

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